Study Material

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PROFESSIONAL
COMPETENCE COURSE

Taxation

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The Institute of Chartered Accountants of India
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STUDY MATERIAL

Integrated Professional Competence Course

PAPER : 4

TAXATION

Assessment Year 2010-11

(As amended by the Finance (No.2) Act, 2009)

BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

This study material has been prepared by the faculty of the Board of Studies. The objective of the study material is to provide teaching material to the students to enable them to obtain knowledge and skills in the subject. Students should also supplement their study by reference to the recommended text books. In case students need any clarifications or have any suggestions to make for further improvement of the material contained herein, they may write to the Director of Studies.

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A WORD ABOUT STUDY MANUAL

In the syllabus for chartered accountancy course, direct and indirect taxes constitute a core competence area for the students. A thorough knowledge of direct and indirect taxes helps the students to increase their analytical abilities. In the accounting technician certificate course, "Taxation" constitutes Paper-4. Students are expected to acquire working knowledge in income-tax, service-tax and value added tax after undergoing this course.

The first 10 chapters of this book deal with income-tax. The rest of the 6 chapters are devoted to service tax and value added tax. The subject matter in the book is based on the law as amended by the Finance (No.2) Act, 2009. Efforts have been made to present the complex law of taxation in as lucid a manner as possible. Care has been taken to present the chapters in a logical sequence to facilitate easy understanding by the students. The latest amendments have been given in italics. Another helpful feature is the addition of self-examination questions which will stimulate analytical thinking by the students. The various illustrations will help in understanding the application of law to practical situations.

The taxation laws in our country undergo many changes. The Board of Studies brings out every year a "Supplementary Study Paper" containing all the amendments in direct and indirect taxes. This is an essential read for all our students. Another useful medium by which the students can keep themselves abreast is the students' newsletter – "The Chartered Accountant Student".

Finally, we would welcome suggestions to make this book more helpful and 'student-friendly'. In case of any doubt, students are welcome to write through *e-Sahaayataa, Grievance Redressal System of the ICAI*.

Happy Reading and Best Wishes!

SYLLABUS

PAPER – 4 : TAXATION

(One paper — Three hours – 100 Marks)

Level of Knowledge: Working knowledge

Objectives:

(a) To gain knowledge of the provisions of Income-tax law relating to the topics mentioned in the contents below and

(b) To gain ability to solve simple problems concerning assessees with the status of 'Individual' covering the areas mentioned in the contents below.

Contents:

PART – I : INCOME-TAX (50 MARKS)

1. Important definitions in the Income-tax Act, 1961
2. Basis of charge; Rates of taxes applicable for different types of assessees
3. Concepts of previous year and assessment year
4. Residential status and scope of total income; Income deemed to be received / deemed to accrue or arise in India
5. Incomes which do not form part of total income
6. Heads of income and the provisions governing computation of income under different heads
7. Income of other persons included in assessee's total income
8. Aggregation of income; Set-off or carry forward and set-off of losses
9. Deductions from gross total income
10. Computation of total income and tax payable; Rebates and reliefs
11. Provisions concerning advance tax and tax deducted at source
12. Provisions for filing of return of income.

PART – II : SERVICE TAX AND VAT (Service tax 25 Marks and VAT 25 Marks)

Objective:

To gain knowledge of the provisions of service tax as mentioned below and basic concepts of value added tax (VAT) in India.

Contents:

1. Service tax – Concepts and general principles
2. Charge of service tax and taxable services
3. Valuation of taxable services
4. Payment of service tax and filing of returns
5. VAT – Concepts and general principles.
6. Calculation of VAT liability including input tax credits
7. Small dealers and composition scheme
8. VAT procedures

Note: If new legislations are enacted in place of the existing legislations the syllabus will accordingly include the corresponding provisions of such new legislations in the place of the existing legislations with effect from the date to be notified by the Institute. Students shall not be examined with reference to any particular State VAT Law.

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PART I

INCOME - TAX

CHAPTER 1

BASIC CONCEPTS

UNIT 1 : INCOME TAX LAW : AN INTRODUCTION

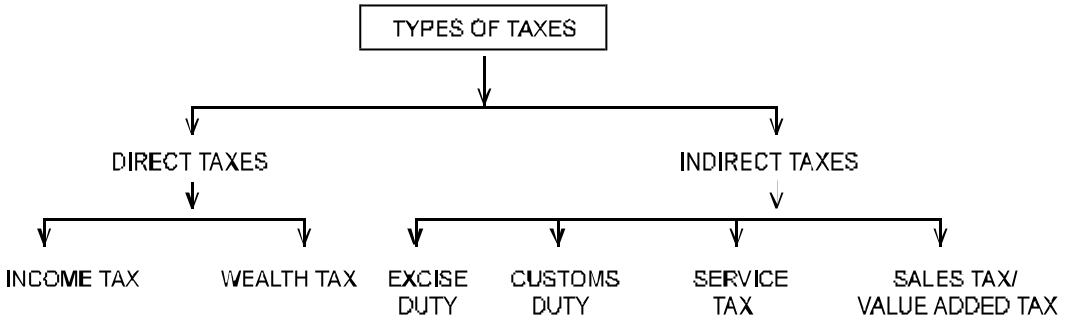
Learning Objectives

After studying this unit, you would be able to -

- understand the meaning of tax
- recognize the types of taxes
- comprehend the reason for levy of taxes
- know the components of income-tax law
- grasp the concept of income
- understand the procedure for computation of total income for the purpose of levy of income-tax
- know that there is a requirement of paying advance tax and deduction of tax at source
- appreciate what a "Return of income" means

1.1 WHAT IS A TAX?

Let us begin by understanding the meaning of tax. Tax is a fee charged by a government on a product, income or activity. There are two types of taxes – Direct taxes and indirect taxes (See Chart below this paragraph). If tax is levied directly on the income or wealth of a person, then it is a direct tax e.g. income-tax. If tax is levied on the price of a good or service, then it is called an indirect tax e.g. excise duty. In the case of indirect taxes, the person paying the tax passes on the incidence to another person.

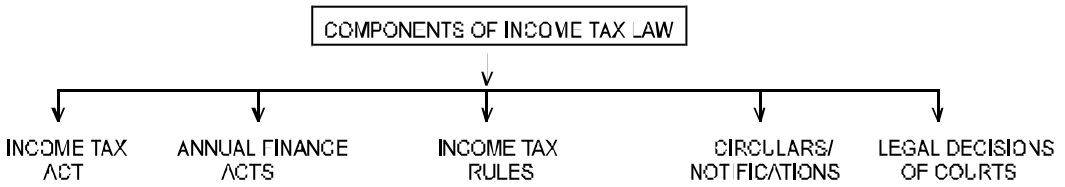


1.2 WHY ARE TAXES LEVIED?

The reason for levy of taxes is that they constitute the basic source of revenue to the government. Revenue so raised is utilized for meeting the expenses of government like defence, provision of education, health-care, infrastructure facilities like roads, dams etc.

1.3 OVERVIEW OF INCOME-TAX LAW IN INDIA

Income-tax is the most significant direct tax. In this material, we would be introducing the students to the Income-tax law in India. The income-tax law in India consists of the following components–



The various instruments of law containing the law relating to income-tax are explained below:

Income-tax Act

The levy of income-tax in India is governed by the Income-tax Act, 1961. In this book we shall briefly refer to this as the Act. This Act came into force on 1st April, 1962. The Act contains 298 sections and XIV schedules. These undergo change every year with additions and deletions brought about by the Finance Act passed by Parliament. In pursuance of the power given by the Income-tax Act, rules have been framed to facilitate proper administration of the Income-tax Act.

The Finance Act

Every year, the Finance Minister of the Government of India presents the Budget to the Parliament. Part A of the budget speech contains the proposed policies of the Government in fiscal areas. Part B of the budget speech contains the detailed tax proposals. In order to implement the above proposals, the Finance Bill is introduced in the Parliament. Once the Finance Bill is approved by the Parliament and gets the assent of the President, it becomes the Finance Act.

Income-tax Rules

The administration of direct taxes is looked after by the Central Board of Direct Taxes (CBDT). The CBDT is empowered to make rules for carrying out the purposes of the Act. For the proper administration of the Income-tax Act, the CBDT frames rules from time to time. These rules are collectively called Income-tax Rules, 1962. It is important to keep in mind that along with the Income-tax Act, these rules should also be studied.

Circulars and Notifications

Circulars are issued by the CBDT from time to time to deal with certain specific problems and to clarify doubts regarding the scope and meaning of the provisions. These circulars are issued for the guidance of the officers and/or assessees. The department is bound by the circulars. While such circulars are not binding the assessees they can take advantage of beneficial circulars.

Case Laws

The study of case laws is an important and unavoidable part of the study of income-tax law. It is not possible for Parliament to conceive and provide for all possible issues that may arise in the implementation of any Act. Hence the judiciary will hear the disputes between the assessees and the department and give decisions on various issues. The Supreme Court is the Apex Court of the country and the law laid down by the Supreme Court is the law of the land. The decisions given by various High Courts will apply in the respective states in which such High Courts have jurisdiction.

1.4 LEVY OF INCOME-TAX

Income-tax is a tax levied on the total income of the previous year of every person. A person includes an individual, Hindu Undivided Family (HUF), Association of Persons (AOP), Body of Individuals(BOI), a firm, a company etc.

1.5 CONCEPT OF INCOME

The definition of income as per the Income-tax Act begins with the words “Income includes”. Therefore, it is an inclusive definition and not an exhaustive one. Such a

definition does not confine the scope of income but leaves room for more inclusions within the ambit of the term. Certain important principles relating to income are enumerated below -

- Income, in general, means a periodic monetary return which accrues or is expected to accrue regularly from definite sources. However, under the Income-tax Act, even certain income which do not arise regularly are treated as income for tax purposes e.g. Winnings from lotteries, crossword puzzles.
- Income normally refers to revenue receipts. Capital receipts are generally not included within the scope of income. However, the Income-tax Act has specifically included certain capital receipts within the definition of income e.g. Capital gains i.e. gains on sale of a capital asset like land.
- Income means net receipts and not gross receipts. Net receipts are arrived at after deducting the expenditure incurred in connection with earning such receipts. The expenditure which can be deducted while computing income under each head [For knowing about heads of income, see step 2 of para 1.6 below] is prescribed under the Income-tax Act.
- Income is taxable either on due basis or receipt basis. For computing income under the heads "Profits and gains of business or profession" and "Income from other sources", the method of accounting regularly employed by the assessee should be considered, which can be either cash system or mercantile system.
- Income earned in a previous year is chargeable to tax in the assessment year. Previous year is the financial year, ending on 31st March, in which income has accrued/ received. Assessment year is the financial year (ending on 31st March) following the previous year. The income of the previous year is assessed during the assessment year following the previous year. For instance, income of previous year 2009-10 is assessed during 2010-11. Therefore, 2010-11 is the assessment year for assessment of income of the previous year 2009-10.

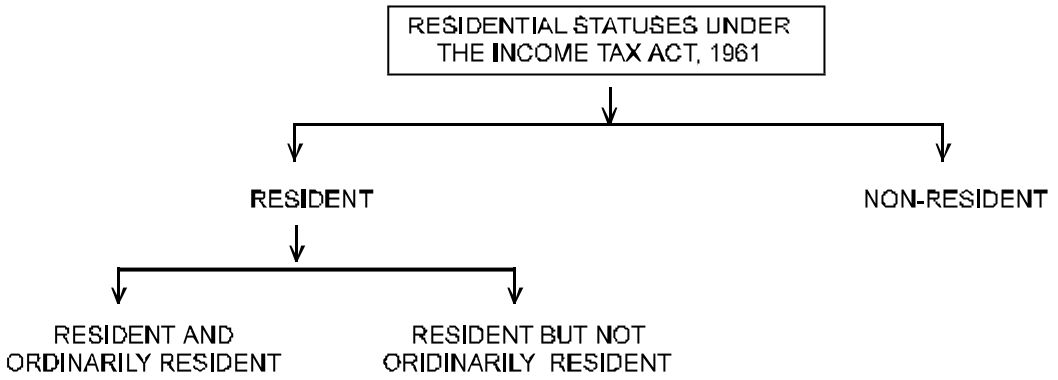
1.6 TOTAL INCOME AND TAX PAYABLE

Income-tax is levied on an assessee's total income. Such total income has to be computed as per the provisions contained in the Income-tax Act, 1961. Let us go step by step to understand the procedure of computation of total income for the purpose of levy of income-tax –

Step 1 – Determination of residential status

The residential status of a person has to be determined to ascertain which income is to be included in computing the total income.

The residential statuses as per the Income-tax Act are shown below –

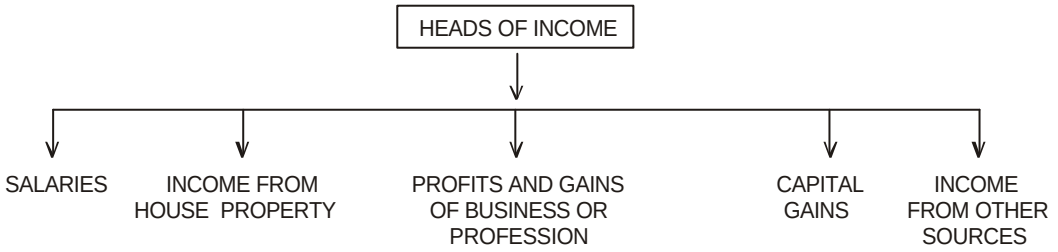


In the case of an individual, the duration for which he is present in India determines his residential status. Based on the time spent by him, he may be (a) resident and ordinarily resident, (b) resident but not ordinarily resident, or (c) non-resident.

The residential status of a person determines the taxability of the income. For e.g., income earned outside India will not be taxable in the hands of a non-resident but will be taxable in case of a resident and ordinarily resident.

Step 2 – Classification of income under different heads

The Act prescribes five heads of income. These are shown below –



These heads of income exhaust all possible types of income that can accrue to or be received by the tax payer. Salary, pension earned is taxable under the head "Salaries". Rental income is taxable under the head "Income from house property". Income derived from carrying on any business or profession is taxable under the head "Profits and gains from business or profession". Profit from sale of a capital asset (like land) is taxable under the head "Capital Gains". The fifth head of income is the residuary head under which income taxable under the Act, but not falling under the first four heads, will be

taxed. The tax payer has to classify the income earned under the relevant head of income.

Step 3 - Exclusion of income not chargeable to tax

There are certain income which are wholly exempt from income-tax e.g. Agricultural income. These income have to be excluded and will not form part of Gross Total Income. Also, some incomes are partially exempt from income-tax e.g. House Rent Allowance, Education Allowance. These incomes are excluded only to the extent of the limits specified in the Act. The balance income over and above the prescribed exemption limits would enter computation of total income and have to be classified under the relevant head of income.

Step 4 - Computation of income under each head

Income is to be computed in accordance with the provisions governing a particular head of income. Under each head of income, there is a charging section which defines the scope of income chargeable under that head. There are deductions and allowances prescribed under each head of income. For example, while calculating income from house property, municipal taxes and interest on loan are allowed as deduction. Similarly, deductions and allowances are prescribed under other heads of income. These deductions etc. have to be considered before arriving at the net income chargeable under each head

Step 5 – Clubbing of income of spouse, minor child etc.

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

Step 6 – Set-off or carry forward and set-off of losses

An assessee may have different sources of income under the same head of income. He might have profit from one source and loss from the other. For instance, an assessee may have profit from his textile business and loss from his printing business. This loss can be set-off against the profits of textile business to arrive at the net income chargeable under the head “Profits and gains of business or profession”.

Similarly, an assessee can have loss under one head of income, say, Income from house property and profits under another head of income, say, Profits and gains of business or

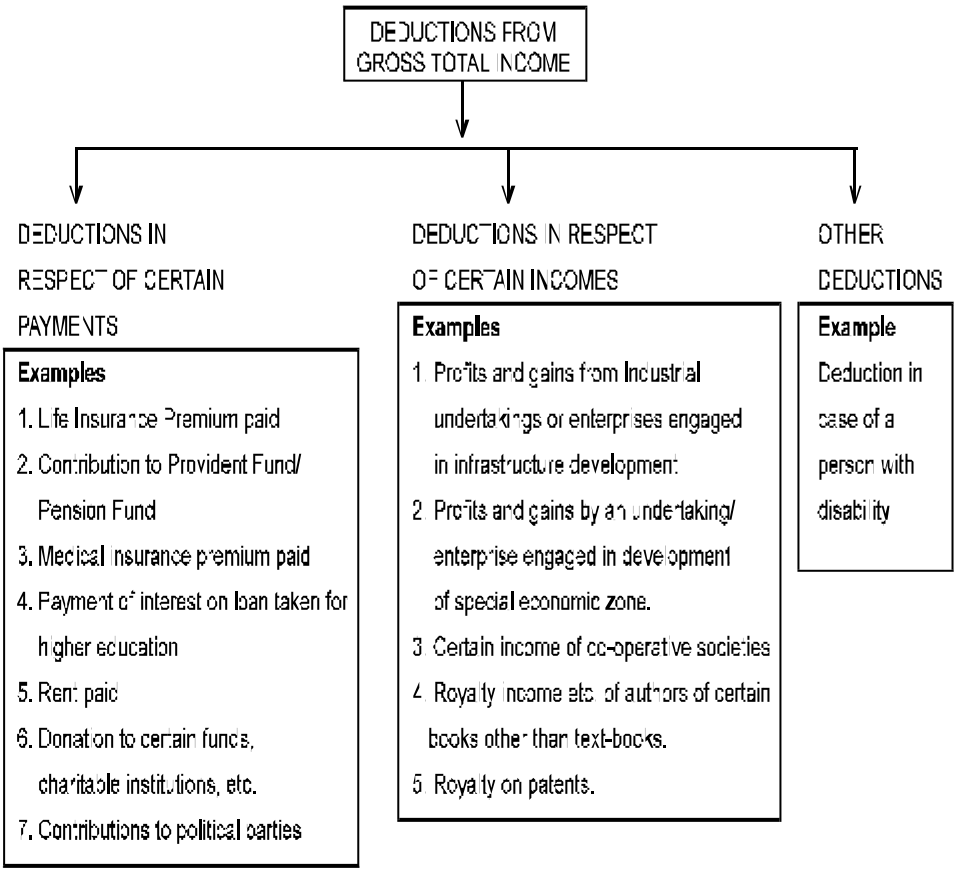
profession. There are provisions in the Income-tax Act for allowing inter-head adjustment in certain cases. Further, losses which cannot be set-off in the current year due to inadequacy of eligible profits can be carried forward for set-off in the subsequent years as per the provisions contained in the Act.

Step 7 – Computation of Gross Total Income.

The final figures of income or loss under each head of income, after allowing the deductions, allowances and other adjustments, are then aggregated, after giving effect to the provisions for clubbing of income and set-off and carry forward of losses, to arrive at the gross total income.

Step 8 – Deductions from Gross Total Income

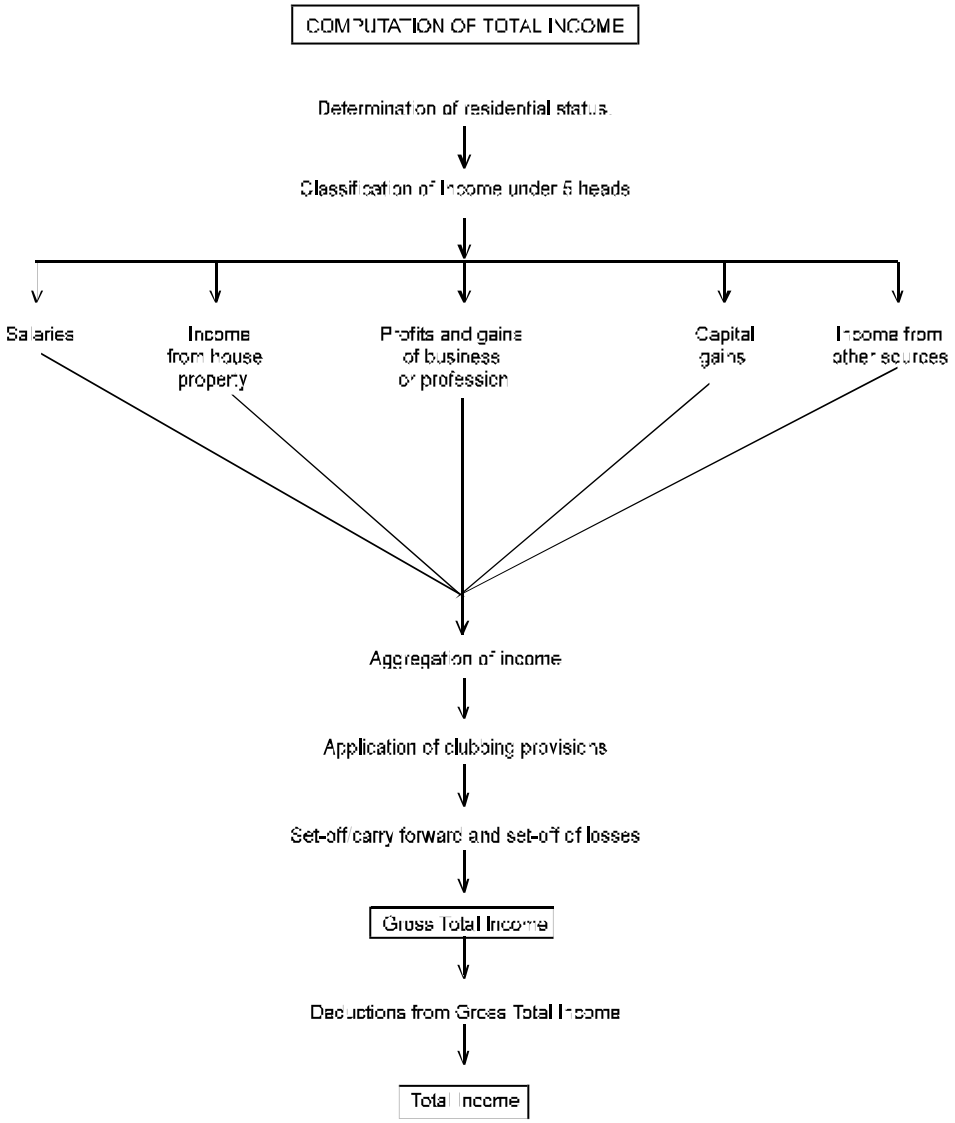
There are deductions prescribed from Gross Total Income. These deductions are of three types –



Step 9 – Total income

The income arrived at, after claiming the above deductions from the Gross Total Income is known as the Total Income. It is also called the Taxable Income. It should be rounded off to the nearest multiple of Rs.10.

The process of computation of total income is shown hereunder –



Step 10 – Application of the rates of tax on the total income

The rates of tax for the different classes of assesses are prescribed by the Annual Finance Act.

For individuals, HUFs etc., there is a slab rate and basic exemption limit. At present, the basic exemption limit is *Rs.1,60,000* for individuals. This means that no tax is payable by individuals with total income of up to *Rs.1,60,000*. Those individuals whose total income is more than *Rs.1,60,000* but less than *Rs.3,00,000* have to pay tax on their total income in excess of *Rs.1,60,000* @ 10% and so on. The highest rate is 30%, which is attracted in respect of income in excess of *Rs.5,00,000*.

For firms and companies, a flat rate of tax is prescribed. At present, the rate is 30% on the whole of their total income.

The tax rates have to be applied on the total income to arrive at the income-tax liability.

Step 11 – Surcharge

Surcharge is an additional tax payable over and above the income-tax. Surcharge is levied as a percentage of income-tax. *From A.Y.2010-11 onwards, surcharge would be applicable only in the case of companies.* The rate of surcharge for domestic companies is 10% and for foreign companies is 2.5%, if their total income exceeds Rs.1 crore.

Step 12 – Education cess and secondary and higher education cess on income-tax

The income-tax, as increased by the surcharge, if applicable, is to be further increased by an additional surcharge called education cess@2%. The Education cess on income-tax is for the purpose of providing universalised quality basic education. This is payable by all assesses who are liable to pay income-tax irrespective of their level of total income. Further, "secondary and higher education cess on income-tax" @1% of income-tax plus surcharge, if applicable, is leviable from A.Y.2008-09 to fulfill the commitment of the Government to provide and finance secondary and higher education.

Step 13 - Advance tax and tax deducted at source

Although the tax liability of an assessee is determined only at the end of the year, tax is required to be paid in advance in certain installments on the basis of estimated income. In certain cases, tax is required to be deducted at source from the income by the payer at the rates prescribed in the Act. Such deduction should be made either at the time of accrual or at the time of payment, as prescribed by the Act. For example, in the case of salary income, the obligation of the employer to deduct tax at source arises only at the time of payment of salary to the employees. Such tax deducted at source has to be remitted to the credit of the Central Government through any branch of the RBI, SBI or any authorized bank. If any tax is still due on the basis of return of income, after

adjusting advance tax and tax deducted at source, the assessee has to pay such tax (called self-assessment tax) at the time of filing of the return.

1.7 RETURN OF INCOME

The Income-tax Act, contains provisions for filing of return of income. Return of income is the format in which the assessee furnishes information as to his total income and tax payable. The format for filing of returns by different assessees is notified by the CBDT. The particulars of income earned under different heads, gross total income, deductions from gross total income, total income and tax payable by the assessee are required to be furnished in a return of income. In short, a return of income is the declaration of income by the assessee in the prescribed format.

The Act has prescribed due dates for filing return of income in case of different assessees. All companies and firms have to mandatorily file their return of income before the due date. Other persons have to file a return of income if their total income exceeds the basic exemption limit.

UNIT – 2 : IMPORTANT DEFINITIONS IN THE INCOME-TAX ACT, 1961

Learning Objectives

After studying this unit, you would be able to understand and appreciate –

- the meaning of the important terms used in the Income-tax Act, 1961
- the scope of definition of those terms for the purposes of this Act.

Section 2 of the Act gives definitions of the various terms and expressions used therein. In order to understand the provisions of the Act, one must have a thorough knowledge of the meanings of certain key terms like 'person', 'assessee', 'income', etc. To understand the meanings of these terms we have to first check whether they are defined in the Act itself. If a particular definition is given in the Act itself, we have to be guided by that definition. If a particular definition is not given in the Act, reference can be made to the General Clauses Act or dictionaries. Students should note this point carefully because certain terms like "dividend", "transfer", etc. have been given a wider meaning in the Income-tax Act than they are commonly understood.

Some of the important terms defined under section 2 are given below:

2.1 ASSESSEE [Section 2(7)] - Assessee means a person by whom any tax or any other sum of money is payable under this Act. It includes every person in respect of whom any proceeding has been taken for the assessment of his income or assessment of fringe benefits. Sometimes, a person becomes assessable in respect of the income of some other persons. In such a case also, he may be considered as an assessee. This term also includes every person who is deemed to be an assessee or an assessee in default under any provision of this Act.

2.2 ASSESSMENT [Section 2(9)] - This is the procedure by which the income of an assessee is determined by the Assessing Officer. It may be by way of a normal assessment or by way of reassessment of an income previously assessed.

2.3 PERSON [Section 2(31)] - The definition of 'assessee' leads us to the definition of 'person' as the former is closely connected with the latter. The term 'person' is important from another point of view also *viz.,* the charge of income-tax is on every 'person'.

The definition is inclusive i.e. a person includes,

(i) an individual,

(ii) a Hindu Undivided Family (HUF),

(iii) a company,

(iv) a firm,

(v) an AOP or a BOI, whether incorporated or not,

(vi) a local authority, and

(vii) every artificial juridical person *e.g.,* an idol or deity.

We may briefly consider some of the above seven categories of assessees each of which constitutes a separate unit of assessment.

(i) Individual - The term 'individual' means only a natural person, *i.e.,* a human being. It includes both males and females. It also includes a minor or a person of unsound mind. But the assessment in such a case may be made under section 161(1) on the guardian or manager of the minor or lunatic. In the case of deceased person, assessment would be made on the legal representative.

(ii) HUF - Under the Income-tax Act, a Hindu undivided family (HUF) is treated as a separate entity for the purpose of assessment. It is included in the definition of the term "person" under section 2(31). The levy of income-tax is on "every person". Therefore, income-tax is payable by a HUF. "Hindu undivided family" has not been defined under the Income-tax Act. The expression is however defined under the Hindu Law as a family, which consists of all males lineally descended from a common ancestor and includes their wives and unmarried daughters.

The relation of a HUF does not arise from a contract but arises from status. A Hindu is born into a HUF. A male member continues to remain a member of the family until there is a partition of the family. After the partition, he ceases to be a member of one family. However, he becomes a member of another smaller family. A female member ceases to be a member of the HUF in which she was born, when she gets married. Thereafter, she becomes a member of the HUF of her husband.

Some members of the HUF are called co-parceners. They are related to each other and to the head of the family. HUF may contain many members, but members within four degrees including the head of the family (kartha) are called co-parceners. A hindu co-parcenary includes those persons who acquire by birth an interest in the joint coparcenary property. Only the coparceners have a right to partition.

A Jain undivided family would also be assessed as a HUF, as Jains are also governed by the laws as Hindus.

Schools of Hindu Law

There are two schools of hindu law. They are –

(1) Mithakshara school of hindu law

(2) Dayabhaga school of hindu law

Mithakshara law is followed by entire India except West Bengal and Assam. There is a basic difference between the two schools of thought with regard to succession. Under the Mithakshara law, the inheritance is by birth. One acquires the right to the family property by his birth and not by succession irrespective of the fact that his elders are living. Thus every child born in the family acquires a right/share in the family property.

Dayabagha law prevails in West Bengal and Assam. In Dayabagha law, nobody acquires the right, share in the property by birth as long as the head of family is living, that is, the children do not acquire any right, share in the family property, as long as his father is alive and only on death of the father, the children will acquire right/share in the property. Thus, the father and his brothers would be the coparceners of the HUF

Assessment of HUF

The income of a HUF is to be assessed in the hands of the HUF and not in the hands of any of its members. This is because HUF is a separate and a distinct tax entity.

Partition of HUF – There are two types of partition. They are –

(1) **Total partition** – is a partition by which the entire family property is divided amongst the coparceners. After the total partition, the HUF ceases to exist as such.

(2) **Partial partition** – is a partition which is partial as regards either the persons constituting the joint family or as regards the properties belonging to the joint family or both. In case of a partial partition as regards persons constituting the joint family, some coparceners may separate from the joint family while the others might continue to remain as part of the joint family. In case of a partial partition as regards the property, there may be a division or severance of interest in respect of some part of the estate of the joint family, while the rest of the estate may continue to remain as property of the joint family.

Effect of partial partitions made after 31st December, 1978

However, partial partitions after 31st December, 1978 are not recognized for tax purposes. If any partial partition has been effected after 31.12.78, then no claim of such partial partition shall be recorded by the Assessing Officer. Such family will continue to be assessed as if no such partial partition has been effected. Every member of the HUF,

immediately before such partial partition, and the HUF shall be jointly and severally liable for any sum payable under the act. The several liability of a member would be proportionate to the share of joint family property allotted to him on such partial partition.

Assessment after total partition

When a claim of total partition of HUF has been made by any member of the HUF on behalf of the HUF, the Assessing Officer shall inquire into such claim. For this purpose, he shall give notice to all the members of the HUF. Thereafter, the Assessing Officer shall, on completion of inquiry, record a finding as to whether total partition has taken place and if so, the date when such partition was effected. If partition has been effected in the previous year, the total income of the HUF for the previous year up to the date of partition shall be assessed as income of the HUF. Every member of the HUF is jointly and severally liable for payment of tax on such assessed income of the HUF. The several liability of a member would be proportionate to the share of joint family property allotted to him on such partition.

Determination of total income of HUF

The following points should be taken into consideration while determining the total income of HUF -

(1) Income from the transfer of a self acquired property by an individual to his HUF for inadequate consideration or conversion of the self-acquired property into property of the HUF is not considered as the income of the HUF. It would be included in the income of the individual member who transferred the property to the HUF [Section 64(2)].

(2) Income from an impartible estate is included in the hands of the holder of the estate and not in the hands of the HUF. Even if the impartible estate is owned by the HUF, income from such estate is includible in the hands of the holder of the estate who is the eldest member of the HUF.

(3) Section 10(2) exempts any receipt by an individual as a member of a HUF out of the family income or out of the income of the impartible estate belonging to the family.

(4) If a member of the HUF receives any fee or remuneration as a director or a partner in a company or firm as a consequence of the investment made in such concern out of the funds of the HUF, such fee/remuneration shall constitute income of the HUF. However, any such fee or remuneration earned by a member of a HUF as a director or partner for services rendered purely in his personal capacity, will be included in the income of the individual member and not the HUF.

(iii) Company [Section 2(17)] - For all purposes of the Act the term 'Company', has a much wider connotation than that under the Companies Act. Under the Act, the expression 'Company' means:

(1) any Indian company as defined in section 2(26); or

(2) any body corporate incorporated by or under the laws of a country outside India, i.e., any foreign company; or

(3) any institution, association or body which is assessable or was assessed as a company for any assessment year under the Indian Income-tax Act, 1922 or for any assessment year commencing on or before 1.4.1970 under the present Act; or

(4) any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by a general or special order of the CBDT to be a company for such assessment years as may be specified in the CBDT's order.

Classes of Companies

(1) Domestic company [Section 2(22A)] - means an Indian company or any other company which, in respect of its income liable to income-tax, has made the prescribed arrangements for the declaration and payment of dividends (including dividends on preference shares) within India, payable out of such income.

Indian company [Section 2(26)] - Two conditions should be satisfied so that a company can be regarded as an Indian company -

(a) the company should have been formed and registered under any law relating to companies which was or is in force in any part of India, and

(b) the registered office or the principal office of the company should be in India.

The expression 'Indian Company' also includes:

(i) A corporation established by or under a Central, State or Provincial Act (like Financial Corporation or a State Road Transport Corporation),

(ii) An institution or association or body which is declared by the Board to be a company under section 2(17)(iv) provided its registered or principal office is in India.

(iii) in the case of the State of Jammu and Kashmir, a company formed and registered under any law for the time being in force in that State.

(iv) in the case of any of the Union territories of Dadra and Nagar Haveli, Goa, Daman and Diu, and Pondicherry, a company formed and registered under any law for the time being in force in that Union territory.

Company in which public are substantially interested [Section 2(18)] - The following companies are said to be companies in which the public are substantially interested:

(i) A company owned by the Government (either Central or State but not Foreign) or the Reserve Bank of India (RBI) or in which not less than 40% of the shares are held by the Government or the RBI or corporation owned by that bank.

(ii) A company which is registered under section 25 of the Companies Act, 1956 (formed for promoting commerce, arts, science, religion, charity or any other useful object).

(iii) A company having no share capital which is declared by the Board for the specified assessment years to be a company in which the public are substantially interested.

(iv) A company which is not a private company as defined in the Companies Act, 1956 and which fulfills any of the following conditions :

- its equity shares should have, as on the last day of the relevant previous year, been listed in a recognised stock exchange in India; or
- its equity shares carrying at least 50% (40% in case of industrial companies) voting power should have been unconditionally allotted to or acquired by and should have been beneficially held throughout the relevant previous year by (a) Government or (b) a Statutory Corporation or (c) a company in which public are substantially interested or (d) any wholly owned subsidiary of company mentioned in (c).

(v) A company which carries on its principal business of accepting deposits from its members and which is declared by the Central Government under section 620A of the Companies Act to be Nidhi or a Mutual Benefit Society.

(vi) A company whose equity shares carrying at least 50% of the voting power have been allotted unconditionally to or acquired unconditionally by and were beneficially held throughout the relevant previous year by one or more co-operative societies.

Person having substantial interest in the company [Section 2(32)] – is a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend), whether with or without a right to participate in profits, carrying at least 20% of the total voting power.

Note: The main criterion is the 'beneficial' ownership and not 'legal' ownership. Therefore, the registered holder of even the majority of equity shares, would not fall within this definition if he has no beneficial interest in the shares. On the other hand, a person who is beneficially entitled to atleast 20% of the equity share capital of a company would fall

within this definition even if he is not the registered holder of any shares.

(2) Foreign company [Section 2(23A)] - Foreign company means a company which is not a domestic company.

(iv) Firm - The terms 'firm', 'partner' and 'partnership' have the same meanings as assigned to them in the Indian Partnership Act. *In addition, the definitions also include the terms as they have been defined in the Limited Liability Partnership Act, 2008.* However, for income-tax purposes a minor admitted to the benefits of an existing partnership would also be treated as partner. This is specified under section 2(23) of the Act. A partnership is the relation between persons who have agreed to share the profits of business carried on by all or any of them acting for all. The persons who have entered into partnership with one another are called individually 'partners' and collectively a 'firm'.

Note –

(i) Consequent to the Limited Liability Partnership Act, 2008 coming into effect in 2009 and notification of the Limited Liability Partnership Rules w.e.f. 1st April, 2009, the Finance (No.2) Act, 2009 has incorporated the taxation scheme of LLPs in the Income-tax Act on the same lines as applicable for general partnerships, i.e. tax liability would be attracted in the hands of the LLP and tax exemption would be available to the partners. Therefore, the same tax treatment would be applicable for both general partnerships and LLPs.

(ii) Consequently, the following definitions in section 2(23) have been amended -

(1) The definition of 'partner' to include within its meaning, a partner of a limited liability partnership;

(2) The definition of 'firm' to include within its meaning, a limited liability partnership; and

(3) The definition of 'partnership' to include within its meaning, a limited liability partnership.

The definition of these terms under the Income-tax Act would, in effect, also include the terms as they have been defined in the Limited Liability Partnership Act, 2008. Section 2(q) of the LLP Act, 2008 defines a 'partner' as any person who becomes a partner in the LLP in accordance with the LLP agreement. An LLP agreement has been defined under section 2(o) to mean any written agreement between the partners of the LLP or between the LLP and its partners which determines the mutual rights and duties of the partners and their rights and duties in relation to the LLP.

(v) Association of Persons (AOP) - When persons combine together for promotion of joint enterprise they are assessable as an AOP when they do not in law constitute a partnership. In order to constitute an association, persons must join in a common purpose, common action and their object must be to produce income; it is not enough that the persons receive the income jointly. Co-heirs, co-legatees or co-donees joining together for a common purpose or action would be chargeable as an AOP.

Body of Individuals (BOI) – It denotes the status of persons like executors or trustees who merely receive the income jointly and who may be assessable in like manner and to the same extent as the beneficiaries individually. Thus co-executors or co-trustees are assessable as a BOI as their title and interest are indivisible. Income-tax shall not be payable by an assessee in respect of the receipt of share of income by him from BOI and on which the tax has already been paid by such BOI.

(vi) Local Authority - The term means a municipal committee, district board, body of port commissioners or other authority legally entitled to or entrusted by the Government with the control or management of a municipal or local fund.

Note : A local authority is taxable in respect of that part of its income which arises from any business carried on by it in so far as that income does not arise from the supply of a commodity or service within its own jurisdictional area. However, income arising from the supply of water and electricity even outside the local authority's own jurisdictional areas is exempt from tax.

(vii) Artificial Persons - This category could cover every artificial juridical person not falling under other heads. An idol, or deity would be assessable in the status of an artificial juridical person.

2.4 INCOME [Section 2(24)] - Section 2(24) of the Act gives a statutory definition of income. This definition is inclusive and not exhaustive. Thus, it gives scope to include more items in the definition of income as circumstances may warrant. At present, the following items of receipts are included in income:—

(1) Profits and gains.

(2) Dividends.

(3) Voluntary contributions received by a trust/institution created wholly or partly for charitable or religious purposes or by an association or institution referred to in section 10(21) or section (23C)(iiiad)/(iiiae)/(iv)/(v)/(vi)/(via) *or an electoral trust* –

Scientific research association approved under section 35(1)(ii)	10(21)
Universities and other educational institutions	10(23C)(iiiad) and (vi)
Hospitals and other medical institutions	10(23C) (iiiae) and (via)
Notified funds or institutions established for charitable purposes	10(23C)(iv)
Notified trusts or institutions established wholly for public religious purposes or wholly for public religious and charitable purposes	10(23C)(v)
Electoral trust	*13B*

(4) The value of any perquisite or profit in lieu of salary taxable under section 17.

(5) Any special allowance or benefit other than the perquisite included above, specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit.

(6) Any allowance granted to the assessee to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living.

(7) The value of any benefit or perquisite whether convertible into money or not, obtained from a company either by a director or by a person who has a substantial interest in the company or by a relative of the director or such person and any sum paid by any such company in respect of any obligation which, but for such payment would have been payable by the director or other person aforesaid.

(8) The value of any benefit or perquisite, whether convertible into money or not, which is obtained by any representative assessee mentioned under section 160(1)(iii) and (iv), or by any beneficiary or any amount paid by the representative assessee for the benefit of the beneficiary which the beneficiary would have ordinarily been required to pay.

(9) Deemed profits chargeable to tax under section 41 or section 59.

(10) Profits and gains of business or profession chargeable to tax under section 28.

(11) Any capital gains chargeable under section 45.

(12) The profits and gains of any insurance business carried on by Mutual Insurance Company or by a cooperative society, computed in accordance with Section 44 or any

surplus taken to be such profits and gains by virtue of the provisions contained in the first Schedule to the Act.

(13) The profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members.

(14) Any winnings from lotteries, cross-word puzzles, races including horse races, card games and other games of any sort or from gambling, or betting of any form or nature whatsoever. For this purpose,

(i) "Lottery" includes winnings, from prizes awarded to any person by draw of lots or by chance or in any other manner whatsoever, under any scheme or arrangement by whatever name called;

(ii) "Card game and other game of any sort" includes any game show, an entertainment programme on television or electronic mode, in which people compete to win prizes or any other similar game.

(15) Any sum received by the assessee from his employees as contributions to any provident fund (PF) or superannuation fund or Employees State Insurance Fund (ESI) or any other fund for the welfare of such employees.

(16) Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy will constitute income.

"Keyman insurance policy" means a life insurance policy taken by a person on the life of another person where the latter is or was an employee or is or was connected in any manner whatsoever with the former's business.

(17) Any sum referred to clause (va) of Section 28. Thus, any sum, whether received or receivable in cash or kind, under an agreement for not carrying out any activity in relation to any business; or not sharing any know-how, patent, copy right, trade-mark, licence, franchise, or any other business or commercial right of a similar nature, or information or technique likely to assist in the manufacture or processing of goods or provision of services, shall be chargeable to income tax under the head "profits and gains of business or profession".

(18) Any sum referred to in section 56(2)(vi) – Gifts received by an individual or HUF from non-relatives on or after 1.4.2006 *but before 1.10.2009*, if the aggregate value of such gifts exceed Rs.50,000 during a year.

(19) Any sum of money or value of property referred to in section 56(2)(vii) w.e.f. 1.10.2009

Students should carefully study the various items of receipts included in the above definition. Some of them like capital gains are not revenue receipts. However, since they have been included in the definition, they are chargeable as income under the Act. The concept of revenue and capital receipts is discussed hereunder –

The Act contemplates a levy of tax on income and not on capital and hence it is very essential to distinguish between capital and revenue receipts. The distinction between capital and revenue receipts is somewhat blurred. Even then, capital receipts cannot be taxed, unless they fall within the scope of the definition of "income" and so the distinction remains real and most material for tax purposes.

Certain capital receipts which have been specifically included in the definition of income are Compensation for modification or termination of services, income by way of capital gains etc.

It is not possible to lay down any single test as infallible or any single criterion as decisive, final and universal in application to determine whether a particular receipt is capital or revenue in nature. Hence, the capital or revenue nature of the receipt must be determined with reference to the facts and circumstances of each case.

Distinction between capital and revenue receipts

The following are some of the important criteria which may be applied to distinguish between capital and revenue receipts.

(1) A receipt referable to fixed capital would be a capital receipt whereas a receipt referable to circulating capital would be a revenue receipt. The former is exempt from tax while the latter is taxable. In cases where a capital asset is transmuted into income and the price realized on its sale takes the form of periodic payments (e.g., annuities and annual installment of capital), the receipt would be taxable even though it is referable to a capital asset.

(2) Profits arising from the sale of a capital asset are chargeable to tax as capital gains under section 45 whereas profits arising from the sale of a trading asset being of revenue nature are taxable as income from business under section 28 provided that the sale is in the regular course of assessees' business or the transaction constitutes an adventure in the nature of trade.

(3) Profits arising from transactions which are entered into in the course of the business regularly carried on by the assessee, or are incidental to, or associated with the business of the assessee would be revenue receipts chargeable to tax. For example, a banker's or

financier's dealings in foreign exchange or sale of shares and securities, a shipbroker's purchases of ship in his own name, a share broker's purchase of shares on his own account would constitute transactions entered and yielding income in the ordinary course of their business. If transactions are partly in the course of and partly outside the regular trading activity of the assessee, the income arising therefrom must be segregated and allocated between the two parts and treated accordingly for tax purposes.

(4) In the case of profit arising from the sale of shares and securities the nature of the profit has to be ascertained from the motive, intention or purpose with which they were bought. If the shares were acquired as an investor or with a view to acquiring a controlling interest or for obtaining a managing or selling agency or a directorship the profit or loss on their sale would be of a capital nature; but if the shares were acquired in the ordinary course of business as a dealer in shares, it would be a taxable receipt. If the shares were acquired with speculative motive the profit or loss (although of a revenue nature) would have to be dealt with separately from other business.

(5) Even a single transaction may constitute a business or an adventure in the nature of trade even if it is outside the normal course of the assessee's business. Repetition of such transactions is not necessary. Thus, a bulk purchase followed by a bulk sale or a series of retail sales or bulk sale followed by a series of retail purchases would constitute an adventure in the nature of trade and consequently the income arising therefrom would be taxable. Purchase of any article with no intention to resell it, but resold under changed circumstances would be a transaction of a capital nature and capital gains arise. However, where an asset is purchased with the intention to resell it, the question whether the profit on sale is capital or revenue in nature depends upon (i) the conduct of the assessee, (ii) the nature and quantity of the article purchased, (iii) the nature of the operations involved, (iv) whether the venture is on capital or revenue account, and (v) other related circumstances of the case.

(6) In the case of annuities which are payable in specified sums at periodic intervals of time the receipt would be of a revenue nature even though it involves the conversion of capital into income for an annuity means the purchase of an income. An annuity received from an employer is taxable as "Income from salaries" whereas all other annuities are chargeable under the head "Income from other sources".

Annual payments, as distinguished from annuities, are in fact annual installments of capital. The purchase price of a business or property may be agreed to be paid in installments annually or otherwise. In such cases, the amount of installment received would be of capital nature not liable to tax. Thus, on the sale of property or business in

consideration of annual payment:

(i) if the sale is for a price which is to be paid in installments, the installments would be capital receipts;

(ii) if the property is sold for an annuity payable regularly, the property disappears and the annuity which takes its place would be chargeable to tax;

(iii) if the property is sold for what looks like an annuity but actually there is no transmutation of the principal sum into income and the annual payments are merely installments of the principal sum with interest only so much of the amount of installments as representing the interest payable would be income chargeable to tax, the balance being capital receipt; and

(iv) if the property is sold for a consideration which is share of the profits or gross receipt of a business, the receipt of the share of profits would be the sale price but still chargeable to tax as income provided that the true bargain was to secure an income and not a fixed capital sum. However, if the circumstances of the case show that the receipts were only installments of a capital nature, though fluctuating in amount and measurable with reference to profits, they would not be taxable.

(7) A receipt in substitution of a source of income is capital receipt not chargeable to tax. Thus compensation received for restraint of trade or profession is a capital receipt. Where an assessee receives compensation of termination of the agency business being the only source of income the receipt is a capital nature but taxable under section 28(ii). But where the assessee has a number of agencies and one of them is terminated and compensation received therefore, the receipt would be of a revenue nature since taking agencies and exploiting the same for earning income is the ordinary course of business and the loss of one agency would be made good by taking another. Compensation received from the employer for premature termination of the service contract is a revenue receipt taxable under section 15. In case where the compensation received is partly of a capital and partly of a revenue nature, the two will have to be segregated and treated accordingly for tax purposes.

Awards in the case of a sportsman, who is not a professional, will not be liable to tax in his hands as it would not be in the nature of income.

A lump sum payment made gratuitously (i.e. gratuity, leave encashment) or by way of compensation or otherwise to the widow or other legal heirs of an employee, who dies while still in active service, is not taxable as income under the Act.

(8) A lumpsum paid in commutation of salaries, pension, royalties or other periodic payments would be income taxable under the respective heads. Amount received under a policy of insurance would be a capital or revenue receipt depending upon the fact whether the policy was held by the assessee as a capital asset or as a trading asset. Likewise, subsidies or grants received from the Government would be generally of a revenue nature since they would be to supplement the income from business. But where a grant is received for specific purpose but not as a supplementary trading receipt (*e.g.*, to enable the company to relieve unemployment or promote family planning) the receipt would be of a capital nature not chargeable to tax. Premium or discount received by a debenture holder, being a capital receipt, would not be chargeable to tax

Mining royalties are revenue receipts taxable as income from other sources irrespective of the fact whether they are received in lump sum or by way of a fixed annual sum or a tonnage royalty or the minimum royalty. Similarly, royalties paid for use of whether paid in lump sum or in installments of fixed or varying amounts would be taxable as income whereas the payment received in lieu of total or partial assignment of patent under which the owner ceases to own the patent as a capital asset would constitute a capital receipt.

Premium on issue of shares or debentures, profit on forfeiture of shares and the fee charged on fresh issue of shares are capital receipts not chargeable to tax. The amount received by a shareholder on the winding up is a capital receipt (except where the receipt is a dividend under section 2(22)). But in case of a partnership, the amount receivable by an outgoing partner in respect of his share of the firm's profit whether, before or after its dissolution would be a revenue receipt chargeable to tax. Compensation received by a partner for relinquishing all his interests in the firm and amounts received in settlement of claim to an interest in the capital of a firm are capital receipts.

It is necessary to note that the capital or revenue nature of a receipt would have to be determined on the basis of the particular facts and circumstances of each case and the question whether a certain item is capital or revenue would be a mixed question of law and fact.

(9) Normally, gifts constitute capital receipts in the hands of the recipient. However, it is possible that gifts may partake the character of income under certain circumstances.

Example :

(i) Gifts received by doctors from their patients is taxable under the head Profits and Gains from Business or Profession.

(ii) *Any sum of money or value of property received without consideration or for*

inadequate consideration by an individual or a HUF from any person, other than a relative, is chargeable under the head "Income from Other Sources" [For details, refer to Unit 5 of Chapter 4 on "Income from Other Sources"].

2.5 DIVIDEND [Section 2(22)] - The term 'dividend' as used in the Act has a wider scope and meaning than under the general law. According to section 2(22) of the Act, the following receipts are deemed to be dividend:

(a) Distribution of accumulated profits, entailing the release of company's assets - Any distribution of accumulated profits, whether capitalised or not, by a company to its shareholders is dividend if it entails the release of all or any part of its assets. For example, if accumulated profits are distributed in cash it is dividend in the hands of the shareholders. Where accumulated profits are distributed in kind, for example by delivery of shares etc. entailing the release of company's assets, the market value of such shares on the date of such distribution is deemed dividend in the hands of the shareholder.

(b) Distribution of debentures, deposit certificates and bonus shares to preference shareholders - Any distribution to its shareholders by a company of debenture stock or deposit certificate in any form, whether with or without interest, and any distribution of bonus shares to preference shareholders to the extent to which the company possesses accumulated profits, whether capitalised or not, will be deemed as dividend. The market value of such bonus shares is taxable in the hands of the preference shareholder. In the case of debentures, debenture stock etc., their value is to be taken at the market rate and if there is no market rate they should be valued according to accepted principles of valuation.

Note: Bonus shares given to equity shareholders are not treated as dividend.

(c) Distribution on liquidation - Any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not, is deemed to be dividend income.

Note: Any distribution made out of the profits of the company after the date of the liquidation cannot amount to dividend. It is a repayment towards capital.

Accumulated profits include all profits of the company up to the date of liquidation whether capitalised or not. But where liquidation is consequent to the compulsory acquisition of an undertaking by the Government or by any corporation owned or controlled by the Government, the accumulated profits do not include any profits of the company prior to the 3 successive previous years immediately preceding the previous year in which such acquisition took place subject to certain exceptions.

(d) Distribution on reduction of capital - Any distribution to its shareholders by a company on the reduction of its capital to the extent to which the company possessed accumulated profits, whether capitalised or not, shall be deemed to be dividend.

Exception - The same exceptions as given in case (c) above shall also apply in this case.

(e) Advance or loan by a closely held company to its shareholder - Any payment by a company in which the public are not substantially interested of any sum by way of advance or loan to any shareholder who is the beneficial owner of 10% or more of the equity capital of the company will be deemed to be dividend to the extent of the accumulated profits. If the loan is not covered by the accumulated profits, it is not deemed to be dividend.

There are two exceptions to this rule:

(i) If the loan is granted in the ordinary course of its business and lending of money is a substantial part of the company's business, the loan or advance to a shareholder is not deemed to be dividend.

(ii) Where a loan had been treated as dividend and subsequently the company declares and distributes dividend to all its shareholders including the borrowing shareholder, and the dividend so paid is set off by the company against the previous borrowing, the adjusted amount will not be again treated as a dividend.

Advance or loan by a closely held company to a specified concern - Any payment by a company in which the public are not substantially interested to any concern (i.e. HUF / Firm / AOP / BOI / Company) in which a shareholder, having the beneficial ownership of atleast 10% of the equity shares is a member or a partner and in which he has a substantial interest (i.e. atleast 20% share of the income of the concern). The dividend income shall be taxable in the hands of the concern. Also, any payments by such a closely held company on behalf of, or for the individual benefit of any such shareholder will also deemed to be dividend. However, in both cases the ceiling limit of dividend is the extent of accumulated profits.

Illustration : Suppose Mr. X is a shareholder in a Company A as well as Company B. He has 10% shareholding in Company A and 20% shareholding in Company B. The accumulated profits of Company A = Rs.10 lakh. A loan of Rs.12 lakh is given by Company A to Company B. This loan up to the extent of accumulated profits of Rs.10 lakh is treated as dividend and is taxable in the hands of Company B.

Other exceptions

Apart from the exceptions cited above, the following also do not constitute "dividend" -

(i) Any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 77A of the Companies Act, 1956;

(ii) any distribution of shares on demerger by the resulting companies to the shareholders of the demerged company (whether or not there is a reduction of capital in the demerged company).

Basis of charge of dividend

Any income by way of dividends, referred to under section 115-O, is excluded from the total income of the shareholder [Section 10(34)]. Under section 115-O, any dividend declared, distributed or paid by a domestic company, whether out of current or accumulated profits, shall be charged to additional income-tax at a flat rate of *15%* in addition to normal income-tax chargeable on the income of the company. This is known as corporate dividend tax. Corporate dividend tax is not leviable on deemed dividend under section 2(22)(e). Hence, the same will be taxed in the hands of the shareholder.

Dividends received from a company, other than a domestic company, are still liable to tax in the hands of the shareholder. For example, dividend received from a foreign company is liable to tax in the hands of the shareholder.

Year of accrual of dividend

Section 8 of the Act provides that deemed dividend under section 2(22) declared by a company or distributed or paid by it shall be deemed to be the income of the previous year in which it is declared, distributed or paid, as the case may be. Any interim dividend shall be deemed to be the income of the previous year in which the amount is unconditionally made available to the member who is entitled to it.

2.6 INDIA [Section 2(25A)] – The term 'India' means –

(i) the territory of India as per article 1 of the Constitution,

(ii) its territorial waters, seabed and subsoil underlying such waters,

(iii) continental shelf,

(iv) exclusive economic zone or

(v) any other specified maritime zone and the air space above its territory and territorial waters.

Specified maritime zone means the maritime zone as referred to in the Territorial Waters, Continental Shelf, Exclusive Economic Zone and other Maritime Zones Act, 1976.

2.7 INFRASTRUCTURE CAPITAL COMPANY [Section 2(26A)] – "Infrastructure capital company" means such company which makes investments by way of acquiring shares or providing long-term finance to -

(1) any enterprise or undertaking wholly engaged -

(a) in the business referred to in section 80-IA(4) i.e. business of

(i) developing/operating and maintaining/developing, operating and maintaining any infrastructure facility fulfilling the specified conditions

(ii) providing telecom services, whether basic or cellular

(iii) developing, developing and operating or maintaining and operating an industrial park or special economic zone notified by the Central Government

(iv) generating, transmitting or distributing power or undertaking substantial renovation and modernization of the existing network of transmission or distribution lines.

(b) in the business referred to in section 80-IAB(1) i.e. any business of developing a SEZ.

(2) an undertaking developing and building a housing project referred to in section 80-IB(10) i.e. approved before 31.3.2007 by a local authority and commences or commenced development and construction on or after 1.10.98 and completes or completed development and construction within the time specified.

(3) a project for constructing a hotel of not less than three-star category as classified by the Central Government or

(4) a project for constructing a hospital with at least 100 beds for patients

2.8 INFRASTRUCTURE CAPITAL FUND [Section 2(26B)] – Infrastructure capital fund means such fund operating under a trust deed registered under the provisions of the Registration Act, 1908 established to raise monies by the trustees for investment by way of acquiring shares or providing long-term finance to -

(1) any enterprise or undertaking wholly engaged in the business referred to in section 80-IA(4) or section 80-IAB(1) or

(2) an undertaking developing and building a housing project referred to in section 80-IB(10) or

(3) a project for constructing a hotel of not less than three star category as classified by the Central Government or

(4) a project for constructing a hospital with at least 100 beds for patients.

2.9 MANUFACTURE [Section 2(29BA)] – *'Manufacture', with its grammatical variations, shall mean a change in a non-living physical object or article or thing,—*

(a) resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use; or

(b) bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure.

UNIT – 3 : BASIS OF CHARGE AND RATES OF TAXES

Learning Objectives

After studying this unit, you would be able to –

- understand the basis of charge of income-tax
- know the rates of taxes applicable for different classes of assessees
- know whether surcharge is applicable to a particular class of assessee and if so, the rate of surcharge and the level of income above which the same is applicable
- understand the concept of marginal relief
- know about the levy of education cess and secondary and higher education cess.

3.1 CHARGE OF INCOME-TAX

Section 4 of the Income-tax Act is the charging section which provides that:

(i) Tax shall be charged at the rates prescribed for the year by the annual Finance Act.

(ii) The charge is on every person specified under section 2(31);

(iii) Tax is chargeable on the total income earned during the previous year and not the assessment year. (There are certain exceptions provided by sections 172, 174, 174A, 175 and 176);

(iv) Tax shall be levied in accordance with and subject to the various provisions contained in the Act.

This section is the back bone of the law of income-tax in so far as it serves as the most operative provision of the Act. The tax liability of a person springs from this section.

3.2 RATES OF TAX

Income-tax is to be charged at the rates fixed for the year by the annual Finance Act. Section 2 read with Part I of the First Schedule to the Finance (No.2) Act, 2009 specifies the rates at which income-tax is to be levied on income chargeable to tax for the A.Y. 2009-10. Part II lays down the rate at which tax is to be deducted at source during the financial year 2009-10 i.e. A.Y. 2010-11 from income subject to such deduction under the Act; Part III lays down the rates for charging income-tax in certain cases, rates for deducting income-tax from income chargeable under the head "salaries" and the rates for computing advance tax for the financial year 2009-10 i.e. A.Y.2010-11. Part III of the First

Schedule to the Finance (No.2) Act, 2009 will become Part I of the First Schedule to the Finance Act, 2010 and so on.

(1) Individual / Hindu Undivided Family (HUF) / Association of Persons (AOP) / Body of Individuals (BOI) / Artificial Juridical Person.

(i) where the total income does not exceed Rs.1,60,000	*Nil;*
(ii) where the total income exceeds Rs.1,60,000 but does not exceed Rs.3,00,000	*10% of the amount by which the total income exceeds Rs.1,60,000*
(iii) where the total income exceeds Rs.3,00,000 but does not exceed Rs.5,00,000	*Rs.14,000 plus 20% of the amount by which the total income exceeds Rs.3,00,000;*
(iv) where the total income exceeds Rs.5,00,000	*Rs.54,000 plus 30% of the amount by which the total income exceeds Rs.5,00,000.*

Illustration*: Mr. X has a total income of Rs.8,00,000. Compute his gross tax liability.*

Tax liability = Rs.54,000 + 30% of Rs.3,00,000 = Rs.1,44,000

Alternatively:

Tax liability :

First Rs.1,60,000	*- Nil*
Next Rs.1,60,000 – Rs.3,00,000	*- @ 10% of Rs.1,40,000 = Rs. 14,000*
Next Rs.3,00,000 – Rs.5,00,000	*- @ 20% of Rs.2,00,000 = Rs. 40,000*
Balance i.e. Rs.5,00,000–Rs.8,00,000	*- @ 30% of Rs.3,00,000 = Rs. 90,000*
	Total tax = Rs.1,44,000

It is to be noted that for a woman resident below the age of 65 years at any time during the previous year, the basic exemption limit is Rs.1,90,000 and for a senior citizen (being a resident individual who is of the age of 65 years or more at any time during the previous year), the basic exemption limit is Rs.2,40,000. Therefore, the tax slabs for these assessees would be as follows –

For resident women below the age of 65 years

(i) where the total income does not exceed Rs.1,90,000	*Nil;*

(ii) where the total income exceeds Rs.1,90,000 but does not exceed Rs.3,00,000	*10% of the amount by which the total income exceeds Rs.1,90,000*
(iii) where the total income exceeds Rs.3,00,000 but does not exceed Rs.5,00,000	*Rs.11,000 plus 20% of the amount by which the total income exceeds Rs.3,00,000;*
(iv) where the total income exceeds Rs.5,00,000	*Rs.51,000 plus 30% of the amount by which the total income exceeds Rs.5,00,000.*

For senior citizens (being resident individuals of the age of 65 years or more)

(i) where the total income does not exceed Rs.2,40,000	*Nil;*
(ii) where the total income exceeds Rs.2,40,000 but does not exceed Rs.3,00,000	*10% of the amount by which the total income exceeds Rs.2,40,000;*
(iii) where the total income exceeds Rs.3,00,000 but does not exceed Rs.5,00,000	*Rs.6,000 plus 20% of the amount by which the total income exceeds Rs.3,00,000;*
(iv) where the total income exceeds Rs.5,00,000	*Rs.46,000 plus 30% of the amount by which the total income exceeds Rs.5,00,000.*

(2) Firm/LLP

On the whole of the total income	30%

(3) Local authority

On the whole of the total income	30%

(4) Co-operative Society

(i) where the total income does not exceed Rs.10,000	10% of the total income;
(ii) where the total income exceeds Rs.10,000 but does not exceed Rs.20,000	Rs.1,000 plus 20% of the amount by which the total income exceeds Rs.10,000
(iii) where the total income exceeds Rs.20,000	Rs.3,000 plus 30% of the amount by which the total income exceeds Rs.20,000.

(5) Company

(a)	In the case of a domestic company	30% of the total income
(b)	In the case of a company other than a domestic company	50% of specified royalties & fees for a rendering technical services and 40% on the balance of total income.

The above rates are prescribed by the annual Finance Acts. However, in respect of certain types of income, as mentioned below, the Income-tax Act has prescribed specific rates –

(1) Section 112 has prescribed the rate of tax @20% in respect of long term capital gains (For details, refer Unit 4 of Chapter 4 – Capital gains)

(2) Section 111A provides for a concessional rate of tax (i.e. 15%) on the short-term capital gains on transfer of -

(i) an equity share in a company or

(ii) a unit of an equity oriented fund.

The conditions for availing the benefit of this concessional rate are –

(i) the transaction of sale of such equity share or unit should be entered into on or after 1.10.2004 and

(ii) such transaction should be chargeable to securities transaction tax.

(3) Section 115BB prescribes the rate of tax @30% for winnings from-

(i) any lottery; or

(ii) crossword puzzle; or

(iii) race including horse race; or

(iv) card game and other game of any sort; or

(v) gambling or betting of any form.

3.3 SURCHARGE

(1) In the case of domestic companies, the rate of surcharge is 10%, where the total income exceeds Rs.1 crore.

(2) In the case of foreign companies, the rate of surcharge is 2.5%, where the total income exceeds Rs.1 crore.

(3) No surcharge is leviable for assessees, other than companies.

3.4 MARGINAL RELIEF

This concept of marginal relief is applicable only in the case of companies w.e.f. A.Y.2010-11. Marginal relief is available in case of companies having a total income exceeding Rs.1 crore i.e. the additional amount of income-tax payable (together with surcharge) on the excess of income over Rs.1 crore should not be more than the amount of income exceeding Rs.1 crore.

3.5 EDUCATION CESS AND SECONDARY AND HIGHER EDUCATION CESS ON INCOME-TAX

The amount of income-tax as increased by the union surcharge, if applicable, should be further increased by an additional surcharge called the "Education cess on income-tax", calculated at the rate of 2% of such income-tax and surcharge, if applicable. Education cess is leviable in the case of all assessees i.e. individuals, HUF, AOP / BOI, firms, local authorities, co-operative societies and companies. Further, "Secondary and higher education œss on income-tax" @1% of income-tax plus surcharge, if applicable, is leviable to fulfill the commitment of the Government to provide and finance secondary and higher education.

UNIT – 4 : CONCEPT OF PREVIOUS YEAR AND ASSESSMENT YEAR

Learning Objectives

After studying this unit, you would be able to understand –

- the meaning and relevance of assessment year and previous year
- what is the previous year for undisclosed sources of income
- circumstances when income of the previous year would be assessed to tax in the previous year itself.

4.1 MEANING OF ASSESSMENT YEAR AND PREVIOUS YEAR

(1) Assessment year - The term has been defined under section 2(9). This means a period of 12 months commencing on 1st April every year. The year in which tax is paid is called the assessment year while the year in respect of the income of which the tax is levied is called the previous year. *For example, for the assessment year 2010-11, the relevant previous year is 2009-10 (1.4.2009 to 31.3.2010).*

(2) Previous year [Section 3] – It means the financial year immediately preceding the assessment year. The income earned during the previous year is taxed in the assessment year.

Business or profession newly set up during the financial year - In such a case, the previous year shall be the period beginning on the date of setting up of the business or profession and ending with 31st March of the said financial year.

If a source of income comes into existence in the said financial year, then the previous year will commence from the date on which the source of income newly comes into existence and will end with 31st March of the financial year.

Illustration:

1. A is running a business from 1992 onwards. Determine the previous year for the *assessment year 2010-11*.

Ans. The previous year will be *1.4.2009 to 31.3.2010.*

2. A chartered accountant sets up his profession on *1st July, 2009*. Determine the previous year for the *assessment year 2010-11.*

Ans. The previous year will be from *1.7.2009 to 31.3.2010*.

4.2 PREVIOUS YEAR FOR UNDISCLOSED SOURCES OF INCOME

There are many occasions when the Assessing Officer detects cash credits, unexplained investments, unexplained expenditure etc, the source for which is not satisfactorily explained by the assessee to the Assessing Officer. The Act contains a series of provisions to provide for these contingencies:

(1) Cash Credits [Section 68]

Where any sum is found credited in the books of the assessee and the assessee offers no explanation about the nature and source or the explanation offered is not satisfactory in the opinion of the Assessing Officer, the sum so credited may be charged as income of the assessee of that previous year.

(2) Unexplained Investments [Section 69]

Where in the financial year immediately preceding the assessment year, the assessee has made investments which are not recorded in the books of account and the assessee offers no explanation about the nature and the source of investments or the explanation offered is not satisfactory, the value of the investments are taxed as income of the assessee of such financial year.

(3) Unexplained money etc. [Section 69A]

Where in any financial year the assessee is found to be the owner of any money, bullion, jewellery or other valuable article and the same is not recorded in the books of account and the assessee offers no explanation about the nature and source of acquisition of such money, bullion etc. or the explanation offered is not satisfactory, the money and the value of bullion etc. may be deemed to be the income of the assessee for such financial year. Ownership is important and mere possession is not enough.

(4) Amount of investments etc., not fully disclosed in the books of account [Section 69B]

Where in any financial year the assessee has made investments or is found to be the owner of any bullion, jewellery or other valuable article and the Assessing Officer finds that the amount spent on making such investments or in acquiring such articles exceeds the amount recorded in the books of account maintained by the assessee and he offers no explanation for the difference or the explanation offered is unsatisfactory, such excess may be deemed to be the income of the assessee for such financial year.

For example, if the assessee is found to be the owner of say 300 gms of gold (market

value of which is Rs.25,000) during the financial year ending 31.3.10 but he has recorded to have spent Rs.15,000 in acquiring it, the Assessing Officer can add Rs.10,000 (i.e. the difference of the market value of such gold and Rs.15,000) as the income of the assessee, if the assessee offers no satisfactory explanation thereof.

(5) Unexplained expenditure [Section 69C]

Where in any financial year an assessee has incurred any expenditure and he offers no explanation about the source of such expenditure or the explanation is unsatisfactory the Assessing Officer can treat such unexplained expenditure as the income of the assessee for such financial year. Such unexplained expenditure which is deemed to be the income of the assessee shall not be allowed as deduction under any head of income.

(6) Amount borrowed or repaid on hundi [Section 69D]

Where any amount is borrowed on a hundi or any amount due thereon is repaid other than through an account-payee cheque drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying for the previous year in which the amount was borrowed or repaid, as the case may be.

However, where any amount borrowed on a hundi has been deemed to be the income of any person, he will not be again liable to be assessed in respect of such amount on repayment of such amount. The amount repaid shall include interest paid on the amount borrowed.

4.3 CERTAIN CASES WHEN INCOME OF A PREVIOUS YEAR WILL BE ASSESSED IN THE PREVIOUS YEAR ITSELF

The income of an assessee for a previous year is charged to income-tax in the assessment year following the previous year. However, in a few cases, this rule does not apply and the income is taxed in the previous year in which it is earned. These exceptions have been made to protect the interests of revenue. The exceptions are as follows:

(1) Shipping business of non-resident [Section 172] - Where a ship, belonging to or chartered by a non-resident, carries passengers, livestock, mail or goods shipped at a port in India, the ship is allowed to leave the port only when the tax has been paid or satisfactory arrangement has been made for payment thereof. 7.5% of the freight paid or payable to the owner or the charterer or to any person on his behalf, whether in India or outside India on account of such carriage is deemed to be his income which is charged to tax in the same year in which it is earned.

(2) Persons leaving India [Section 174] - Where it appears to the Assessing Officer that any individual may leave India during the current assessment year or shortly after its expiry and he has no present intention of returning to India, the total income of such individual for the period from the expiry of the respective previous year up to the probable date of his departure from India is chargeable to tax in that assessment year.

Example: Suppose Mr. X is leaving India for USA on *10.6.2010* and it appears to the Assessing Officer that he has no intention to return. Before leaving India, Mr. X will be required to pay income tax on the income earned during the *P.Y. 2009-10* as well as the total income earned during the period *1.4.2010 to 10.06.2010.*

(3) AOP / BOI / Artificial Juridical Person formed for a particular event or purpose [Section 174A] - If an AOP/BOI etc. is formed or established for a particular event or purpose and the Assessing Officer apprehends that the AOP/BOI is likely to be dissolved in the same year or in the next year, he can make assessment of the income up to the date of dissolution as income of the relevant assessment year.

(4) Persons likely to transfer property to avoid tax [Section 175] - During the current assessment year, if it appears to the Assessing Officer that a person is likely to charge, sell, transfer, dispose of or otherwise part with any of his assets to avoid payment of any liability under this Act, the total income of such person for the period from the expiry of the previous year to the date, when the Assessing Officer commences proceedings under this section is chargeable to tax in that assessment year.

(5) Discontinued business [Section 176] - Where any business or profession is discontinued in any assessment year, the income of the period from the expiry of the previous year up to the date of such discontinuance may, at the discretion of the Assessing Officer, be charged to tax in that assessment year.

Self-examination questions

1. The basic source of income-tax law is -
   a) Income-tax Act, 1961
   b) Circulars/Notifications issued by CBDT
   c) Judgments of Courts
2. A domestic company means -
   a) Only an Indian company

b) Only a foreign company which has made the prescribed arrangements for declaration and payment of dividends in India

c) Indian company and a foreign company which has made the prescribed arrangements for declaration and payment of dividends in India.

3. The rates of income tax are mentioned in -

a) Income-tax Act, 1961

b) The Annual Finance Acts

c) Both in the Income-tax Act, 1961 and the Annual Finance Acts.

4. The surcharge applicable in the case of an individual is -

a) 10% of tax payable

b) 10% of tax payable if total income exceeds Rs.10 lakh

c) Nil

5. The additional benefit available to a resident woman assessee below the age of 65 years at any time during the previous year 2009-10 is -

a) Higher basic exemption limit of Rs.1,90,000

b) Higher basic exemption limit of Rs.1,85,000

c) Higher basic exemption limit of Rs.1 ,80,000

6. In respect of a resident assessee, who is of the age of 65 years or more at any time during the previous year 2009-10, -

a) Higher basic exemption of Rs.2,25,000 is available

b) Higher basic exemption of Rs.2,40,000 is available

c) Higher basic exemption of Rs.1,95,000 is available.

7. The rate of tax applicable to a domestic company for A.Y. 2010-11 is -

a) 30%

b) 35%

c) 40%

8. The surcharge applicable to a domestic company for A.Y. 2010-11 is -
   a) 10%
   b) 10% if total income exceeds 10 lakh
   c) 10% if the total income exceeds Rs.1crore.
9. The surcharge applicable to a foreign company for A.Y. 2010-11 is -
   a) Nil
   b) 2.5% if the total income exceeds Rs.1crore.
   c) 2.5%
10. The rate of tax applicable to a firm for A.Y. 2010-11 is -
   a) 30%
   b) 35%
   c) 40%
11. Define the following terms under the Income-tax Act, 1961 -
   (i) Assessee
   (ii) Person
   (iii) Previous year
12. Write short notes on the following -
   (i) Year of accrual of dividend
   (ii) Marginal relief
13. "Income of a previous year will be charged to tax in the assessment year following the previous year"- Discuss the exceptions to this general rule.
14. In certain cases, unexplained cash credit, unexplained investment, unexplained money or unexplained jewellery etc. is detected by the Assessing Officer. What is the previous year for charging such income to tax? Explain.

Answers

1. a; **2**. c; **3.** c; **4.** c; **5.** a; **6.** b; **7.** a; **8.** c; **9.** b; **10.** a.

CHAPTER 2

RESIDENCE AND SCOPE OF TOTAL INCOME

UNIT – 1 : RESIDENTIAL STATUS AND SCOPE OF TOTAL INCOME

Learning objectives

After studying this unit, you would be able to understand -

- the relevance and significance of residential status in determining total income of a person
- the types of residential status
- the rules for determining residential status for different categories of persons
- the scope of income includible in total income for each residential status

1.1 RESIDENTIAL STATUS [SECTION 6]

The incidence of tax on any assessee depends upon his residential status under the Act. Therefore, after determining whether a particular amount is capital or revenue in nature, if the receipt is of a revenue nature and chargeable to tax, it has to be seen whether the assessee is liable to tax in respect of that income. The taxability of a particular receipt would thus depend upon not only the nature of the income and the place of its accrual or receipt but also upon the assessee's residential status.

For all purposes of income-tax, taxpayers are classified into three broad categories on the basis of their residential status. viz

(1) Resident and ordinarily resident

(2) Resident but not o rdinarily resident

(3) Non-resident

The residential status of an assessee must be ascertained with reference to each previous year. A person who is resident and ordinarily resident in one year may become non-resident or resident but not ordinarily resident in another year or *vice versa.* The provisions for determining the residential status of assessees are:

(1) Residential status of Individuals

Under section 6(1), an individual is said to be resident in India in any previous year, if he satisfies **any one** of the following conditions:

(i) He has been in India during the previous year for a total period of 182 days or more, or

(ii) He has been in India during the 4 years immediately preceding the previous year for a total period of 365 days or more and has been in India for at least 60 days in the previous year.

If the individual satisfies any one of the conditions mentioned above, he is a resident. If both the above conditions are not satisfied, the individual is a non-resident.

Note:

(a) The term "stay in India" includes stay in the territorial waters of India (i.e. 12 nautical miles into the sea from the Indian coastline). Even the stay in a ship or boat moored in the territorial waters of India would be sufficient to make the individual resident in India.

(b) It is not necessary that the period of stay must be continuous or active nor is it essential that the stay should be at the usual place of residence, business or employment of the individual.

(c) For the purpose of counting the number of days stayed in India, both the date of departure as well as the date of arrival are considered to be in India.

(d) The residence of an individual for income-tax purpose has nothing to do with citizenship, place of birth or domicile. An individual can, therefore, be resident in more countries than one even though he can have only one domicile.

Exceptions:

The following categories of individuals will be treated as residents only if the period of their stay during the relevant previous year amounts to 182 days. In other words even if such persons were in India for 365 days during the 4 preceding years and 60 days in the relevant previous year, they will not be treated as resident.

(1) Indian citizens, who leave India in any previous year as a member of the crew of an Indian ship or for purposes of employment outside India, or

(2) Indian citizen or person of Indian origin* engaged outside India in an employment or

a business or profession or in any other vocation, who comes on a visit to India in any previous year

* A person is said to be of Indian origin if he or either of his parents or either of his grandparents were born in undivided India.

Not-ordinarily resident - Only individuals and HUF can be resident but not ordinarily resident in India. All other classes of assessees can be either a resident or non-resident. A not-ordinarily resident person is one who satisfies any one of the conditions specified under section 6(6).

(i) If such individual has been non-resident in India in any 9 out of the 10 previous years preceding the relevant previous year, or

(ii) If such individual has during the 7 previous years preceding the relevant previous year been in India for a period of 729 days or less.

Note: In simpler terms, an individual is said to be a resident and ordinarily resident if he satisfies both the following conditions:

(i) He is a resident in any 2 out of the last 10 years preceding the relevant previous year, and

(ii) His total stay in India in the last 7 years preceding the relevant previous year is 730 days or more.

If the individual satisfies both the conditions mentioned above, he is a resident and ordinarily resident but if only one or none of the conditions are satisfied, the individual is a resident but not ordinarily resident.

Illustration 1

Steve Waugh, the Australian cricketer comes to India for 100 days every year. Find out his residential status for the A.Y. 2010-11.

Solution

For the purpose of his residential status in India for A.Y. 2010-11, the relevant previous year is 2009-10.

Step 1: The total stay of Steve Waugh in the last 4 years preceding the previous year is 400 days (i.e.100 × 4) and his stay in the previous year is 100 days. Therefore, since he

has satisfied the second condition in section 6(1), he is a resident.

Step 2: Since his total stay in India in the last 7 years preceding the previous year is 700 days (i.e. 100 × 7), he does not satisfy the minimum requirement of 730 days in 7 years. Any one of the conditions not being satisfied, the individual is resident but not ordinarily resident.

Therefore, the residential status of Steve Waugh for the assessment year 2010-11 is resident but not ordinarily resident.

Illustration 2

Mr. B, a Canadian citizen, comes to India for the first time during the P.Y.2005-06. During the financial years 2005-06, 2006-07, 2007-08, 2008-09 and 2009-10, he was in India for 55 days, 60 days, 90 days, 150 days and 70 days respectively. Determine his residential status for the A.Y.2010-11.

Solution

During the previous year 2009-10, Mr. B was in India for 70 days and during the 4 years preceding the previous year 2009-10, he was in India for 355 days (i.e. 55+ 60+ 90+ 150 days).

Thus, he does not satisfy section 6(1). Therefore, he is a non-resident for the previous year 2009-10.

Illustration 3

Mr. C, a Japanese citizen left India after a stay of 10 years on 1.06.2007. During the financial year 2008-09, he comes to India for 46 days. Later, he returns to India for 1 year on 10.10.2009. Determine his residential status for the A.Y. 2010-11.

Solution

During the previous year 2009-10, Mr. C was in India for 173 days (i.e. 22+ 30+ 31+ 31+ 28+ 31 days). His stay in the last 4 years is:

2008-09	-	46	
2007-08	-	62	(i.e. 30 + 31 + 1)
2006-07	-	365	(since he left India on 01.06.2007 after 10 years)
2005-06	-	365	(since he left India on 01.06.2007 after 10 years)
		838	

Mr. C is a resident since his stay in the previous year 2009-10 is 173 days and in the last

4 years is more than 365 days.

For the purpose of being ordinarily resident, it is evident from the above calculations, that

(i) his stay in the last 7 years is more than 730 days and

(ii) since he was in India for 10 years prior to 1.6.2007, he was a resident in at least 2 out of the last 10 years preceding the relevant previous year.

Therefore, Mr.C is a resident and ordinarily resident for the A.Y.2010-11.

Illustration 4

Mr. D, an Indian citizen, leaves India on 22.9.2009 for the first time, to work as an officer of a company in France. Determine his residential status for the A.Y. 2010-11.

Solution

During the previous year 2009-10, Mr. D, an Indian citizen, was in India for 175 days (i.e. 30+ 31+ 30+31+ 31+22 days). He does not satisfy the minimum criteria of 182 days. Also, since he is an Indian citizen leaving India for the purposes of employment, the second condition under section 6(1) is not applicable to him.

Therefore, Mr. D is a non-resident for the A.Y.2010-11.

(2) Residential status of HUF

A HUF would be resident in India if the control and management of its affairs is situated wholly or partly in India. If the control and management of the affairs is situated wholly outside India it would become a non-resident.

The expression 'control and management' referred to under section 6 refers to the central control and management and not to the carrying on of day-to-day business by servants, employees or agents. The business may be done from outside India and yet its control and management may be wholly within India. Therefore, control and management of a business is said to be situated at a place where the head and brain of the adventure is situated. The place of control may be different from the usual place of running the business and sometimes even the registered office of the assessee. This is because the control and management of a business need not necessarily be done from the place of business or from the registered office of the assessee. But control and management do imply the functioning of the controlling and directing power at a particular place with some degree of permanence.

If the HUF is resident, then the status of the Karta determines whether it is resident and

ordinarily resident or resident but not ordinarily resident. If the karta is resident and ordinarily resident, then the HUF is resident and ordinarily resident and if the karta is resident but not ordinarily resident, then HUF is resident but not ordinarily resident.

Illustration 5

The business of a HUF is transacted from Australia and all the policy decisions are taken there. Mr. E, the karta of the HUF, who was born in Kolkata, visits India during the P.Y.2009-10 after 15 years. He comes to India on 1.4.2009 and leaves for Australia on 1.12.2009. Determine the residential status of Mr.E and the HUF for A.Y. 2010-11.

Solution

(a) During the P.Y.2009-10, Mr. E has stayed in India for 245 days (i.e. 30+31+30+31+31+ 30+31+30+1 days). Therefore, he is resident. However, since he has come to India after 15 years, he cannot satisfy any of the conditions for being ordinarily resident.

Therefore, the residential status of Mr. E for the P.Y. 2009-10 is resident but not ordinarily resident.

(b) Since the business of the HUF is transacted from Australia and nothing is mentioned regarding its control and management, it is assumed that the control and management is also wholly outside India. Therefore, the HUF is a non-resident for the P.Y. 2009-10.

(3) Residential status of firms and association of persons

A firm and an AOP would be resident in India if the control and management of its affairs is situated wholly or partly in India. Where the control and management of the affairs is situated wholly outside India, the firm would become a non-resident.

(4) Residential status of companies

A company is said to be resident in India if -

(i) it is an Indian company as defined under section 2(26), or

(ii) its control and management is situated wholly in India during the accounting year.

Thus, every Indian company is resident in India irrespective of the fact whether the control and management of its affairs is exercised from India or outside. But a company, other than an Indian company, would become resident in India only if the entire control and management of its affairs is in India.

The control and management of the affairs of company are said to be exercised from the place where the director's meetings (not shareholders' meetings) are held, decisions taken and directions issued.

(5) Residential status of local authorities and artificial juridical persons

Local authorities and artificial juridical persons would be resident in India if the control and management of its affairs is situated wholly or partly in India. Where the control and management of the affairs is situated wholly outside India, they would become non-residents.

1.2 SCOPE OF TOTAL INCOME

Section 5 provides the scope of total income in terms of the residential status of the assessee because the incidence of tax on any person depends upon his residential status. The scope of total income of an assessee depends upon the following three important considerations:

(i) the residential status of the assessee (as discussed earlier);

(ii) the place of accrual or receipt of income, whether actual or deemed; and

(iii) the point of time at which the income had accrued to or was received by or on behalf of the assessee.

The ambit of total income of the three classes of assessees would be as follows:

(1) Resident and ordinarily resident - The total income of a resident assessee would, under section 5(1), consists of:

(i) income received or deemed to be received in India during the previous year;

(ii) income which accrues or arises or is deemed to accrue or arise in India during the previous year; and

(iii) income which accrues or arises outside India even if it is not received or brought into India during the previous year.

In simpler terms, a resident and ordinarily resident has to pay tax on the total income accrued or deemed to accrue, received or deemed to be received in or outside India.

(2) Resident but not ordinarily resident – Under section 5(1), the computation of total income of resident but not ordinarily resident is the same as in the case of resident and ordinarily resident stated above except for the fact that the income accruing or arising to

him outside India is not to be included in his total income. However, where such income is derived from a business controlled from or profession set up in India, then it must be included in his total income even though it accrues or arises outside India.

(3) Non-resident - A non-resident's total income under section 5(2) includes:

(i) income received or deemed to be received in India in the previous year; and

(ii) income which accrues or arises or is deemed to accrue or arise in India during the previous year.

Note:

All assessees, whether resident or not, are chargeable to tax in respect of their income accrued, arisen, received or deemed to accrue, arise or to be received in India whereas residents alone are chargeable to tax in respect of income which accrues or arises outside India.

RESIDENT AND ORDINARILY RESIDENT	RESIDENT BUT NOT ORDINARILY RESIDENT	NON-RESIDENT
Income received/ deemed to be received/ accrued or arisen/deemed to accrue or arise in or outside India.	Income which is received/ deemed to be received/ accrued or arisen/deemed to accrue or arise in India. and Income which accrues or arises outside India being derived from a business controlled from or profession set up in India.	Income received/ deemed to be received/ accrued or arisen/deemed to accrue or arise in India.

UNIT – 2 : DEEMED RECEIPT AND ACCRUAL OF INCOME IN INDIA

Learning objectives

After studying this unit, you would be able to understand -

- which are the income deemed to be received in India
- the meaning of income accruing or arising in India
- which are the income deemed to accrue or arise in India.

The taxability of a certain item as income would depend upon the method of accounting followed by the assessee. This is because under the cash system of accounting an income would be taxable only when it is received by the assessee himself or on his behalf. But under the mercantile system it would be taxable once the assessee gets the legal right to claim the amount. However, it has been specifically provided that in the case of income from salaries, the liability to tax arises immediately when the income is due to the assessee irrespective of the method of accounting followed. Likewise, in the case of dividends, the income would be included in total income of the shareholder under section 8 in the year in which the final dividend is declared and, in the case of interim dividend, in the year in which they are made unconditionally available to the shareholders.

2.1 MEANING OF "INCOME RECEIVED OR DEEMED TO BE RECEIVED"

All assessees are liable to tax in respect of the income received or deemed to be received by them in India during the previous year irrespective of -

(i) their residential status, and

(ii) the place of its accrual.

Income is to be included in the total income of the assessee immediately on its actual or deemed receipt. The receipt of income refers to only the first occasion when the recipient gets the money under his control. Therefore, when once an amount is received as income, remittance or transmission of that amount from one place or person to another does not constitute receipt of income in the hands of the subsequent recipient or at the place of subsequent receipt.

Income deemed to be received – Under section 7, the following shall be deemed to be received by the assessee during the previous year irrespective of whether he had actually received the same or not -

(i) The annual accretion in the previous year to the balance to the credit of an employee participating in a recognised provident fund (RPF). Thus, the contribution of the employer in excess of 12% of salary or interest credited in excess of 9.5% p.a. is deemed to be received by the assessee.

(ii) The taxable transferred balance from unrecognized to recognized provident fund (being the employer's contribution and interest thereon).

(iii) The contribution made by the Central Government or any other employer in the previous year to the account of an employee under a pension scheme referred to under section 80CCD.

2.2 MEANING OF INCOME 'ACCRUING' AND 'ARISING'

Accrue refers to the right to receive income, whereas due refers to the right to enforce payment of the same. For e.g. salary for work done in December will accrue throughout the month, day to day, but will become due on the salary bill being passed on 31st December or 1st January. Similarly, on Government securities, interest payable on specified dates arise during the period of holding, day to day, but will become due for payment on the specified dates. Example: Interest on Government securities is usually payable on specified dates, say on 1st January and 1st July. In all such cases, the interest would be said to accrue from 1st July to 31st December and on 1st January, it will fall due for payment.

It must be noted that income which has been taxed on accrual basis cannot be assessed again on receipt basis, as it will amount to double taxation. For example, when a loan to a director has already been treated as dividend under section 2(22)(e) and later dividend is declared, distributed and adjusted against the loan, the same cannot be treated as dividend income again.

With a view to removing difficulties and clarifying doubts in the taxation of income, *Explanation* 1 to Section 5 specifically provides that an item of income accruing or arising outside India shall not be deemed to be received in India merely because it is taken into account in a balance sheet prepared in India.

Further, *Explanation* 2 to Section 5 makes it clear that once an item of income is included in the assessee's total income and subjected to tax on the ground of its accrual/deemed accrual or receipt, it cannot again be included in the person's total income and subjected to tax either in the same or in a subsequent year on the ground of its receipt - whether actual or deemed.

2.3 INCOME DEEMED TO ACCRUE OR ARISE IN INDIA [SECTION 9]

Certain types of income are deemed to accrue or arise in India even though they may actually accrue or arise outside India. The categories of income which are deemed to accrue or arise in India are:

(i) Any income accruing or arising to an assessee in any place outside India whether directly or indirectly (a) through or from any business connection in India, (b) through or from any property in India, (c) through or from any asset or source of income in India or (d) through the transfer of a capital asset situated in India.

(ii) Income, which falls under the head "Salaries", if it is earned in India. Any income under the head "Salaries" payable for rest period or leave period which is preceded and succeeded by services rendered in India, and forms part of the service contract of employment, shall be regarded as income earned in India.

(iii) Income from 'Salaries' which is payable by the Government to a citizen of India for services rendered outside India (However, allowances and perquisites paid outside India by the Government is exempt).

(iv) Dividend paid by a Indian company outside India.

(v) Interest (discussed in para 5 below)

(vi) Royalty (discussed in para 6 below)

(vii) Fees for technical services (discussed in para 7 below)

(1)(a) Income from business connection

The expression "business connection" has been explained in *Explanation 2* to section 9(1)(i).

(i) 'Business connection' shall include any business activity carried out through a person acting on behalf of the non-resident.

(ii) He must have an authority which is habitually exercised to conclude contracts on behalf of the non-resident. However, if his activities are limited to the purchase of goods or merchandise for the non-resident, this provision will not apply.

(iii) Where he has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident, a business connection is established.

(iv) Business connection is also established where he habitually secures orders in India, mainly or wholly for the non-resident. Further, there may be situations when other non-residents control the above-mentioned non-resident. Secondly, this non-resident may also control other non-residents. Thirdly, all other non-residents may be subject to the same common control, as that of the non-resident. In all the three situations, business connection is established, where a person habitually secures orders in India, mainly or wholly for such non-residents.

Exception:

"Business connection", however, shall not be held to be established in cases where the non-resident carries on business through a broker, general commission agent or any other agent of an independent status, if such a person is acting in the ordinary course of his business.

A broker, general commission agent or any other agent shall be deemed to have an independent status where he does not work mainly or wholly for the non-resident. He will however, not be considered to have an independent status in the three situations explained in (iv) above, where he is employed by such a non-resident.

Where a business is carried on in India through a person referred to in (ii), (iii) or (iv) mentioned above, only so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India.

(1) (b) &(c) Income from property, asset or source of income

Any income which arises from any property (movable, immovable, tangible and intangible property) would be deemed to accrue or arise in India eg. hire charges or rent paid outside India for the use of the machinery or buildings situated in India, deposits with an Indian company for which interest is received outside India etc.

(1)(d) Income from the transfer of a capital asset

Capital gains arising from the transfer of a capital asset situated in India would be deemed to accrue or arise in India in all cases irrespective of the fact whether (i) the capital asset is movable or immovable, tangible or intangible; (ii) the place of registration of the document of transfer etc., is in India or outside; and (iii) the place of payment of the consideration for the transfer is within India or outside.

(2) & (3) Income from salaries

Under section 9(1)(ii) income which falls under the head ‘salaries’, would be deemed to

accrue or arise in India, if it is in respect of services rendered in India.

Exception under section 9(2):

Pension payable outside India by the Government to its officials and judges who permanently reside outside India shall not be deemed to accrue or arise in India. It may however, be noted here that the salary of an employee in the United Nations Organisation (UNO) or in its constituent bodies is exempt under United Nations (Privilege and Immunity) Act.

(4) Income from dividends

All dividends paid by an Indian company must be deemed to accrue or arise in India. Under section 10(34), income from dividends referred to in section 115-O are exempt from tax in the hands of the shareholder. It may be noted that dividend distribution tax under section 115-O does not apply to deemed dividend under section 2(22)(e), which is chargeable in the previous year in which such dividend is distributed or paid.

(5) Interest

Under section 9(1)(v), an interest is deemed to accrue or arise in India if it is payable by -

(i) the Central Government or any State Government.

(ii) a person resident in India (except where it is payable in respect of any money borrowed and used for the purposes of a business or profession carried on by him outside India or for the purposes of making or earning any income from any source outside India)

(iii) a non-resident when it is payable in respect of any debt incurred or moneys borrowed and used for the purpose of a business or profession carried on in India by him. Interest on money borrowed by the non-resident for any purpose other than a business or profession, will not be deemed to accrue or arise in India. Thus, if a non-resident 'A' borrows money from a non-resident 'B' and invests the same in shares of an Indian company, interest payable by 'A' to 'B' will not be deemed to accrue or arise in India.

(6) Royalty

Royalty will be will be deemed to accrue or arise in India when it is payable by -

(i) the Government; or

(ii) a person who is a resident in India except in cases where it is payable for the transfer of any right or the use of any property or information or for the utilization of services for the purposes of a business or profession carried on by such person

outside India or for the purposes of making or earning any income from any source outside India; or

(iii) a non-resident only when the royalty is payable in respect of any right, property or information used or services utilised for purposes of a business or profession carried on in India or for the purposes of making or earning any income from any source in India.

Lumpsum royalty payments made by a resident for the transfer of all or any rights (including the granting of a licence) in respect of computer software supplied by a non-resident manufacturer along with computer hardware under any scheme approved by the Government under the Policy on Computer Software Export, Software Development and Training, 1986 shall not be deemed to accrue or arise in India.

"Computer software" means any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customised electronic data.

The term 'royalty' means consideration (including any lumpsum consideration but excluding any consideration which would be the income of the recipient chargeable under the head 'Capital gains') for:

(i) the transfer of all or any rights (including the granting of licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;

(ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property;

(iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property;

(iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;

(v) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB;

(vi) the transfer of all or any rights (including the granting of licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films;

(vii) the rendering of any service in connection with the activities listed above.

The definition of 'royalty' for this purpose is wide enough to cover both industrial royalties as well as copyright royalties. The deduction specially excludes income which should be chargeable to tax under the head 'capital gains'.

(7) Fees for technical services

Any fees for technical services will be deemed to accrue or arise in India if they are payable by -

(i) the Government.

(ii) a person who is resident in India, except in cases where the fees are payable in respect of technical services utilised in a business or profession carried on by such person outside India or for the purpose of making or earning any income from any source outside India.

(iii) a person who is a non-resident, only where the fees are payable in respect of services utilised in a business or profession carried on by the non-resident in India or where such services are utilised for the purpose of making or earning any income from any source in India.

Fees for technical services means any consideration (including any lumpsum consideration) for the rendering of any managerial, technical or consultancy services (including providing the services of technical or other personnel). However, it does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head 'Salaries'.

Income deemed to accrue or arise in India to a non-resident by way of interest, royalty and fee for technical services to be taxed irrespective of territorial nexus

Explanation to section 9 clarifies that income by way of interest, royalty or fee for technical services which is deemed to accrue or arise in India by virtue of clauses (v), (vi) and (vii) of section 9(1), shall be included in the total income of the non-resident, whether or not the non-resident has a residence or place of business or business connection in India.

Illustration 6

Determine the taxability of the following incomes in the hands of a resident and ordinarily resident, resident but not ordinarily resident, and non-resident for the A.Y. 2010-11.

Particulars	Amount (Rs.)
Interest on UK Development Bonds, 50% of interest received in India	10,000
Income from a business in Chennai (50% is received in India)	20,000
Profits on sale of shares of an Indian company received in London	20,000
Dividend from British company received in London	5,000
Profits on sale of plant at Germany 50% of profits are received in India	40,000
Income earned from business in Germany which is controlled from Delhi (Rs.40,000 is received in India)	70,000
Profits from a business in Delhi but managed entirely from London	15,000
Rent from property in London deposited in a Indian Bank at London, brought to India	50,000
Interest for debentures in an Indian company received in London.	12,000
Fees for technical services rendered in India but received in London	8,000
Profits from a business in Bombay managed from London	26,000
Pension for services rendered in India but received in Burma	4,000
Income from property situated in Pakistan received there	16,000
Past foreign untaxed income brought to India during the previ ous year	5,000
Income from agricultural land in Nepal received there and then brought to India	18,000
Income from profession in Kenya which was set up in India, received there but spent in India	5,000
Gift received on the occasion of his wedding	20,000
Interest on savings bank deposit in State Bank of India	10,000
Income from a business in Russia, controlled from Russia	20,000
Dividend from Reliance Petroleum Limited, an Indian Company	5,000
Agricultural income from a land in Rajasthan	15,000

Solution:

Computation of total income for the A.Y.2010-11

Particulars	Resident and ordinarily resident	Resident but not ordinarily resident	Non-resident
Interest on UK Development Bonds, 50% of interest received in India	10,000	5,000	5,000
Income from a business in Chennai (50% is received in India)	20,000	20,000	20,000
Profits on sale of shares of an Indian company received in London	20,000	20,000	20,000
Dividend from British company received in London	5,000	-	-
Profits on sale of plant at Germany 50% of profits are received in India	40,000	20,000	20,000
Income earned from business in Germany which is controlled from Delhi, out of which Rs.40,000 is received in India	70,000	70,000	40,000
Profits from a business in Delhi but managed entirely from London	15,000	15,000	15,000
Rent from property in London deposited in a Bank at London, later on remitted to India	50,000	-	-
Interest for debentures in an Indian company received in London.	12,000	12,000	12,000
Fees for technical services rendered in India but received in London	8,000	8,000	8,000
Profits from a business in Bombay managed from London	26,000	26,000	26,000
Pension for services rendered in India but	4,000	4,000	4,000

received in Burma			
Income from property situated in Pakistan received there	16,000	-	-
Past foreign untaxed income brought to India during the previous year	-	-	-
Income from agricultural land in Nepal received there and then brought to India	18,000	-	-
Income from profession in Kenya which was set up in India, received there but spent in India	5,000	5,000	-
Gift received on the occasion of his wedding [not an income]	-	-	-
Interest on savings bank deposit in State Bank of India	10,000	10,000	10,000
Income from a business in Russia, controlled from Russia	20,000	-	-
Dividend from Reliance Petroleum Limited, an Indian Company [it is exempt u/s 10(34)]	-	-	-
Agricultural income from a land in Rajasthan [it is exempt u/s 10(1)]	-	-	-
Total Income	**3,49,000**	**2,15,000**	**1,80,000**

Self-examination questions

1. If Anirudh has stayed in India in the P.Y. 2009-10 for 181 days, and he is non-resident in 9 out of 10 years immediately preceding the current previous year and he has stayed in India for 365 days in all in the 4 years immediately preceding the current previous year and 420 days in all in the 7 years immediately preceding the current previous year , his residential status for the A.Y.2010-11 would be -

   a) Resident and ordinarily resident

   b) Resident but not ordinarily resident

   c) Non-resident

2. Raman was employed in Hindustan Lever Ltd. He received a salary at Rs.40,000 p.m. from 1.4.2009 to 27.9.2009. He resigned and left for Dubai for the first time on 1.10.2009 and got salary of rupee equivalent of Rs.80,000 p.m. from 1.10.2009 to 31.3.2010. His salary for October to December 2009 was credited in his Dubai bank account and the salary for January to March 2010 was credited in his Bombay account directly. He is liable to tax in respect of -

   a) Income received in India from Hindustan Lever Ltd;

   b) Income received in India and in Dubai;

   c) Income received in India from Hindustan Lever Ltd. and income directly credited in India;

3. A company, other than an Indian company, would be a resident in India for the P.Y.2009-10 if, during that year, its control and management is situated -

   a) wholly in India

   b) partly in India

   c) wholly or partly in India.

4. Income accruing in London and received there is taxable in India in the case of -

   a) resident and ordinarily resident only

   b) both resident and ordinarily resident and resident but not ordinarily resident

   c) both resident and non-resident

5. When is an individual said to be “Resident and ordinarily resident” under the Income-tax Act, 1961?

6. How is royalty defined under section 9 of the Income-tax Act?

7. Write short notes on -

   a) Business connection

   b) Income deemed to accrue or arise in India.

8. Discuss the provisions relating to determination of residential status of individuals.

9. When are the following income deemed to accrue or arise in India?

   a) Interest

   b) Fees for technical services.

10. Discuss the correctness or otherwise of the statement – "Income deemed to accrue or arise in India to a non-resident by way of interest, royalty and fees for technical services is to be taxed irrespective of territorial nexus."

Answers

1. b; **2.** b; **3.** a; **4.** a.

CHAPTER 3

INCOMES WHICH DO NOT FORM PART OF TOTAL INCOME

Learning Objectives

After studying this chapter, you would be able to understand –

- which are the income not forming part of total income
- the extent to which such income are excluded from total income
- the conditions to be satisfied for availing exemption
- the tax holiday available for newly established industrial units in free trade zones, export processing zones, special economic zones etc.
- the tax holiday available for 100% export oriented undertakings
- the conditions to be satisfied by wholly charitable or religious trusts for claiming exemption
- the cases where anonymous donations are chargeable to tax
- the categories of income derived by a political party which are exempt from tax
- the conditions to be fulfilled by the political party to claim such exemption

INTRODUCTION

In this chapter, we are going to study section 10 which enumerates the various categories of income that are exempt from tax. Thereafter, we shall also consider sections 10A, 10AA, 10B, 10BA which deal with exemption in respect of income of industrial units in free trade zones, special economic zones, 100% EOUs and undertakings engaged in export of certain articles or things. Section 11 provides exemption in respect of income derived from property held under trust wholly for charitable or religious purposes. Section 13A exempts certain categories of income derived by a political party.

1. INCOMES NOT INCLUDED IN TOTAL INCOME [SECTION 10]

The various items of income referred to in the different clauses of section 10 are excluded from the total income of an assessee. These incomes are known as exempted incomes.

Consequently, such income shall not enter into the computation of taxable income or the rate of tax.

Restrictions on allowability of expenditure [Section 14A] – (i) As per section 14A, expenditure incurred in relation to any exempt income is not allowed as a deduction while computing income under any of the five heads of income [Sub-section (1)].

However, the Assessing Officer is not empowered to reassess under section 147 or to pass an order increasing the liability of the assessee by way of enhancing the assessment or reducing a refund already made or otherwise increase the liability of the assessee under section 154, for any assessment year beginning on or before 1.4.2001 i.e. for any assessment year prior to A.Y. 2002-03 [Proviso to sub-section (1)].

The Assessing Officer is empowered to determine the amount of expenditure incurred in relation to such income which does not form part of total income in accordance with such method as may be prescribed [Sub-section (2)].

The method for determining expenditure in relation to exempt income is to be prescribed by the CBDT for the purpose of disallowance of such expenditure under section 14A. Such method should be adopted by the Assessing Officer if he is not satisfied with the correctness of the claim of the assessee, having regard to the accounts of the assessee.

Further, the Assessing Officer is empowered adopt such method, where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of total income [Sub-section (3)].

Rule 8D lays down the method for determining the amount of expenditure in relation to income not includible in total income.

If the Assessing Officer, having regard to the accounts of the assessee of a previous year, is not satisfied with –

(a) the correctness of the claim of expenditure by the assessee; or

(b) the claim made by the assessee that no expenditure has been incurred in relation to exempt income for such previous year,

he shall determine the amount of expenditure in relation to such income in the manner provided hereunder –

The expenditure in relation to income not forming part of total income shall be the aggregate of the following:

(i) the amount of expenditure directly relating to income which does not form part of total income;

(ii) in a case where the assessee has incurred expenditure by way of interest during the previous year which is not directly attributable to any particular income or receipt, an amount computed in accordance with the following formula, namely :

$$A \times \frac{B}{C}$$

Where,

A = amount of expenditure by way of interest other than the amount of interest included in clause (i) incurred during the previous year;

B = the average of value of investment, income from which does not or shall not form part of the total income, as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year;

C = the average of total assets as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year;

'Total assets' means total assets as appearing in the balance sheet excluding the increase on account of revaluation of assets but including the decrease on account of revaluation of assets.

(iii) an amount equal to one-half per cent of the average of the value of investment, income from which does not or shall not form part of the total income, as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year.

Difference between Section 10 and Chapter VI-A deductions - Certain other incomes are also wholly or partly rendered tax-free by being allowed as deductions in computation of total income under Chapter VI-A. Students should note a very important difference between exemptions under section 10 and the deductions under Chapter VI-A. While the incomes which are exempt under section 10 will not be included for computing total income, incomes from which deductions are allowable under Chapter VI-A will first be included in the gross total income (GTI) and then the deductions will be allowed. Let us now see the various incomes that are exempt from tax and the conditions to be satisfied in order to be eligible for exemptions.

(1) Agricultural income [Section 10(1)] – (i) Section 10(1) provides that agricultural income is not to be included in the total income of the assessee. The reason for totally

exempting agricultural income from the scope of central income tax is that under the Constitution, the Parliament has no power to levy a tax on agricultural income.

(ii) **Indirect way of taxing agricultural income -** However, a method has been laid down to levy tax on agricultural income in an indirect way. This concept is known as partial integration of taxes. It is applicable to individuals, HUF, unregistered firms, AOP, BOI and artificial persons. Two conditions which need to satisfied for partial integration are:

1. The net agricultural income should exceed Rs.5,000 p.a., and
2. Non-agricultural income should exceed the maximum amount not chargeable to tax. (i.e. *Rs.2,40,000* for senior citizens, *Rs.1,90,000* for women assessees below 65 years of age, *Rs.1,60,000* for all other individuals.)

It may be noted that aggregation provisions do not apply to company, firm assessed as such (FAS), co-operative society and local authority. The object of aggregating the net agricultural income with non-agricultural income is to tax the non-agricultural income at higher rates.

Tax calculation in such cases is as follows:

Step 1: Add non-agricultural income with net agricultural income. Compute tax on the aggregate amount.

Step 2: Add net agricultural income and the maximum exemption limit available to the assessee (i.e. *Rs.1,60,000 / Rs.1,90,000 / Rs.2,40,000*). Compute tax on the aggregate amount.

Step 3: Deduct the amount of income tax calculated in step 2 from the income tax calculated in step 1 i.e. Step 1 – Step 2.

Step 4: The sum so arrived at shall be increased by education cess @2% and secondary and higher education cess @1%.

The above concept can be clearly understood with the help of the following illustrations:

Illustration 1

Mr. X, a resident, has provided the following particulars of his income for the P.Y.2009-10.

i.	Income from salary (computed)	- Rs.2,40,000
ii.	Income from house property (computed)	- Rs.2,00,000
iii.	Agricultural income from a land in Jaipur	- Rs.1,80,000
iv.	Expenses incurred for earning agricultural income	- Rs.1,20,000

Compute his tax liability assuming his age is -

(a) 45 years

(b) 70 years

Solution

Computation of total income of Mr.X for the A.Y.2010-11

Particulars	Amount (Rs.)	Amount (Rs.)
Income from salary		2,40,000
Income from house property		2,00,000
Net agricultural income [Rs.1,80,000 – Rs.1,20,000]	60,000	
Less: Exempt under section 10(1)	(60,000)	-
Gross Total Income		**4,40,000**
Less: Deductions under Chapter VI-A		-
Total Income		**4,40,000**

(a) Computation of tax liability (age 45 years)

For the purpose of partial integration of taxes, Mr. X has satisfied both the conditions i.e.

1. Net agricultural income exceeds Rs.5,000 p.a., and
2. Non agricultural income exceeds the basic exemption limit of *Rs.1,60,000.*

His tax liability is computed in the following manner:

Step 1: Rs.4,40,000 + Rs.60,000 = Rs.5,00,000.

Tax on Rs.5,00,000 = Rs.54,000

Step 2: Rs.60,000 + Rs.1,60,000 = Rs.2,20,000.

Tax on Rs.2,20,000 = Rs.6,000 (i.e. 10% of Rs.60,000)

Step 3 : Rs.54,000 – Rs.6,000 = Rs.48,000.

Step 4 : Total tax payable = Rs.48,000 + 2% of Rs.48,000 + 1% of Rs.48,000= Rs.49,440.

(b) Computation of tax liability (age 70 years)

For the purpose of partial integration of taxes, Mr. X has satisfied both the conditions i.e.

1. Net agricultural income exceeds Rs.5,000 p.a., and
2. Non-agricultural income exceeds the basic exemption limit of *Rs.2,40,000*.

His tax liability is computed in the following manner:

Step 1: Rs.4,40,000 + Rs.60,000 = Rs.5,00,000.

Tax on Rs.5,00,000 = Rs.46,000 (i.e. Rs.6,000 + 20% of Rs.2,00,000)

Step 2: Rs.60,000 + Rs.2,40,000 = Rs.3,00,000.

Tax on Rs.3,00,000 = Rs.6,000 (i.e. 10% of Rs.60,000)

Step 3: Rs.46,000 – Rs.6,000 = Rs.40,000.

Step 4: Total tax payable = Rs.40,000 + 2% of Rs.40,000 + 1% of Rs.40,000= Rs.41,200.

(iii) Definition of agricultural income [Section 2(1A)]

This definition is very wide and covers the income of not only the cultivators but also the land holders who might have rented out the lands. Agricultural income may be received in cash or in kind.

Three ways: Agricultural income may arise in any one of the following three ways:-

(1) It may be rent or revenue derived from land situated in India and used for agricultural purposes.

(2) It may be income derived from such land through agriculture or the performance of a process ordinarily employed by a cultivator or receiver of rent in kind to render the produce fit to be taken to the market or through the sale of such agricultural produce in the market.

(3) Lastly, agricultural income may be derived from any farm building required for agricultural operations.

Now let us take a critical look at the following aspects:

(1) Land has to be situated in India - If agricultural lands are situated in a foreign State, the entire income would be taxable.

(2) "Agriculture" and "agricultural purposes" - These terms have not been defined in the Act. However, cultivation of a field involving expenditure of human skill and labour on the land

can be broadly termed as agriculture.

(a) "Agriculture" means tilling of the land, sowing of the seeds and similar operations. These are basic operations and require the expenditure of human skill and labour on land itself. Those operations which the agriculturists have to resort to and which are absolutely necessary for the purpose of effectively raising produce from the land are the basic operations.

(b) Operations to be performed after the produce sprouts from the land (*e.g.,* weeding, digging etc.) are subsequent operations. These subsequent operations would be agricultural operations only when taken in conjunction with and as a continuation of the basic operations. Simply performing these subsequent operations without raising such products is not characterized as agriculture.

(c) "Agriculture" comprises within its scope the basic as well as the subsidiary operations regardless of the nature of the produce raised on the land. These produce may be grain, fruits or vegetables necessary for *sustenance* of human beings including plantation and groves or grass or pasture for consumption of beasts or articles of luxury such as betel, coffee, tea, spices, tobacco or commercial crops like cotton flax, jute hemp and indigo. The term comprises of products of land having some utility either for consumption or for trade and commerce and would include forest products such as sal, tendu leaves etc.

(d) However, the term 'agriculture' cannot be extended to all activities which have some distant relation to land like dairy farming, breeding and rearing of live stock, butter and cheese making and poultry farming. This aspect is discussed in detail later on.

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

However, the Madras High Court, in *CIT v. Soundarya Nursery (2000) 241 ITR 530*, observed that nursing activity involves carrying out of several operations on land before the saplings were transplanted in suitable containers including pots and thereafter kept in

shade or green house for further operation and growth. Therefore, income arising from nursery should be considered as agricultural income.

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

(4) Process ordinarily employed - The process to which the agricultural produce is subject should be a process which is ordinarily employed by a cultivator. It may be manual or mechanical. However, it must be employed to render the produce fit to be taken to the market. For example, before making rice fit to be taken to the market we have to remove the basic grain from the hay, we have to remove the chaff from the grain, we have to properly filter them, we have to remove stones etc. and we have to pack the grain in gunny bags. In that condition alone the rice can be taken to the market and sold. This process of making the rice ready for the market may involve manual operations or mechanical operations. All these operations constitute the process ordinarily employed to make the product fit for the market. The produce must retain its original character in spite of the processing unless there is no market for selling it in that condition.

Explanation regarding gains arising on the transfer of urban agricultural land - the capital gains arising from the transfer of such urban agricultural land would not be treated as agricultural income under section 10 but will be taxable under section 45. Urban area means any area which is within the jurisdiction of a municipality or cantonment board having a population of atleast 10,000 and any area outside the limits of such municipality or cantonment board but within a maximum distance of 8 km. from such limits as notified by the Central Government. In other words,

Example: Suppose A sells agricultural land situated in New Delhi for Rs. 10 lakh and makes a surplus of Rs.8 lakh over its cost of acquisition. This surplus will not constitute agricultural income exempt under section 10(1) and will be taxable under section 45.

(5) Income from farm building - Income from any farm building which satisfies the following conditions would be agricultural income and would consequently be exempt from tax:

(a) The building should be on or in the immediate vicinity of the agricultural land;

(b) It should be owned and occupied by the receiver of the rent or revenue of any such land or occupied by the cultivator or the receiver of rent in kind of any land with respect to which land or the produce of which land the process discussed above is carried on;

(c) The receiver of the rent or revenue or the cultivator or the receiver of rent in kind should, by reason of his connection with such land require it as a dwelling house or other out building.

In addition to the above three conditions any one of the following two conditions should also be satisfied:

(i) The land should either be assessed to land revenue in India or be subject to a local rate assessed and collected by the officers of the Government as such or;

(ii) Where the land is not so assessed to land revenue in India or is not subject to local rate:-

(a) It should not be situated in any area as comprised within the jurisdiction of a municipality or a cantonment board and which has a population not less than 10,000.

(b) It should not be within 8 km. from the local limits of such municipality or cantonment board as notified by the Central Government

Income derived from any such building or land arising from any other use (other than those discussed above) shall not be agricultural income.

(iv) Indirect connection with the land - We have seen above that agricultural income is exempt, whether it is received by the tiller or the landlord. However, non-agricultural income does not become agricultural merely on account of its indirect connection with the land. The following examples will illustrate the above point.

1. A rural society had as its principal business the selling on behalf of its member societies, butter made by these societies from cream sold to them by farmers. The making of butter was a factory process separated from the farm. It was held that the butter resulting from the factory operations separated from the farm was not an agricultural product and the society was, therefore, not entitled to exemption from income tax.

2. X was the managing agent of a company. He was entitled for a commission at the rate of 10% p.a. on the annual net profits of the company. A part of the company's income was agricultural income. X claimed that since his remuneration was calculated with reference to income of the company, part of which was agricultural income, such part of the commission as was proportionate to the agricultural income was exempt from income tax. It was held that X received remuneration under a contract for personal service calculated on the amount of profits earned by the company and that remuneration was not an agricultural income.

3. Y owned 100 acres of agricultural land, a part of which was used as pasture for cows. The lands were purely maintained for manuring and other purposes connected with

agriculture and only the surplus milk after satisfying the assessee's needs was sold. The question arose whether income from such sale of milk was agricultural income. It was held that the regularity with which the sales of milk were effected and quantity of milk sold showed that the assessee carried on regular business of producing milk and selling it as a commercial proposition. Hence, it was not agricultural income.

4. B was a shareholder in certain tea companies, 60% of whose income was exempt from tax as agricultural income. She claimed that 60% of the dividend received by her on her shares in those companies was also exempt from tax as agricultural income. It was held that dividend is derived from the investment made in the shares of the company and is not an agricultural income.

5. In regard to forest trees of spontaneous growth which grow on the soil unaided by any human skill and labour there is no cultivation of the soil at all. Even though operations in the nature of forestry operations performed by the assessee may have the effect of nursing and fostering the growth of such forest trees, it cannot constitute agricultural operations. Income from the sale of such forest trees of spontaneous growth do not, therefore, constitute agricultural income.

(v) For better understanding of the concept, certain examples of agricultural income and non-agricultural income are given below:

Agricultural income

1. Income derived from the sale of seeds.
2. Income from growing of flowers and creepers.
3. Rent received from land used for grazing of cattle required for agricultural activities.
4. Income from growing of bamboo.

Non-agricultural income

1. Income from breeding of livestock.
2. Income from poultry farming.
3. Income from fisheries.
4. Income from dairy farming.

(vi) Apportionment in certain cases - Where the agricultural produce like tea, cotton, tobacco, sugarcane etc. are subjected to a manufacturing process and the manufactured product is sold, the profit on such sales will consist of agricultural income as well as business income. That portion of the profit representing agricultural income will be

exempted. For this purpose, rules 7, 7A, 7B & 8 of Income-tax Rules, 1962 provides the basis of apportionment.

(a) Rule 7 - Income from growing and manufacturing of any product other than tea - Where income is partially agricultural income and partially income chargeable to income-tax under the head 'profits and gains of business', the market value of any agricultural produce which has been raised by the assessee or received by him as rent in kind and which has been utilised as raw material in such business or the sale receipts of which are included in the accounts of the business shall be deducted. No further deduction shall be made in respect of any expenditure incurred by the assessee as a cultivator or receiver of rent in kind.

Determination of market value - There are two possibilities here :

(a) The agricultural produce is capable of being sold in the market either in its raw stage or after application of any ordinary process to make it fit to be taken to the market. In such a case, the value calculated at the average price at which it has been so sold during the relevant previous year will be the market value.

(b) It is possible that the agricultural produce is not capable of being ordinarily sold in the market in its raw form or after application of any ordinary process. In such case the market value will be the total of the following:—

  (i) The expenses of cultivation;

  (ii) The land revenue or rent paid for the area in which it was grown; and

  (iii) Such amount as the Assessing Officer finds having regard to the circumstances in each case to represent at reasonable profit.

Illustration 2

Mr. B grows sugarcane and uses the same for the purpose of manufacturing sugar in his factory. 30% of sugarcane produce is sold for Rs.10 lacs, and the cost of cultivation of such sugarcane is Rs.5 lacs. The cost of cultivation of the balance sugarcane (70%) is Rs.14 lacs and the market value of the same is Rs.22 lacs. After incurring Rs.1.5 lacs in the manufacturing process on the balance sugarcane, the sugar was sold for Rs.25 lacs. Compute B's business income and agricultural income.

Solution

Income from sale of sugarcane gives rise to agricultural income and from sale of sugar gives rise to business income.

Business income	=	Sales – Market value of 70% of sugarcane produce – Manufacturing expenses
	=	Rs.25 lacs – Rs.22 lacs - Rs.1.5 lacs
	=	Rs.1.5 lacs.
Agricultural income	=	Market value of sugarcane produce – Cost of cultivation
	=	[Rs10 lacs + Rs.22 lacs] – [Rs.5 lacs + Rs.14 lacs]
	=	Rs.32 lacs – Rs.19 lacs
	=	Rs.13 lacs.

(b) Rule 7A – Income from growing and manufacturing of rubber – This rule is applicable when income derived from the sale of latex or cenex or latex based crepes or brown crepes manufactured from field latex or coagulum obtained from rubber plants grown by the seller in India. In such cases 35% profits on sale is taxable as business income under the head profits and gains from business or profession, and the balance 65% is agricultural income and is exempt.

Illustration 3

Mr. C manufactures latex from the rubber plants grown by him in India. These are then sold in the market for Rs.30 lacs. The cost of growing rubber plants is Rs.10 lacs and that of manufacturing latex is Rs.8 lacs. Compute his total income.

Solution

The total income of Mr. C comprises of agricultural income and business income.

Total profits from the sale of latex	= Rs.30 lacs – Rs.10 lacs – Rs.8 lacs.	
	= Rs.12 lacs.	
Agricultural income	= 65% of Rs.12 lacs.	= Rs.7.8 lacs
Business income	= 35% of Rs.12 lacs.	= Rs.4.2 lacs

(c) Rule 7B – Income from growing and manufacturing of coffee – (a) In case of income derived from the sale of coffee grown and cured by the seller in India, 25% profits on sale is taxable as business income under the head "Profits and gains from business or profession", and the balance 75% is agricultural income and is exempt. (b) In case of income derived from the sale of coffee grown, cured, roasted and grounded by the seller in India, with or without mixing chicory or other flavouring ingredients, 40% profits on sale is taxable as business

income under the head "Profits and gains from business or profession", and the balance 60% is agricultural income and is exempt.

(d) Rule 8 - Income from growing and manufacturing of tea - This rule applies only in cases where the assessee himself grows tea leaves and manufactures tea in India. In such cases 40% profits on sale is taxable as business income under the head "Profits and gains from business or profession", and the balance 60% is agricultural income and is exempt.

(2) Amounts received by a member from the income of the HUF [Section 10(2)]

(i) As seen in the first Chapter, a HUF is a 'person' and hence a unit of assessment under the Act. Income earned by the HUF is assessable in its own hands.

(ii) In order to prevent double taxation of one and the same income, once in the hands of the HUF which earns it and again in the hands of a member when it is paid out to him, section 10(2) provides that members of a HUF do not have to pay tax in respect of any amounts received by them from the family.

(iii) The exemption applies only in respect of a payment made by the HUF to its member

(1) out of the income of the family or

(2) out of the income of the impartible estate belonging to the family.

(3) Share income of a partner [Section 10(2A)] - This clause exempts from tax a partner's share in the total income of the firm. In other words, the partner's share in the total income of the firm determined in accordance with the profit-sharing ratio will be exempt from tax.

(4) Exemption to non-residents and person resident outside India [Section 10(4)]

(i) This clause provides that in the case of a non-resident, any income by way of interest on Central Government securities as may be prescribed will be exempt. Even income by way of premium on the redemption of such bonds is exempt.

(ii) However, the Central Government shall not notify any such bonds or securities after 1.6.2002. Hence, this exemption will no more be available in respect of any further issue of bonds or securities on or after the 1.6.2002.

(iii) In the case of an individual who is a person resident outside India, as defined in FERA, 1973, any income by way of interest on moneys standing to his credit in a Non-resident (External) Account (NRE A/c) in any bank in India will be exempt, subject to fulfillment of certain conditions.

(iv) In this context, it may be noted that the joint holders of the NRE Accounts do not constitute an AOP by merely having these accounts in joint names. The benefit of exemption under section 10(4)(ii) will be available to such joint account holders, subject to fulfilment of other conditions contained in that section by each of the individual joint account holders.

(5) Interest on savings certificates [Section 10(4B)]

(i) An individual, being a citizen of India or a person of Indian origin, who is non-resident shall be entitled for exemption in respect of interest on such saving certificates issued before 1.6.2002 by the Central Government and notified by it in the Official Gazette in this behalf.

(ii) However, to claim such exemption, the individual should have subscribed to such certificates in convertible foreign exchange remitted from a country outside India in accordance with the provisions of the FERA.

(6) Leave travel concession [Section 10(5)]

(i) This clause exempts the leave travel concession (LTC) received by employees from their employers for proceeding to any place in India,

(a) either on leave or

(b) after retirement from service or

(c) after termination of his service.

(ii) The benefit is available to individuals - citizens as well as non-citizens - in respect of travel concession or assistance for himself or herself and for his/her family- *i.e.,* spouse and children of the individual and parents, brothers and sisters of the individual or any of them wholly or mainly dependent on the individual.

(iii) Limit of exemption - The exemption in all cases will be limited to the amount actually spent subject to such conditions as specified in Rule 2B regarding the ceiling on the number of journeys for the place of destination.

Under Rule 2B the exemption will be available in respect of 2 journeys performed in a block of 4 calendar years commencing from the calendar year 1986. Where such travel concession or assistance is not availed by the individual during any block of 4 calendar years, one such unavailed LTC will be carried forward to the immediately succeeding block of 4 calendar years and will be eligible for exemption.

Example: An employee does not avail any LTC for the block 2002-05. He avails it during 2006. It is allowed to carry forward maximum one such holiday to be used in the succeeding block. Therefore, this will be eligible for exemption and two more journeys can be further availed.

(iv) Monetary limits

Where the journey is performed on or after the 1.10.1997, the amount exempted under section 10(5) in respect of the value of LTC shall be the amount actually incurred on such travel subject to the following conditions:

(1) where it is performed by air, an amount not exceeding the air economy fare of the National Carrier by the shortest route to the place of destination;

(2) where places of origin of journey and destination are connected by rail and the journey is performed by any mode of transport other than by air an amount not exceeding the air-conditioned first class rail fare by the shortest route to the place of destination; and

(3) where the places of origin of journey and destination or part thereof are not connected by rail, the amount eligible for exemption shall be,—

(A) where a recognised public transport system exists, an amount not exceeding the 1st class or deluxe class fare, as the case may be, on such transport by the shortest route to the place of destination ; and

(B) where no recognised public transport system exists, an amount equivalent to the air-conditioned first class rail fare, for the distance of the journey by the shortest route, as if the journey had been performed by rail.

Note: The exemption referred to shall not be available to more than two surviving children of an individual after 1.10.1998. This restrictive sub-rule shall not apply in respect of children born before 1.10.1998 and also in case of multiple births after one child.

Illustration 4

Mr. D went on a holiday on 25.12.2009 to Delhi with his wife and three children (one son – age 5 years; twin daughters – age 2 years). They went by flight (economy class) and the total cost of tickets reimbursed by his employer was Rs 60,000 (Rs 45,000 for adults and 15,000 for the three minor children). Compute the amount of LTC exempt.

Solution

Since the son's age is more than the twin daughters, Mr. D can avail exemption for all his three children. The restriction of two children is not applicable to multiple births after one child. The holiday being in India and the journey being performed by air (economy class), the entire reimbursement met by the employer is fully exempt.

Illustration 5

In the above illustration 4, will be there be any difference if among his three children the twins were 5 years old and the son 3 years old? Discuss.

Solution

Since the twins' age is more than the son, Mr. D cannot avail for exemption for all his three children. LTC exemption can be availed in respect of only two children. Taxable LTC = $Rs 15,000 \times \frac{1}{3}$ = Rs.5,000 .

LTC exempt is only Rs.55,000 (i.e. Rs.60,000 – Rs.5,000)

(7) Exemption in the case of individuals, who are not citizens of India [Section 10(6)]- Individual assessees who are not citizens of India are entitled to certain exemptions:

(i) Section 10(6)(ii) grants exemption to a person in respect of the remuneration received by him for services as an official of an embassy, high commission, legation, consulate or the trade representation of a foreign State or as a member of the staff of any of these officials.

Conditions -

(a) The remuneration received by our corresponding Government officers resident in such foreign countries should be exempt.

(b) The above-mentioned officers should be the subjects of the respective countries and should not be engaged in any other business or profession or employment in India.

(ii) Section 10(6)(vi) provides that remuneration received by a foreign national as an employee of a foreign enterprise for service rendered by him during his stay in India is also exempt from tax.

Conditions -

(1) The foreign enterprise is not engaged in a business activity in India;

(2) The employee's stay in India does not exceed a total of 90 days in the previous year;

(3) The remuneration is not liable to be deducted from the employer's income chargeable to tax under the Act.

(iii) Section 10(6)(viii) provides that salary income received by or due to a non-citizen of India who is also non-resident for services rendered in connection with his employment on a

foreign ship where his total stay in India does not exceed a total of 90 days in the previous year.

(iv) Section 10(6)(xi) provides that any remuneration received by employees of foreign Government from their respective Government during their stay in India in connection with their training in any establishment or office of the Government or any public sector undertaking is exempt from tax. For this purpose, the expression 'public sector undertaking' will cover Statutory Corporations; companies wholly owned by the Central Government or State Government or jointly by the Central and State Government and subsidiaries of such companies, societies registered under the Societies Registration Act, 1860 or any other similar law, which are wholly financed by the Central Government or State Government or jointly by the Central or State Government.

(8) Tax on royalty or fees for technical services derived by foreign companies [Section 10(6A)] - The benefit of exemption under this section is available to foreign companies only. As per this clause, tax paid by the Government or by an Indian concern on behalf of a foreign company is exempt in the hands of such foreign company provided all the following conditions are satisfied:

(i) Such tax must have been payable by the foreign company in respect of income received from the Government or the Indian concern by way of royalty or fees for technical services.

(ii) Such income by way of royalty or fees for technical services must have been received in pursuance of an agreement made by the foreign company with the Government or the Indian concern on or after 1.4.1976 but before 1.6.2002 and such agreement must have been approved by the Central Government. However, where the agreement relates to a subject matter which is included in the industrial policy of the Government and such agreement is in accordance with that policy, no approval of the Central Government is necessary.

(9) Tax paid on behalf of non-resident [Section 10(6B)] – This clause provides that the amount of tax paid by Government or an Indian concern on behalf of a non-resident or a foreign company in respect of its income will not be included in computing the total income of such non-resident or foreign company in pursuance of an agreement entered before 1.6.2002 between the Central Government and the Government of foreign State or an international organisation under the terms of that agreement or of any related agreement which has been approved before 1.6.2002 by the Central Government.

(10) Tax paid on behalf of foreign state or foreign enterprise on amount paid as consideration of acquiring aircraft, etc. on lease [Section 10(6BB)] - Under this section, exemption is provided in respect of tax paid by an Indian company engaged in the business of

operation of an aircraft, on income derived by the Government of a foreign State or a foreign enterprise as a consideration of acquiring an aircraft or aircraft engine on lease under an agreement entered into after 31.3.1997 but before 1.4.1999 or entered into after 31.3.2007 and approved by the Central Government

However, payment for providing spares, facilities or services in connection with the operation of leased aircraft is not covered under this clause.

(11) Income from projects connected with the security of India [Section 10(6C)] - Any income arising to such foreign company as the Central Government may notify, by way of fees for technical services received in pursuance of an agreement entered into with that Government for providing services in or outside India in projects connected with security of India will be exempt. Such exemption is also available in respect of royalty for technical services arising to the foreign company.

(12) Allowances payable outside India [Section 10(7)] - Allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for services rendered outside India are exempt from tax. Students may remember that in such cases under section 9(1)(ii), the income chargeable under the head 'Salaries' is deemed to accrue in India. The residential status of the recipient will, however, not affect this exemption.

(13) Co-operative technical assistance programmes [Sections 10(8) and (9)] - Individuals who are assigned duties in India in connection with any co-operative technical assistance programmes and projects would be exempt from tax on their receipts by way of:

(a) remuneration received directly or indirectly from the Government of a foreign State for rendering such services; and

(b) any other income accruing or arising outside India (but is not deemed to accrue or arise in India) in respect of which the individual is required to pay income-tax or other social security tax to the Government of that foreign State.

A similar exemption would be available under section 10(9) in respect of the income of any member of the family of any such individual referred to above provided that the income:

(i) actually accrues outside India;

(ii) cannot be deemed to accrue or arise in India; and

(iii) in respect of which such member is required to pay income or social security tax to the Government of that foreign State.

(14) Consultant remuneration [Sections 10(8A) and (8B)] - Under clause (8A), any remuneration or fee received by a consultant, directly or indirectly, out of the funds made available to an international organisation (agency) under a technical assistance grant agreement with the agency and Govemment of a foreign State is exempted from income-tax. The expression "Consultant" means any individual who is either not a citizen of India or, being a citizen of India, is resident but not ordinarily resident, or any other person who is a non-resident and is engaged by the agency for rendering technical services in India in accordance with an agreement entered into by the Central Government and the State agency and the agreement relating to the engagements of the consultant is approved by the prescribed authority.

Under clause (8B), the remuneration received by an employee of the consultant is exempted from income-tax provided such employee is either not a citizen of India or, being a citizen of India, is resident but not ordinarily resident and the contract of his service is approved by the prescribed authority before the commencement of his service.

Section 10(9) discussed above exempts the income of any member of the family of any such individual as is referred to in clauses (8A) and (8B) accompanying him to India, which accrues or arises outside India, and in respect of which such member is required to pay any income or social security tax to the country of his origin.

(15) Gratuity [Section 10(10)]

1. Retirement gratuity received under the Pension Code Regulations applicable to members of the Defence Service is fully exempt from tax.

2. **Central / State Government Employees**: Any death cum retirement gratuity is fully exempt from tax.

3. **Non-government employees covered by the Payment of Gratuity Act, 1972**

Any death cum retirement gratuity is exempt from tax to the extent of least of the following:

(i) Rs.3,50,000

(ii) Gratuity actually received

(iii) 15 days' salary based on last drawn salary for each completed year of service or part thereof in excess of 6 months

Note: Salary for this purpose means basic salary and dearness allowance. No. of days in a month for this purpose, shall be taken as 26.

4. **Non-government employees not covered by the Payment of Gratuity Act, 1972**

Any death cum retirement gratuity is exempt from tax to the extent of least of the following:

(i) Rs.3,50,000

(ii) Gratuity actually received

(iii) Half month's salary (based on last 10 months' average salary immediately preceding the month of retirement or death) for each completed year of service (fraction to be ignored)

Note: Salary for this purpose means basic salary and dearness allowance, if provided in the terms of employment for retirement benefits, forming part of salary and commission which is expressed as a fixed percentage of turnover.

Students must also note the following points:

(1) Gratuity received during the period of service is fully taxable.

(2) Where gratuity is received from 2 or more employers in the same year then aggregate amount of gratuity exempt from tax cannot exceed Rs.3,50,000.

(3) Where gratuity is received in any earlier year from former employer and again received from another employer in a later year, the limit of Rs.3,50,000 will be reduced by the amount of gratuity exempt earlier.

(4) The exemption in respect of gratuities would be available even if the gratuity is received by the widow, children or dependents of a deceased employee.

Illustration 6

Mr.Ravi retired on 15.6.2009 after completion of 26 years 8 months of service and received gratuity of Rs.6,00,000. At the time of retirement his salary was:

Basic Salary	:	Rs.5,000 p.m.
Dearness Allowance	:	Rs.3,000 p.m. (60% of which is for retirement benefits)
Commission	:	1% of turnover (turnover in the last 12 months was Rs.12,00,000)
Bonus	:	Rs.12,000 p.a.

Compute his taxable gratuity assuming:

(a) He is non-government employee and covered by the Payment of Gratuity Act 1972.

(b) He is non-government employee and not covered by Payment of Gratuity Act 1972.

(c) He is a Government employee.

Solution

(a) He is covered by the Payment of Gratuity Act 1972.

Gratuity received at the time of retirement			Rs.6,00,000
Less : Exemption under section 10(10) :			
Least of the following :			
i.	Gratuity received	Rs.6,00,000	
ii.	Statutory limit	Rs.3,50,000	
iii.	15 days salary based on last drawn salary for each completed year of service or part thereof in excess of 6 months		
	$\frac{15}{26} \times$ last drawn salary $\times$ years of service		
	$\frac{15}{26} \times (Rs.5,000 + Rs.3,000) \times 27 =$	Rs.1,24,615	Rs.1,24,615
		Taxable Gratuity	Rs.4,75,385

(b) He is not covered by the Payment of Gratuity Act 1972.

Gratuity received at the time of retirement		Rs.6,00,000
Less : Exemption under section 10(10) (note 1)		Rs.1,01,400
	Taxable Gratuity	Rs.4,98,600

Note 1: Exemption under section 10(10) is least of the following :

i.	Gratuity received	Rs.6,00,000
ii.	Statutory limit	Rs.3,50,000
iii.	Half month's salary based on average salary of last 10 months preceding the month of retirement for each completed year of service.	

i.e. $\frac{1}{2} \times$ Averagesalary $\times$ years of service

$$= \frac{1}{2} \times \frac{\left[(5,000 \times 10) + (3,000 \times 60\% \times 10) + \left(1\% \times 12,00,000 \times \frac{10}{12}\right)\right]}{10} \times 26$$

= Rs.1,01,400

(c) He is a government employee

Gratuity received at the time of retirement	Rs.6,00,000
Less : Exemption under section 10(10)	Rs.6,00,000
Taxable gratuity	Nil

(16) Payment in commutation of pension [Section 10(10A)]

Pension is of two types: commuted and uncommuted.

Uncommuted Pension: Uncommuted pension refers to pension received periodically. It is fully taxable in the hands of both government and non-government employees.

Commuted Pension: Commuted pension means lump sum amount taken by commuting the whole or part of the pension. Its treatment is discussed below:

(a) Employees of the Central Government/local authorities/Statutory Corporation/ members of the Defence Services: Any commuted pension received is fully exempt from tax.

(b) Non-Government Employee : Any commuted pension received is exempt from tax in the following manner :

If the employee is in receipt of gratuity,

Exemption = 1/3rd of the amount of pension which he would have received had he commuted the whole of the pension.

$$= \left[\frac{1}{3} \times \frac{\text{commuted pension received}}{\text{commutation \%}} \times 100\%\right]$$

If the employee does not receive any gratuity

Exemption = ½ of the amount of pension which he would have received had he commuted the whole of the pension.

$$= \left[\frac{1}{2} \times \frac{\text{commuted pension received}}{\text{commutation \%}} \times 100\%\right]$$

Note:

1. Judges of the Supreme Court and High Court will be entitled to exemption of the commuted portion not exceeding ½ of the pension.
2. Any commuted pension received by an individual out of annuity plan of the Life Insurance Corporation of India (LIC) from a fund set up by that Corporation will be exempted.

Illustration 7

Mr. Sagar retired on 1.10.2009 receiving Rs.5,000 p.m. as pension. On 1.2.2010, he commuted 60% of his pension and received Rs.3,00,000 as commuted pension. You are required to compute his taxable pension assuming:

a. He is a government employee.

b. He is a non-government employee, receiving gratuity of Rs.5,00,000 at the time of retirement.

c. He is a non-government employee and is in receipt of no gratuity at the time of retirement.

Solution

(a) He is a government employee.

Uncommuted pension received (October – March)		Rs.24,000
[(Rs.5,000 × 4 months) + (40% of Rs.5,000 × 2 months)]		
Commuted pension received	Rs.3,00,000	
Less : Exempt u/s 10(10A)	Rs.3,00,000	NIL
Taxable pension		Rs 24,000

(b) He is a non-government employee, receiving gratuity Rs.5,00,000 at the time of retirement.

Uncommuted pension received (October – March)	Rs.24,000
[(Rs.5,000 × 4 months) + (40% of Rs.5,000 × 2 months)]	

Commuted pension received	Rs.3,00,000	
Less : Exempt u/s 10(10A)		
$\left(\frac{1}{3}\times\frac{Rs\,3,00,000}{60\%}\times 100\%\right)$	Rs.1,66,667	Rs.1,33,333
∴ Taxable pension		Rs.1,57,333

(c) He is a non-government employee and is not in receipt of gratuity at the time of retirement.

Uncommuted pension received (October – March)		Rs.24,000
[(Rs.5,000 × 4 months) + (40% of Rs.5,000 × 2 months)]		
Commuted pension received	Rs.3,00,000	
Less : Exempt u/s 10(10A)		
$\left(\frac{1}{2}\times\frac{Rs\,3,00,000}{60\%}\times 100\%\right)$	Rs.2,50,000	Rs.50,000
∴ Taxable pension		Rs.74,000

(17) Exemption of amount received by way of encashment of unutilised earned leave on retirement [Section 10(10AA)] - It provides exemption in respect of amount received by way of encashment of unutilised earned leave by an employee at the time of his retirement whether on superannuation or otherwise. The provisions of this clause are mentioned below:

(a) Government employees: Leave salary received at the time of retirement is fully exempt from tax.

(b) Non-government employees: Leave salary received at the time of retirement is exempt from tax to the extent of least of the following :

(i) Rs.3,00,000

(ii) Leave salary actually received

(iii) 10 months' salary (on the basis of average salary of last 10 months)

(iv) Cash equivalent of leave (based on last 10 months' average salary immediately preceding the date of retirement) to the credit of the employee at the time of retirement or death (calculated at 30 days' credit for each completed year of service (fraction to be ignored)

Note:

1. Leave salary received during the period of service is fully taxable.
2. Where leave salary is received from two or more employers in the same year, then the aggregate amount of leave salary exempt from tax cannot exceed Rs.3,00,000.
3. Where leave salary is received in any earlier year from a former employer and again received from another employer in a later year, the limit of Rs.3,00,000 will be reduced by the amount of leave salary exempt earlier.
4. Salary for this purpose means basic salary and dearness allowance, if provided in the terms of employment for retirement benefits and commission which is expressed as a fixed percentage of turnover.
5. 'Average salary' will be determined on the basis of the salary drawn during the period of ten months immediately preceding the date of his retirement whether on superannuation or otherwise.

Illustration 8

Mr. Gupta retired on 1.12.2009 after 20 years 10 months of service, receiving leave salary of Rs.5,00,000. Other details of his salary income are:

Basic Salary	:	Rs.5,000 p.m. (Rs.1,000 was increased w.e.f. 1.4.09)
Dearness Allowance	:	Rs.3,000 p.m. (60% of which is for retirement benefits)
Commission	:	Rs.500 p.m.
Bonus	:	Rs.1,000 p.m.

Leave availed during service : 480 days

He was entitled to 30 days leave every year.

You are required to compute his taxable leave salary assuming:

(a) He is a government employee.

(b) He is a non government employee.

Solution

(a) He is a government employee.

Leave Salary received at the time of retirement	Rs 5,00,000

Less : Exemption under section 10(10AA)	Rs 5,00,000
Taxable Leave salary	Nil

(b) He is a non-government employee

Leave Salary received at the time of retirement	Rs.5,00,000
Less : Exempt under section 10(10AA) [note 1]	Rs. 26,400
∴ Taxable Leave Salary	Rs.4,73,600

Note 1 : Exemption under section 10(10AA) is least of the following:

(i)	Leave salary received	Rs.5,00,000
(ii)	Statutory limit	Rs.3,00,000
(iii)	10 months salary based on average salary of last 10 months	
	i.e. $\left[10 \times \frac{\text{Salary of last 10 months i.e. Feb - Nov}}{10 \text{ months}}\right]$	
	$= \left[10 \times \frac{(5000 \times 8) + (4000 \times 2) + (60\% \times 3000 \times 10)}{10 \text{ months}}\right]$	Rs.66,000
(iv)	Cash equivalent of leave standing at the credit of the employee based on the average salary of last 10 months (max. 30 days per year of service)	
	Leave Due = Leave allowed – Leave taken	
	= (30 days per year × 20 years) – 480 days	
	= 120 days	
	i.e. $\left[\frac{\text{Leave due (in days)}}{30 \text{ days}} \times \text{Average salary p.m.}\right]$	
	$= \left[\frac{120 \text{ days}}{30 \text{ days}} \times \frac{\text{Rs } 66,000}{10}\right]$	Rs.26,400

(18) Retrenchment compensation [Section 10(10B)] - Retrenchment compensation will be exempt from tax subject to the following limits:

(a) Amount calculated in accordance with the provisions of section 25F of the Industrial Disputes Act, 1947; or

(b) An amount, not less than Rs.5,00,000 as may be notified by the Central Government in this behalf,

whichever is lower.

The retrenchment compensation for this purpose means the compensation paid under Industrial Disputes Act, 1947 or under any Act, Rule, Order or Notification issued under any law. It also includes compensation paid on transfer of employment under section 25F or closing down of an undertaking under section 25FF of the Industrial Disputes Act, 1947.

The above limits will not be applicable to cases where the compensation is paid under any scheme approved by the Central Government for giving special protection to workmen under certain circumstances.

Illustration 9

Mr. Garg received retrenchment compensation of Rs.10,00,000 after 30 years 4 months of service. At the time of retrenchment, he was drawing basic salary Rs.20,000 p.m.; dearness allowance Rs.5,000 p.m. Compute his taxable retrenchment compensation.

Solution

Retrenchment compensation received	Rs.10,00,000
Less : Exemption under section10(10B) [Note 1]	Rs. 4,32,692
Taxable retrenchment compensation	Rs. 5,67,308

Note 1 : Exemption is to the extent of least of the following :

(i) Compensation actually received = Rs.10,00,000

(ii) Statutory Limit = Rs.5,00,000

(iii) Amount calculated in accordance with provisions of the Industrial Disputes Act, 1947

$$\text{i.e.}\ \frac{15}{26} \times \text{Avg salary of last 3 mths} \times \text{Completed yrs of service and part thereof in excess of 6 mths}$$

$$= \left[\frac{15}{26} \times \frac{(20{,}000 \times 3) + (5{,}000 \times 3)}{3} \times 30 \text{ years}\right] \quad = \text{Rs.}4{,}32{,}692$$

(19) Payments to Bhopal Gas Victims [Section 10(10BB)] - Any payment made to a person under Bhopal Gas Leak Disaster (Processing of Claims) Act, 1985 and any scheme framed

thereunder will be fully exempt. However, payments made to any assessee in connection with Bhopal Gas Leak Disaster to the extent he has been allowed a deduction under the Act on account of any loss or damage caused to him by such disaster will not be exempted.

(20) Exemption of compensation received on account of disaster [Section 10(10BC)]

(i) This clause exempts any amount received or receivable as compensation by an individual or his legal heir on account of any disaster.

(ii) Such compensation should be granted by the Central Government or a State Government or a local authority.

(iii) However, exemption would not be available in respect of compensation for alleviating any damage or loss, which has already been allowed as deduction under the Act.

(iv) "Disaster" means a catastrophe, mishap, calamity or grave occurrence in any area, arising from natural or man made causes, or by accident or negligence. It should have the effect of causing -

(1) substantial loss of life or human suffering; or

(2) damage to, and destruction of, property; or

(3) damage to, or degradation of, environment.

It should be of such a nature or magnitude as to be beyond the coping capacity of the community of the affected area.

(21) Voluntary Retirement Receipts [Section 10(10C)] - Compensation received by an employee at the time of voluntary retirement is exempt from tax subject to the following conditions :

Eligible Undertakings - The employee of the following undertakings are eligible for exemption under this clause :

(i) Public sector company

(ii) Any other company

(iii) An authority established under a Central/State or Provincial Act

(iv) A local authority

(v) A co-operative society

(vi) An University established or incorporated under a Central/State or Provincial Act and an Institution declared to be an University by the University Grants Commission.

(vii) An Indian Institute of Technology

(viii) Such Institute of Management as the Central Government may, by notification in the Official Gazette, specify in this behalf

(ix) Any State Government

(x) The Central Government

(xi) An institution, having importance throughout India or in any state or states, as the Central Government may specify by notification in the Official Gazette.

Limit : The maximum limit of exemption should not exceed Rs.5 lakh.

Such compensation should be at the time of his voluntary retirement or termination of his service, in accordance with any scheme or schemes of voluntary retirement or, in the case of public sector company, a scheme of voluntary separation. The exemption will be available even if such compensation is received in installments.

The schemes should be framed in accordance with such guidelines, as may be prescribed and should include the criteria of economic viability.

Guidelines

Rule 2BA prescribes the guidelines for the purposes of the above clause. They are as follows:

1. It applies to an employee of the company or the authority, as the case may be, who has completed 10 years of service or completed 40 years of age.

   However, this requirement is not applicable in case of an employee of a public sector company under the scheme of voluntary separation framed by the company.

2. It applies to all employees by whatever name called, including workers and executives of the company or the authority except directors of a company or a cooperative society.

3. The scheme of voluntary retirement or separation must have been drawn to result in overall reduction in the existing strength of the employees of a company or the authority or a cooperative society.

4. The vacancy caused by the voluntary retirement or separation must not be filled up.

5. The retiring employee of a company shall not be employed in another company or concern belonging to the same management.

6. The amount receivable on account of voluntary retirement or separation of the employee must not exceed the amount equivalent to three months' salary for each completed year

of service or salary at the time of retirement multiplied by the balance months of service left before the date of his retirement or superannuation.

Note *- Where any relief has been allowed to any assessee under section 89 for any assessment year in respect of any amount received or receivable on his voluntary retirement or termination of service or voluntary separation, no exemption under section 10(10C) shall be allowed to him in relation to that assessment year or any other assessment year.*

Illustration 10

Mr. Dutta received voluntary retirement compensation of Rs.7,00,000 after 30 years 4 months of service. He still has 6 years of service left. At the time of voluntary retirement, he was drawing basic salary Rs.20,000 p.m.; Dearness allowance (which forms part of pay) Rs.5,000 p.m. Compute his taxable voluntary retirement compensation, assuming that he does not claim any relief under section 89.

Solution

Voluntary retirement compensation received	Rs.7,00,000
Less: Exemption under section 10(10C) [Note 1]	Rs.5,00,000
Taxable voluntary retirement compensation	Rs.2,00,000

Note 1: Exemption is to the extent of least of the following:

(i)	Compensation actually received	= Rs.7,00,000
(ii)	Statutory limit	= Rs.5,00,000
(iii)	Last drawn salary × 3 × completed years of service	
	= (20,000+5,000) × 3 × 30 years	= Rs.22,50,000
(iv)	Last drawn salary × remaining months of service	
	= (20,000+5,000) × 6 × 12 months	= Rs.18,00,000

(22) Income-tax paid by employer [Section 10(10CC)] – This clause provides for exemption in the hands of an employee, being an individual deriving income by way of perquisites, not provided by way of monetary payment within the meaning of section 17(2). This applies where the tax on such income is actually paid by the employer, at the option of the employer, on behalf of such employee, notwithstanding anything contained in section 200 of the Companies Act, 1956.

This provision will provide relief to the employee if the employer is willing to bear the tax burden in respect non-monetary perquisites provided by it to the employee as otherwise the

tax so paid by employer would have been treated as income of the employee.

(23) Receipts from LIC [Section 10(10D)] - This clause clarifies that any sum received under a Life Insurance Policy, including the sum allocated by way of bonus on such policy shall not be included in the total income of a person.

Recently, policies were introduced in respect of which the premium payable was very high. Sometimes, such premium was payable on a one-time basis. They are similar to deposits or bonds. With a view to ensure that such insurance policies are treated at par with other investment schemes, clause 10D has been rationalised as follows -

(i) Any sum received, under an insurance policy issued on or after 1.4.03 in respect of which the premium payable/paid during any of the years during the term of the policy exceeds twenty per cent of the actual capital sum assured, shall not be exempt. Therefore, sum received in respect of such policies issued prior to 1.4.03 will continue to enjoy exemption.

(ii) However, such sum received under such policy on the death of a person shall continue to be exempt.

(iii) For the purpose of calculating the actual capital sum assured under this clause,

(a) the value of any premiums agreed to be returned or

(b) the value of any benefit by way of bonus or otherwise, over and above the sum actually assured,

shall not be taken into account. Such premium or bonus may be received either by the policy holder or by any other person.

(iv) Any sum received under section 80DD(3) shall not be exempt under this clause in addition to sum received under 80DDA(3) or under a Keyman insurance policy.

(24) Payment from provident funds [Sections 10(11) and (12)] - The following payments received by an assessee will be fully exempt from tax:

(a) Provident Fund (PF) to which Provident Fund Act, 1925, applies; or

(b) Public Provident Fund.

(c) Accumulated balance payable to an employee participating in a RPF (subject to certain conditions).

The conditions for the purpose of RPF above are as follows:

(i) The employee should have rendered continuous service with the employer from whom

the amount is received for a period of at least five years; or

(ii) Where the employee had not rendered such continuous service the reason for the termination of his service should have been his ill-health or contraction or discontinuance of employer's business or any other cause beyond the control of the employee.

If such conditions are not satisfied the payments become taxable in the hands of the employee.

(25) Payment from superannuation funds [Section 10(13)] - Any payment received by any employee from an approved superannuation fund shall be entirely excluded from his total income if the payment is made

(a) on the death of a beneficiary;

(b) to an employee in lieu or in commutation of an annuity on his retirement at or after a specified age or on his becoming incapacitated prior to such retirement; or

(c) by way of refund of contribution on the death of a beneficiary; or

(d) by way of contribution to an employee on his leaving the service in connection with which the fund is established otherwise than by retirement at or after a specified age or his becoming incapacitated prior to such retirement.

In the case of (d) above the amount of exemption will be to the extent the payment made does not exceed the contribution made prior to 1-4-1962 and the interest thereon.

(26) House rent allowance (HRA) [Section 10(13A)] – HRA is a special allowance specifically granted to an employee by his employer towards payment of rent for residence of the employee. HRA granted to an employee is exempt to the extent of least of the following :

Metro Cities (i.e. Delhi, Kolkata, Mumbai, Chennai)	Other Cities
1) HRA actually received.	1) HRA actually received
2) Rent paid-10% of salary for the relevant period	2) Rent paid - 10% of salary for the relevant period
3) 50% of salary for the relevant period	3) 40% of salary for the relevant period

Note:

1. Exemption is not available to an assessee who lives in his own house, or in a house for

which he has not incurred the expenditure of rent.

2. Salary for this purpose means basic salary, dearness allowance, if provided in terms of employment and commission as a fixed percentage of turnover.

3. Relevant period means the period during which the said accommodation was occupied by the assessee during the previous year.

Illustration 11

Mr. Raj Kumar has the following receipts from his employer:

(1)	Basic pay	Rs.3,000 p.m.
(2)	Dearness allowance (D.A.)	Rs. 600 p.m.
(3)	Commission	Rs.6,000 p.a.
(4)	Motor car for personal use (expenditure met by the employer)	Rs. 500 p.m
(5)	House rent allowance	Rs. 900 p.m.

Find out the amount of HRA eligible for exemption to Mr. Raj Kumar assuming that he paid a rent of Rs.1,000 p.m. for his accommodation at Kanpur. DA forms part of salary for retirement benefits.

Solution:

HRA received	Rs. 10,800
Less: Exempt under section 10(13A) [Note 1]	Rs. 7,680
Taxable HRA	Rs . 3,120

Note 1: Exemption shall be least of the following three limits:

(a) the actual amount received (900 × 12) = Rs.10,800

(b) excess of the actual rent paid by the assessee over 10% of his salary

= Rent Paid - 10% of salary for the relevant period

= (1,000×12) - 10% of [(3,000+600) × 12]

= (12,000 - 4,320) = Rs. 7,680

(c) 40% salary as his accommodation is situated at Kanpur

= 40% of [(3,000+ 600) × 12] = Rs.17,280

Note: For the purpose of exemption under section 10(13A), salary includes dearness

allowance only when the terms of employment so provide, but excludes all other allowances and perquisites.

(27) Special allowances to meet expenses relating to duties or personal expenses [Section 10(14)] - This clause provides for exemption (as per Rule 2BB) in respect of the following:

(i) Special allowances or benefit not being in the nature of a perquisite, specifically granted to meet expenses incurred wholly, necessarily and exclusively in the performance of the duties of an office or employment of profit. For the allowances under this category, there is no limit on the amount which the employee can receive from the employer, but whatever amount is received should be fully utilized for the purpose for which it was given to him.

(ii) Special allowances granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at the place where he ordinarily resides or to compensate him for the increased cost of living. For the allowances under this category, there is a limit on the amount which the employee can receive from the employer. Any amount received by the employee in excess of these specified limits will be taxable in his hands as income from salary for the year. It does not matter whether the amount which is received is actually spent or not by the employee for the purpose for which it was given to him.

Rule 2BB

The following allowances have been prescribed in Rule 2BB:

Allowances prescribed for the purposes of section 10(14)(ii)

(a) any allowance granted to meet the cost of travel on tour or on transfer (Travelling Allowance);

(b) any allowance, whether granted on tour or for the period of journey in connection with transfer, to meet the ordinary daily charges incurred by an employee on account of absence from his normal place of duty;

(c) any allowance granted to meet the expenditure incurred on conveyance in performance of duties of an office or employment of profit (Conveyance Allowance);

(d) any allowance granted to meet the expenditure incurred on a helper where such helper is engaged in the performance of the duties of an office or employment of profit (Helper Allowance);

(e) any allowance granted for encouraging the academic research and training pursuits in

educational and research institutions;

(f) any allowance granted to meet the expenditure on the purchase or maintenance of uniform for wear during the performance of the duties of an office or employment of profit (Uniform Allowance).

Explanation - For the purpose of clause (a) "allowance granted to meet the cost of travel on transfer" includes any sum paid in connection with the transfer, packing and transportation of personal effects on such transfer.

Allowances prescribed for the purposes of sub-clause (ii) of section 10(14)

1. Any Special Compensatory Allowance in the nature of Special Compensatory (Hilly Areas) Allowance or High Altitude Allowance or Uncongenial Climate Allowance or Snow Bound Area Allowance or Avalanche Allowance - Rs.800 or Rs.7,000 or Rs.300 per month depending upon the specified locations.
2. Any Special Compensatory Allowance in the nature of border area allowance or remote locality allowance or difficult area allowance or disturbed area allowance -Rs.1,300 or Rs.1,100 or Rs.1,050 or Rs.750 or Rs.300 or Rs.200 per month depending upon the specified locations.
3. Special Compensatory (Tribal Areas / Schedule Areas / Agency Areas) Allowance - Rs.200 per month.
4. Any allowance granted to an employee working in any transport system to meet his personal expenditure during his duty performed in the course of running such transport from one place to another, provided that such employee is not in receipt of daily allowance – 70% of such allowance upto a maximum of Rs.6,000 per month.
5. Children Education Allowance - Rs.100 per month per child upto a maximum of two children.
6. Any allowance granted to an employee to meet the hostel expenditure on his child Rs.300 per month per child upto a maximum of two children.
7. Compensatory Field Area Allowance - Rs.1,300 per month in specified areas.
8. Compensatory Modified Field Area Allowance - Rs.500 per month in specified areas.
9. Any special allowance in the nature of counter insurgency allowance granted to the members of the armed forces operating in areas away from their permanent locations for a period of more than 30 days - Rs.1,300 per month.

Any assessee claiming exemption in respect of allowances mentioned at serial numbers

7, 8 and 9 shall not be entitled to exemption in respect of the allowance referred to at serial number 2.

10. Any transport allowance granted to an employee (other than those referred to in Sl. No. 11 below) to meet his expenditure for the purpose of commuting between the place of his residence and the place of his duty - Rs.800 per month.

11. Any transport allowance granted to an employee who is blind or orthopaedically handicapped with disability of the lower extremities of the body, to meet his expenditure for commuting between his residence and place of duty - Rs.1,600 per month.

12. Underground Allowance of Rs.800 per month would be granted to an employee who is working in uncongenial, unnatural climate in underground coal mines. This is applicable to whole of India.

Illustration 12

Mr. Srikant has two sons. He is in receipt of children education allowance of Rs 150 p.m. for his elder son and Rs.70 p.m. for his younger son. Both his sons are going to school. He also receives the following allowances:

Transport allowance : Rs.1,000 p.m. (amount spent Rs.600 p.m.)

Tribal area allowance : Rs.500 p.m.

Compute his taxable allowances.

Solution

Taxable allowance in the hands of Mr. Srikant is computed as under -

Children Education Allowance:

Elder son	[(Rs.150 – Rs.100) p.m. × 12 months]	= Rs.600	
Younger son	[(Rs.70 – Rs.70) p.m. × 12 months]	= Nil	Rs. 600
Transport allowance	[(Rs.1,000 – Rs.800) p.m. × 12 months]		Rs.2,400
Tribal area allowance	[(Rs.500 – Rs.200)p.m. × 12 months]		Rs.3,600
		∴ **Taxable allowances**	**Rs.6,600**

(28) Interest income arising to certain persons [Section 10(15)]

(i) Income by way of interest, premium on redemption or other payment on notified securities, bonds, annuity certificates or other savings certificates subject to such

conditions and limits as may be specified in the notification.

(ii) Interest on 7% Capital Investment Bonds and 10.1% Relief Bonds, 1993 notified by the Central Government This exemption is available to Individuals and HUFs. Such capital Investment Bonds are not specified on or after the 1.6. 2002.

(iii) Interest on NRI bonds, 1988 and NRI Bonds (Second Series), and Resurgent India Bonds, 1998 issued by the SBI arising to (i) Non Resident Indians who own such bonds, (ii) their nominees or survivors, (iii) donees who have received such bonds by way of gift from such non-residents. The interest and principal received in respect of such bonds whether on maturity or otherwise should not be taken out of India. The exemption will continue to apply even after the non-resident, after purchase of such bonds, becomes a resident in any subsequent year. However, the exemption will not apply in the previous year in which such bonds are encashed prior to their maturity. Such bonds shall not be specified on or after 1.06.2002.

(iv) Interest on securities held by the Issue Department of Central Bank of Ceylon constituted under the Ceylon Monetary Law Act, 1949.

(v) Interest payable to any bank incorporated in a country outside India and authorised to perform central banking functions in that country on any deposits made by it, with the approval of the RBI, with any scheduled bank.

(vi) Interest payable to the Nordic Investment Bank, on a loan advanced by it to a project approved by the Central Government in terms of the Memorandum of Understanding entered into by the Central Government with that Bank on 25.11.86.

(vii) Interest payable to the European Investment Bank, on a loan granted by it in pursuance of the framework agreement for financial co-operation entered into by the Central Government with the Bank on 25.11.1993.

(viii) Interest payable—

(a) by the Government or a local authority on moneys borrowed by it before 1.6.2001 or debts owed by it before 1.6.2001 to sources outside India;

(b) by an industrial undertaking in India on moneys borrowed by it before 1.6.2001 under a loan agreement entered into with any such financial institution in a foreign country as may be approved by the Central Government;

(c) by an industrial undertaking in India on moneys borrowed or debt incurred by it before 1.6.2001 in a foreign country for the purchase outside India of raw material

or capital equipment or components provided that the loan or the debt is approved by the Central Government, to the extent to which such interest does not exceed the amount of the interest calculated at the rate approved by the Government;

"Purchase of capital plant and machinery" includes the purchase of such capital plant and machinery under hire-purchase agreement or a lease agreement with an option to purchase such plant and machinery.

Exemption has also been given for payment of usance interest payable outside India by an undertaking engaged in ship-breaking business, in respect of purchase of a ship from outside India.

(d) by IFCI, IDBI, the Export-Import Bank of India and the Industrial Credit and Investment Corporation of India, NHB, SIDBI, on moneys borrowed from sources outside India before 1.6.2001 to the extent to which the interest does not exceed the amount of interest calculated at the rate approved by the Central Government having regard to the terms of the loan and its repayment;

(e) by any other financial institution or a banking company established in India on loans raised in foreign countries before 1.6.2001 under approved agreements for the purpose of advancing loans to industrial undertakings in India for importing raw materials or capital plant and machinery or other goods which the Central Government may consider necessary to import in the public interest;

(f) by an industrial undertaking in India on moneys borrowed by it in foreign currency from foreign sources under a loan agreement approved by the Central Government before 1.6.2001 having regard to the need for industrial development in India will be exempt from income-tax, to the extent to which such interest does not exceed the amount of interest calculated at the rates approved by the Central Government in this behalf, having regard to the terms of the loan and its repayment.

(g) by a scheduled bank on deposits in foreign currency held by a non-resident or a person who is not ordinarily resident, where the acceptance of such deposits by the bank is approved by the RBI. It may be noted that for the purpose of exemption under this clause, a scheduled bank does not include a co-operative bank.

(h) by an Indian public limited company being a company eligible for deduction u/s 36(1)(viii), mainly engaged in providing long-term finance for construction or purchase of residential houses in India on loans raised in foreign countries under a loan agreement approved by the Central Government before 1.6.03

(i) by public sector companies on certain specified bonds and debentures subject to the conditions which the Central Government may specify by notification, including the condition that the holder of such bonds or debentures registers his name and holding with that company;

Accordingly, the Central Government has specified tax free bonds issued by India Infrastructure Company Ltd., the interest on which would be exempt under this section.

(j) by Government of India on deposit made by an employee of the Central or State Government or a public sector company in accordance with the scheme as may be notified of the moneys due to him on account of his retirement while on superannuation or otherwise. It is significant that this scheme is not applicable to non-Government employees.

The term 'industrial undertaking' means any undertaking which is engaged in :

(i) the manufacture or processing of goods; or

(ii) the manufacture of computer software or recording of programmes on any disc, tape, perforated media or other information device; or

(iii) the business of generation or generation and distribution of electricity or any other form of power; or

(iv) the business of providing tele-communication services; or

(v) mining; or

(vi) construction of ships, or

(vii) the business of ship-breaking; or

(viii) the operation of ships or aircrafts or construction or operation of rail systems.

For the purposes of the clause, "interest" shall not include interest paid on delayed payment of loan or default if which is more than 2% p.a. over the rate of interest payable in terms of such loan. Interest would include hedging transaction charges on account of currency fluctuation.

(ix) Bhopal Gas Victims - Section 10(15)(v) provides exemption in respect of interest on securities held by the Welfare Commissioner, Bhopal Gas Victims, Bhopal, in the Reserve Bank's Account No. SL/DH 048. Recently, in terms of an order of the Supreme Court to finance the construction of a hospital at Bhopal to serve the victims of the gas

leak, the shares of the Union Carbide Indian Ltd., have been sold. The sale consideration reserved for construction has been deposited with SBI, New Delhi. The interest on the aforesaid deposit and similar deposits which may be made in future needs to be provided income tax exemption. The scope of the above exemption has been extended to interest on deposits for the benefit of the victims of the Bhopal Gas Leak disaster. Such deposits can be held in such account with the RBI or with a public sector bank as the Central Government may notify in the Official Gazette. Such notification may have prospective or retrospective effect. However, in no case it can be effective from a period earlier than 1-4-1994.

(x) Interest on Gold Deposit Bond issued under the Gold Deposit Scheme, 1999 notified by the Central Government.

(xi) Interest on bonds, issued by –

(a) a local authority; or

(b) a State Pooled Finance Entity

and specified by the Central Government by notification in the Official Gazette.

"State Pooled Finance Entity" means such entity which is set up in accordance with the guidelines for the Pooled Finance Development Scheme notified by the Central Government in the Ministry of Urban Development.

Accordingly, the Central Government has specified the "Tax-free Pooled Finance Development Bonds" under Pooled Finance Development Fund Scheme of Government of India, interest from which would be exempt under section 10(15).

(xii) interest income received by a non-resident/not-ordinarily resident in India 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.

(29) Payments for acquisition of aircraft [Section 10(15A)] – Any payment made by an Indian company engaged in the business of operation of aircraft to acquire an aircraft on lease from the government of a foreign State or a foreign enterprise under an agreement not being an agreement entered into between 1-4-1997 and 31-3-1999, and approved by the Central Government in this behalf will be exempt. For the purpose of this clause 'foreign enterprise' means a person who is a non-resident.

This exemption has been withdrawn in respect of all such agreements entered into on or after 1st April, 2007.

The exemption for lease payments shall continue with regard to agreements entered into before 1.4.2007. Consequently, the benefit of exemption from tax, on the tax paid will be available in respect of lease payments made in pursuance of agreements entered into on or after 1.4.2007. The effect of these amendments is that up to 31.3.2007, the consideration for lease itself is exempt from tax. With effect from 1.4.2007, the consideration for lease is taxable and if the Indian company who makes payment of such consideration undertakes to bear the tax on behalf of the lessor, then such tax shall not be considered as income and further taxed. Such tax paid by the Indian company would be exempt from further tax. This is provided in clause (6BB) of section 10.

(30) Educational scholarships [Section 10(16)] - The value of scholarship granted to meet the cost of education would be exempt from tax in the hands of the recipient irrespective of the amount or source of scholarship.

(31) Payments to MPs & MLAs [Section 10(17)] – The following incomes of Members of Parliament or State Legislatures will be exempt:

(i) Daily allowance received by any Member of Parliament or of State Legislatures or any Committee thereof.

(ii) In the case of a Member of Parliament or of any Committee thereof any allowance received under Members of Parliament (Constituency Allowance) Rules, 1986; and

(iii) Any constituency allowance received by any person by reason of his membership of any State Legislature under any Act or rules made by that State Legislature.

(32) Awards for literary, scientific and artistic works and other awards by the Government [Section 10(17A)] - Any award instituted in the public interest by the Central/State Government or any body approved by the Central Government and a reward by Central/State Government for such purposes as may be approved by the Central Government in public interest, will enjoy exemption under this clause.

(33) Pension received by recipient of gallantry awards [Section 10(18)] - Any income by way of pension received by an individual who has been awarded "Param Vir Chakra" or "Maha Vir Chakra" or "Vir Chakra" or such other gallantry award as the Central Government may, by notification in the Official Gazette, specify in this behalf.

In case of the death of the awardee, any income by way of family pension received by any member of the family of the individual shall also be exempt under this clause. The expression "family" shall have the meaning assigned to it in the Explanation to clause (5) of the said section.

(34) Family pension received by widow/children/nominated heirs of members of armed forces [Section 10(19)] – Exemption is available in respect of family pension received by the widow or children or nominated heirs, of a member of the armed forces (including para-military

forces) of the Union, where the death of such member has occurred in the course of operational duties, in specified circumstances and circumstances.

(35) Annual value of palaces of former rulers [Section 10(19A)] - The annual value of any one palace in the occupation of former Rulers would be excluded from their total income provided such annual value was exempt from income-tax before the de-recognition of Rulers of Indian States and abolition of their privy purses.

(36) Income of local authorities [Section 10(20)] – (i) All income arising to a local authority, other than from trade or business carried on by it which accrues or arises from the supply of commodity or service under its jurisdictional area is excludible from its total income.

(ii) Exemption is available to income derived by a local authority from the supply of water or electricity even outside its juridical area.

(iii) For the purposes of this clause, "local authority" means the following:

(1) Panchayat

(2) Municipality

(3) Municipal Committee and District Board legally entitled to, or entrusted by the Government with the control or management of a Municipal or local Fund

(4) Cantonment Board

(37) Income of scientific research associations approved under section 35(1)(ii) [Section 10(21)] - This clause also provides for exemption in respect of any income of scientific research associations which are approved under section 35(1)(ii). This exemption has however, been made subject to the following conditions:

(i) It should apply its income or accumulate for application wholly and exclusively to its objects and provisions of section 11(2) and (3) would also apply in relation to such accumulation.

(ii) The association should invest or deposit its funds in the forms or modes specified in section 11(5). This condition would however not apply to -

  (1) any assets held by the research association where such assets form part of the corpus of the fund of the association as on 1-6-1993;

  (2) any debentures of a company acquired by the association before 1-3-1983;

  (3) any bonus shares coming as an accretion to the corpus mentioned above;

  (4) voluntary contributions in the form of jewellery, furniture or any article notified.

(iii) The exemption will not apply to income of such association which are in the nature of profits and gains of business unless the business is incidental to the attainment of its objectives and separate books of account are maintained in respect of such business.

(iv) However, approval once granted may be withdrawn if at any time the Government is satisfied that –

(1) the scientific research association has not applied its income in accordance with sections 11(2) and (3);

(2) the scientific research association has not invested or deposited its funds in accordance with section 11(5).

Such withdrawal shall be made after giving reasonable opportunity to the assessee. A copy of the order shall be sent to the Assessing Officer as well as the assessee.

(38) Income of news agency [Section 10(22B)] – (i) This clause provides income-tax exemption on any income of such news agency set up in India solely for collection and distribution of news as specified by the Central Government.

(ii) However, in order to get this exemption, the news agency should:

(a) apply its income or accumulate it for application solely for collection and distribution of news.

(b) It should not also distribute its income in any manner to its members.

(iii) Any notification issued by the Central Government under this clause will have effect for 3 assessment years. It may include an assessment year or years commencing before the date of notification.

(iv) However, once the notification has been issued, the notification may be rescinded approval if at any time the Government is satisfied that the news agency has not applied or accumulated or distributed its income in accordance with the provisions of this section.

(v) The notification may be rescinded after giving reasonable opportunity to the assessee. A copy of the order shall be sent to the Assessing Officer as well as the assessee.

(39) Income of professional associations [Section 10(23A)] – (i) Associations or institutions of the following classes approved by the Government and applying their income or accumulating it solely to their objects shall be exempt from tax on certain items of their income. The association or institution must:

(a) be established in India;

(b) have as its object the control, supervision, regulation or encouragement of the profession

of law, medicine, accountancy, engineering or architecture, or any other profession specified by the Central Government.

(ii) All income arising to such an association, except the following categories of income, are exempt from inclusion in income :

(a) income under the head 'interest on securities';

(b) income under the head 'income from house property';

(c) income received for rendering any specific service; and

(d) income by way of interest or dividends derived from its investments.

(iii) However, approval once granted may be withdrawn if at any time the Government is satisfied that –

(1) the association or institution has not applied or accumulated its income in accordance with the provisions of the section;

(2) the activities of the association or institution are not being carried out in accordance with the conditions imposed on the basis of which the approval was granted.

(iv) Such withdrawal shall be made after giving reasonable opportunity to the assessee. A copy of the order shall be sent to the Assessing Officer as well as the assessee.

(40) Income of institutions established by armed forces [Section 10(23AA)] - Any income received by any person on behalf of any regimental fund or non-public fund established by the armed forces of the Union for the welfare of the past and present members of such forces or their dependents is exempt from tax.

Students may note that donations to such institutions will qualify for deduction under section 80G.

(41) Income of Funds established for welfare of employees of which such employees are members [Section 10(23AAA)] - A number of funds have been established for the welfare of employees or their dependents in which such employees themselves are members. These funds are utilised to provide cash benefits to a member on his superannuation, or in the event of his illness or illness of any member of his family, or to the dependents of a member on his death.

Example : XYZ Ltd. has an employee welfare fund. Employees, who are members of the fund, contribute a portion of their salary to the fund. The company makes an annual contribution equal to the employees' contribution. The funds thus made available are utilised by the fund to provide benefits to the members or their dependents in case of illness etc. The surplus fund

may be invested in bonds, Government securities or deposited with banks. Essentially, these funds are in the nature of mutual benefit funds. Hence, their income does not qualify for exemption under section 10(23C)(iv). Since they are not charitable institutions they cannot also claim exemption under section 11 in respect of their income. They are now entitled for exemption under section 10(23AAA).

The exemption will be available only if the following conditions are fulfilled :

(i) the fund should have been established for the welfare of employees or their dependents and for such purposes as may be notified by the Board;

(ii) such employees should be the members of the fund;

(iii) the fund should apply its income, or accumulate it for application, wholly and exclusively to the objects for which it is established;

(iv) the fund shall invest its fund and contributions made by the employees and other sums received by it in any one mode specified under section 11(5);

(v) the fund should be approved by the Commissioner in accordance with the prescribed rules. The approval shall have effect for such assessment year or years not exceeding three assessment years as may be specified in the order of approval.

Note:

1. There are no conditions regarding accumulation towards the object of the fund.
2. There is no requirement of application of any minimum percentage of the income towards the object of the fund.
3. No time limit has been prescribed within which the fund must exercise the option of accumulation.
4. Any contribution made by an employer to this approved welfare fund would also not be allowed as a deduction.

(42) Income of Fund set up by Life Insurance Corporation under pension scheme [Section 10(23AAB)] - Any income of a fund set up by the LIC of India or any other insurer under a pension scheme to which contribution is made by any person for receiving pensions from such fund. Such scheme should be approved by the Controller of Insurance or the IRDA.

(43) Income of institution established for development of Khadi and Village Industries [Section 10(23B)] – (i) The exemption will be available to institutions constituted as public charitable trusts or registered under the Societies Registration Act, 1860 or under any law

corresponding to that Act in force in any part of India existing solely for development of khadi and village industries.

(ii) Income derived by such institutions from the production, sale or marketing of Khadi products or village industries would be exempt for income-tax.

(iii) The conditions for availing exemption are:

(1) The institution has to apply its income or accumulate it for application, solely for the development of village industries.

(2) They should be approved by the Khadi and Village Industries Commission.

(3) Such approval is granted for a period of 3 years at a time.

(iv) However, approval once granted may be withdrawn if at any time the Government is satisfied that –

(1) the institution has not applied or accumulated its income in accordance with the provisions of the section;

(2) the activities of the institution are not being carried out in accordance with the conditions imposed on the basis of which the approval was granted.

(v) Such withdrawal shall be made after giving reasonable opportunity to the assessee. A copy of the order shall be sent to the Assessing Officer as well as the assessee.

(44) Income of authorities set up under State or Provincial Act for promotion of Khadi and Village Industries [Section 10(23BB)] - Income derived by authorities similar to Khadi and Village Industries Commission, set up under any State or Provincial Act, for the development of Khadi or Village industries in the state is exempt from tax.

(45) Income of authorities set up to administer religious or charitable trusts [Section 10(23BBA) – (i) Income of bodies or authorities established, constituted or appointed under any enactment for the administration of public, religious or charitable trust or endowments (including maths, temples, gurudwaras, wakfs, churches, synagogues, agiaries or other places of public religious worship) or societies for religious or charitable purpose is exempt from tax.

(ii) However, exemption will apply to the income of the administrative bodies or authorities but shall not apply to the income of any such trust, endowment or society mentioned above.

(46) Income of European Economic Community (EEC) [Section 10(23BBB)] - This clause provides exemption on any income of the EEC derived in India by way of interest, dividends or

capital gains from investments made out of its funds under a scheme notified by the Government.

(47) Income derived by the SAARC Fund for Regional Projects [Section 10(23BBC)] - Any income derived by the SAARC Fund for Regional Projects which was set up by Colombo Declaration shall be exempt.

(48) Income of the ASOSAI-SECRETARIAT [Section 10(23BBD)] - Any income of the Secretariat of the Asian Organisation of the Supreme Audit Institutions will be exempt.

The exemption is available for 10 previous years relevant to assessment years beginning on 1.4.2001 and ending on 31.3. 2011 i.e., from A.Y.2001-02 to A.Y.2010-11.

(49) Income of the IRDA [Section 10(23BBE)] - Any income of the IRDA established under section 3(1) of the IRDA Act, 1999 will be exempt.

(50) Exemption of income of North-Eastern Development Finance Corporation Limited [Section 10(23BBF)]

(i) This section provides for exemption of any income of the North-Eastern Development Finance Corporation Limited, being a company formed and registered under the Companies Act, 1956.

(ii) The exemption has been phased out beginning with inclusion of 20% of the total income for tax for the assessment year 2006-07, 40% for the assessment year 2007-08, 60% for the assessment year 2008-09, 80% for the assessment year 2009-10 and 100% from the assessment year 2010-11. The exemption under this clause shall be fully phased out in assessment year 2010-11 and no exemption would be available from such assessment year.

(51) Exemption of income of Central Electricity Regulatory Commission [Section 10(23BBG)]

This section provides exemption to any income of Central Electricity Regulatory Commission constituted under sub-section (1) of Section 76 of the Electricity Act, 2003.

(52) Income of certain funds or institutions [Section 10(23C)] - An exemption is available in respect of any income received by any person on behalf of the following entities:

(i) the Prime Minister's National Relief Fund [Sub-clause (i)];

(ii) the Prime Minister's Fund (Promotion of Folk Art) [Sub-clause (ii)];

(iii) the Prime Minister's Aid to Students Fund [Sub-clause (iii)];

(iv) the National Foundation for Communal Harmony [Sub-clause (iiia)];

(v) any other Fund or Institution for charitable purposes approved by the prescribed authority having regard to the objects of the fund or institution and its importance throughout India or throughout any State or States [Sub-clause (iv)];

(vi) any trust (including any other legal obligation) or institution wholly for public religious or public religious and charitable purposes approved by the prescribed authority [Sub-clause (v)];

(vii) any university or other educational institution wholly or substantially financed by the Government which exists solely for educational purposes and not for profit [Sub-clause (iiiab)];

(viii) any university or other educational institution existing solely for educational purposes and not for profit and its aggregate annual receipts do not exceed Rs. 1 crore [Sub-clause (iiiad)];

(ix) any hospital or other institution wholly or substantially financed by the Government, which exists solely for philanthropic purposes and not for profit and which exists for the reception and treatment of persons suffering from illness or mental defectiveness or treatment of convalescing persons or persons requiring medical attention [Sub-clause (iiiac)];

(x) any hospital or other institution as described in (ix) above if its aggregate annual receipts do not exceed the prescribed limit of Rs.1 crore [Sub-clause (iiiae)];

(xi) any other university or educational institutions approved by prescribed authority [Sub-clause (vi)];

(xii) any other hospital, etc. approved by prescribed authority [Sub-clause (via)].

Note:

1. The application form for such exemption will have to be made in the prescribed form and manner.
2. The prescribed authority, is empowered to call for such documents or information as it considers necessary in order to satisfy itself about the genuineness of the activities of the fund or trust or institution or any university or other educational institution or any hospital or other medical institution, before approving the same under section 10(23C)(iv), (v), (vi) or (via). Such documents may include audited annual accounts. The prescribed authority may also make such inquiries as it may deem necessary for this purpose.
3. Exemption under section 10(23C)(iv) or (v) would apply only if the funds are invested or

deposited for any period during the relevant previous year otherwise in the modes specified in Section 11(5). This requirement will not however apply where the investment is maintained in the form of jewellery, furniture or any other article notified by the Board. For this purpose, the fund or trust or institution must fulfill the following conditions:

(a) It should apply its income or accumulate it for application wholly and exclusively to the objects for which it is established,

(b) In case where more than 15% of its income is accumulated on or after 1.4.2002, the period of accumulation of the amount exceeding 15% of its income shall be maximum 5 years.

(c) It should invest or deposit the following kinds of funds:

— any assets which form part of the corpus of the fund, trust or institution as on 1.6.1973;

— any equity shares of a public company held by any University or other educational institution or any hospital or other medical institution where such assets form part of its corpus as on 1.6.1998;

— any debentures, issued by or on behalf of any company or corporation, acquired by the fund, trust or institution, etc. before 1.3.1983;

— any bonus shares allotted to the fund, trust or institution, etc. in respect of the shares mentioned above forming part of the corpus of such fund, etc.

— any voluntary contributions received and maintained in the form of jewellery, furniture or other article as the Board may specify for any period during the previous year. However, such assets should not be in the forms or modes of investment laid down in section 11(5).

4. Investments or deposits made before 1.4.1989 in any mode or form not specified in Section 11(5) should be liquidated and invested in such modes, by 30.3.1993.

5. In case of (xi) and (xii) above, if any funds of such institution or hospital are invested before 1-6-1998 in any mode other than that specified in section 11(5), the exemption to such an institution shall not be denied if such funds do not continue to be so invested or deposited after 30.3.2001.

6. Exemption under sub-clause (iv) or (v) (vi) or (via) would be available only if the funds are invested in mode specified in section 11(5), within 1 year from the end of the previous year in which the asset is acquired or 31.3.1992, whichever is earlier.

7. Exemption under section 10(23C)(iv) or (v) or (vi) or (via) would not apply to profits and gains of business in all cases. However, where the business is incidental to the attainment of its objectives and separate books of account are maintained in respect of the business, the exemption would apply to such business profits also.

8. Notification issued under sub-clauses (iv) and (v) before 13.7.2006, being the date on which the Taxation Laws (Amendment) Act, 2006 received the assent of the President, shall have effect for a maximum 3 assessment years at any one time. Any notification issued by the Central Government [under sub-clauses (iv) or (v)] on or after 13.7.2006 will be valid until withdrawn and there will be no requirement on the part of the assessee to seek renewal of the same after 3 years.

9. In order to expedite disposal of such applications, it has now been provided that where such an application is made on or after 13.7.2006, every notification under sub-clause (iv) or sub-clause (v) shall be issued or approval under sub-clause (vi) or sub-clause (via) shall be granted or an order rejecting the application shall be passed within the period of 12 months from the end of the month in which such application was received.

10. If the total income of any entity referred to in sub-clauses (iv), (v), (vi) and (via) of section 10(23C), without giving effect to the provisions of the said sub-clauses, exceeds the basic exemption limit in any previous year, it shall –

    (1) get its accounts audited in respect of that year by a chartered accountant; and

    (2) furnish such audit report along with the return of income for the relevant assessment year. The report must be in the prescribed form, duly signed and verified by the accountant, and must contain such particulars as may be prescribed.

11. In case of donations received between 26.1.2001and 30.9.2001 for the purpose of providing relief to victims of the Gujarat earthquake, any amount unutilized or mis-utilized and not transferred to the Prime Minister's National Relief Fund on or before 31.3.2004 shall be deemed to be the income of the previous year, chargeable to tax. Further, exemption will not be available if such fund/institution does not render accounts of income and expenditure to authority prescribed under section 80G(5C)(v) as prescribed.

12. Where the fund / trust / institution / university / hospital etc. does not apply its income during the year of receipt and accumulates it, and subsequently makes a payment or credit out of such accumulated income, to any institution or trust registered u/s 12AA or to any fund / trust / institution / university / hospital, such payment or credit shall not be considered to be an application of income for its specified objectives.

13. The Central Government, or prescribed authority shall have the power to withdraw the approval or rescind the notification if :

    (i) such fund/institution/university/hospital etc. has not applied its income or invested/deposited its funds in accordance with the provisions. or

    (ii) the activities of such fund, etc are not genuine; or

    (iii) such activities are n ot being carried out in accordance with the conditions based upon which it was notified or approved.

    However, the approval or notification can be withdrawn or rescinded only after issuing a show cause notice and giving reasonable opportunity to such fund, etc. of being heard. After withdrawing the approval or rescinding the notification, a copy of the order is to be forwarded to the concerned fund/institution, etc. as well as to the Assessing Officer.

14. The time limit for making an application for grant o f exemption or continuation thereof under section 10(23C) by a fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in sub-clauses (iv)/(v)/(vi)/(via) of section 10(23C) has been specified in respect of such applications made on or after 1.6.2006. Such applications have to be filed *on or before 30th September of the succeeding financial year*.

    For example, if an educational institution seeks exemption under clause (vi) for P.Y.2009-10 (i.e. A.Y.2010-11), it has to make an application for grant of exemption by 30.9.2010.

15. However, any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of the said section shall be included in the total income.

16. It has also been provided that all pending applications in respect of which no notification has been issued under the said sub-clause (iv) or (v) before 1st June, 2007, shall stand transferred on that day to the pre9scribed authority and the prescribed authority may proceed with such applications from the stage at which they were on that day.

(53) Income of Mutual Fund [Section 10(23D)] – (i) The income of a Mutual Fund set up by a public sector bank / public financial institution / SEBI / RBI subject to certain conditions is exempt.

(ii) "Public sector bank" means SBI or any nationalised bank *or a bank included in the category "other public sector banks" by the RBI, for example, IDBI Bank.*

Note:

1. The income of a mutual fund registered under the SEBI will be exempt without any conditions laid down by the Central Government
2. In the case of other mutual funds the condition will be applicable.

(54) Income of Investor Protection Funds [Section 10(23EA)] – (i) Clause (23EA) excludes any income by way of contributions received from recognized stock exchanges and the members thereof, from the total income of an Investor Protection Fund set up by recognised stock exchanges in India, either jointly or separately, and notified by the Central Government in this behalf.

(ii) Where any amount standing to the credit of the Fund and not charged to income-tax during any previous year is shared, either wholly or in part, with a recognised stock exchange, the whole of the amount so shared shall be deemed to be the income of the previous year in which such amount is so shared and shall accordingly be chargeable to income-tax.

(55) Exemption of specified income of Investor Protection Fund set up by commodity exchanges [Section 10(23EC)]

(i) This clause exempts income, by way of contributions received from commodity exchanges and the members thereof, of such Investor Protection Fund set up by commodity exchanges in India, either jointly or separately, as the Central Government may, by notification in the Official Gazette, specify in this behalf.

(ii) Where any amount standing to the credit of the said Fund and not charged to income-tax during any previous year is shared, either wholly or in part, with a commodity exchange, the entire amount so shared shall be deemed to be the income of the previous year in which the amount is so shared and shall accordingly be chargeable to income-tax.

(iii) A "commodity exchange" means a "registered association" as defined in clause section 2(jj) of the Forward Contracts (Regulation) Act, 1952. i.e. an association to which for the time being a certificate of registration has been granted by the Forward Markets Commission under section 14B of that Act.

(56) Income of Venture Capital Company / Fund [Section 10(23FB)] - This clause exempts any income of a venture capital company or venture capital fund set up to raise funds for investment in a venture capital undertaking. In order to obtain the exemption, the venture

capital company or venture capital fund will require a certificate of registration by SEBI. Further, they should fulfill the conditions specified by the Central Government and SEBI.

It is clarified that the income of a venture capital company or venture capital fund shall continue to be exempt if the shares of the venture capital undertaking, in which the venture capital company or venture capital fund has made the initial investment, are subsequently listed in a recognized stock exchange in India.

This clause restricts such exemption only in respect of income of a venture capital company or venture capital fund from investment in a venture capital undertaking engaged in certain specified businesses or industries.

For this purpose, a venture capital undertaking has been defined to mean such domestic company whose shares are not listed in a recognised stock exchange in India and which is engaged in –

(i) the business of -

  (A) nanotechnology;

  (B) information technology relating to hardware and software development;

  (C) seed research and development;

  (D) bio-technology;

  (E) research and development of new chemical entities in the pharmaceutical sector;

  (F) production of bio-fuels,

  (G) building and operating composite hotel-cum-convention centre with seating capacity of more than three thousand; or

  (H) developing or operating and maintaining or developing, operating and maintaining any infrastructure facility as defined in the Explanation to clause (i) of sub-section (4) of section 80-IA i.e.

    (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;

    (4) a port, airport, inland waterway, inland port or navigational channel in the sea.

(ii) dairy or poultry industry.

Therefore, exemption under this clause would be available only if the venture capital company/venture capital fund invests in the businesses or industries specified above. In such cases, tax would be payable by the investor under section 115U. If the venture capital company/venture capital fund invests in other businesses or industries, then it would not be eligible for exemption under this clause.

(57) Income of trade unions [Section 10(24)] - Any income under the heads "income from house property" and "income from other sources" of a registered trade union, within the meaning of the Trade Unions Act, 1926, formed primarily for the purpose of regulating the relations between workmen and the employers or between workmen and workmen will be exempt. Further, this exemption is also available in respect of an association of such registered unions.

(58) Income of provident funds, superannuation funds, gratuity funds [Section 10(25)] - Income of a recognized provident fund (RPF) and of an approved superannuation fund or gratuity fund is exempt from tax and the trustees of these funds would not be liable to tax thereon.

The exemption also applies to

(i) the interest on securities which are held by or are the property of statutory provident fund (SPF) governed by the Provident Funds Act, 1925;

(ii) the capital gains, if any arising to it from the sale, exchange or transfer of such securities;

(iii) any income received by the Board of Trustees constituted under Coal Mines Provident Fund and Miscellaneous Provisions Act, 1984 and under the Employees Provident Funds and Miscellaneous Provisions Act, 1952, on behalf of the Deposit Linked Insurance Funds established under these respective Acts.

(59) Income tax exemption to Employees State Insurance (ESI) Fund [Section 10(25A)] - The contributions paid under ESI Act, 1948 and all other moneys received on behalf of the ESI Corporation are paid into a Fund called the ESI Fund. This Fund is held and administered by the ESI Corporation. The amounts lying in the Fund are to be expended for payment of cash benefits and provision of medical treatment and attendance to insured persons and their families, establishment and maintenance of hospitals and dispensaries, etc.

Any income of the ESI Fund is exempted.

(60) Income of member of a scheduled tribe [Section 10(26)] - A member of a Scheduled Tribe residing in

(i) any area (specified in the Constitution) or

(ii) in the States of Manipur, Tripura, Arunachal Pradesh, Mizoram and Nagaland, or

(iii) in the Ladakh region of the state of Jammu and Kashmir

is exempt from tax on his income arising or accruing -

(a) from any source in the areas or States aforesaid.

(b) by way of dividend or interest on securities.

(61) Exemption of income of a Sikkimese Individual [Section 10(26AAA)]

(i) The following income, which accrues or arises to a Sikkimese individual, would be exempt from income-tax –

(a) income from any source in the State of Sikkim; or

(b) income by way of dividend or interest on securities.

(ii) However, this exemption will not be available to a Sikkimese woman who, on or after 1st April, 2008, marries a non-Sikkimese individual.

(62) Exemption of income of an Agricultural Produce Market Committee or Board [Section 10(26AAB)]

Any income of an Agricultural Produce Market Committee or Board constituted under any law for the time being in force for the purpose of regulating the marketing of agricultural produce would be exempt.

(63) Income of a corporation etc. for the promotion of interests of members of scheduled casts or tribes or both [Section 10(26B)] - Any income of a corporation (established by a Central, State or Provincial Act) or other body, institution or association (wholly financed by Government) formed for promotion of the interests of the members of scheduled castes or tribes or backward classes or of any two or all of them is exempt from tax.

(64) Exemption of income of corporations established to protect interests of minority community [Section 10(26BB)] - Any income of a corporation established by the Central Government or any State Government for promoting the interests of the members of a minority community will be exempt from income tax. Section 80G also provides tax relief in respect of donations made to these corporations.

(65) Exemption of income of corporation established by a Central, State or Provincial Act for welfare of ex-servicemen [Section 10(26BBB)] - This clause exempts any income of a corporation established by a Central, State or Provincial Act for the welfare and economic

upliftment of ex-servicemen, being citizens of India.

(66) Co-operatives for scheduled castes [Section 10(27)] - Any income of a co-operative society formed for promoting the interests of the members of either the scheduled castes or scheduled tribes will be exempted from being included in the total income of the society.

Conditions:

(a) The membership of the co-operative society should consist of only other co-operative societies formed for similar purposes, and

(b) The finances of the society shall be provided by the Government and such other societies.

(67) Incomes of certain bodies like Coffee Board, etc. [Section 10(29A)] - Under this clause, any income accruing or arising to the following bodies is exempt from tax:

(a) the Coffee Board constituted under section 4 of the Coffee Act, 1942,

(b) the Rubber Board constituted under section 4(1) of the Rubber Board Act, 1947,

(c) the Tea Board established under section 4 of the Tea Act, 1953,

(d) the Tobacco Board constituted under the Tobacco Board Act, 1975,

(e) the Marine Products Export Development Authority established under section 4 of the Marine Products Export Development Authority Act, 1972,

(f) the Agricultural and Processed Food Products Export Development Authority established under section 4 of the Agricultural and Processed Food Products Export Development Act, 1985,

(g) the Spices Board constituted under section 3(1) of the Spices Board Act, 1986,

(h) the Coir Board established under the Coir Industry Act, 1953.

(68) Tea board subsidy [Section 10(30)] - The amount of any subsidy received by any assessee engaged in the business of growing and manufacturing tea in India through or from the Tea Board will be wholly exempt from tax.

Conditions:

(a) The subsidy should have been received under any scheme for replantation or replacement of the bushes or for rejuvenation or consolidation of areas used for cultivation of tea.

(b) The assessee should furnish a certificate from the Tea Board as to the subsidy received by him during the previous year to the Assessing Officer along with his return of the relevant assessment year or with in the time extended by the Assessing Officer for the purpose.

(69) Other subsidies [Section 10(31)] - Amount of any subsidy received by an assessee engaged in the business of growing and manufacturing rubber, coffee, cardamom or other specified commodity in India from or through the Rubber Board, Coffee Board, Spices Board or any other Board in respect of any other commodity under any scheme for replantation or replacement of rubber, coffee, cardamom or other plants or for rejuvenation or consolidation of areas used for cultivation of all such commodities will be exempt from income-tax. Condition for submission of certificate is applicable.

(70) Exemption in respect of clubbed income of minor [Section 10(32)] - In case the income of an individual (i.e. the parent) includes the income of his minor child in terms of section 64(1A), such parent shall be entitled to exemption of Rs.1,500 in respect of each minor child. However, if income of any minor so includible is less than Rs.1,500, then the entire income shall be exempt.

Illustration 13

Mr. Khanna has an income from salary of Rs.3,00,000. Details of income of his minor children are:

Minor daughter has earned an interest income from a bank : Rs.5,000

His minor son has also earned an interest income on NSC : Rs.1,000.

Compute his gross total income for the P.Y. 2009-10.

Solution

Gross Total income of Mr. Khanna for the P.Y.2009-10

Income from Salary				Rs.3,00,000
Income from other sources				
- Minor daughter's interest income from bank	5,000			
Less: Exempt under section 10(32)	(1,500)	Rs 3,500		
- Minor son's interest income on NSC	1,000			
Less: Exempt under section 10(32)	(1,000)	Nil		Rs. 3,500
Gross Total Income				Rs.3,03,500

(71) Exemption of capital gain on transfer of a unit of Unit Scheme, 1964 (US 64) [Section 10(33)] - This clause provides that any income arising from the transfer of specified units, shall be exempt from tax. Such transfer should take place on or after 1.4.2002.

(72) Exclusion of dividends referred to in Section 115-O from total income [Section 10(34)] - This clause provides that any income by way of dividends referred to in section 115-O shall be exempt.

The Explanation to this section provides 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.

(73) Exemption of income from units from the Administrator of specified undertaking / specified company / mutual fund specified in clause (23D) [Section 10(35)] - This clause provides that any income received in respect of units from the Administrator of the specified undertaking / specified company / Mutual Fund specified under clause (23D) shall be exempt. Exemption shall not apply to any income arising from transfer of such units.

(74) Exemption of long term capital gains on transfer of listed equity shares [Section 10(36)] – Any income arising from transfer of a long-term capital asset, being an eligible equity share in a company purchased on or after 1.3.2003 but before 1.3.2004, and held for a period of 12 months or more shall be exempt from tax.

"Eligible equity share" means –

(i) any equity share in a company being a constituent of BSE-500 Index of the Stock Exchange, Mumbai as on 1.3.2003 and the transactions of purchase and sale of such equity share are entered into on a recognised stock exchange in India;

(ii) any equity share in a company allotted through a public issue on or after 1.3.2003 and listed in a recognised stock exchange in India before 1.3.2004 and the transaction of sale of such share is entered into on a recognised stock exchange in India.

(75) Exemption of capital gains on compulsory acquisition of agricultural land situated within specified urban limits [Section 10(37)] – With a view to mitigate the hardship faced by the farmers whose agricultural land situated in specified urban limits has been compulsorily acquired, clause (37) has been inserted to exempt the capital gains arising to an individual or a HUF from transfer of agricultural land by way of compulsory acquisition.

Such exemption is available where the compensation or the enhanced compensation or consideration, as the case may be, is received on or after 1.4. 2004.

The exemption is available only when such land has been used for agricultural purposes during the preceding two years by such individual or a parent of his or by such HUF.

Illustration 14

Mr. Kumar has an agricultural land (costing Rs.6 lakh) in Lucknow and has been using it for agricultural purposes since 1.4.1995 till 1.8.2000 when the Government took over compulsory acquisition of this land. A compensation of Rs.10 lakh was settled. The compensation was received by Mr. Kumar on 1.7.2009. Compute the amount of capital gains taxable in the hands of Mr. Kumar.

Solution

In the given problem, compulsory acquisition of an urban agricultural land has taken place and the compensation is received after 1.4.2004. This land had also been used for at least 2 years by the assessee himself for agricultural purposes. Thus, as per section 10(37), entire capital gains arising on such compulsory acquisition will be fully exempt and nothing is taxable in the hands of Mr. Kumar in the year of receipt of compensation i.e. A.Y.2010-11.

Illustration 15

Will your answer be any different if Mr. Kumar had by his own will sold this land to his friend Mr. Sharma? Explain.

Solution

As per section 10(37), exemption is available if compulsory acquisition of urban agricultural land takes place. Since the sale is out of own will and desire, the provisions of this section are not attracted and the capital gains arising on such sale will be taxable in the hands of Mr. Kumar.

Illustration 16

Will your answer be different if Mr. Kumar had not used this land for agricultural activities? Explain.

Solution

As per section 10(37), exemption is available only when such land has been used for agricultural purposes during the preceding two years by such individual or a parent of his or by such HUF. Since the assessee has not used it for agricultural activities, the provisions of this section are not attracted and the capital gains arising on such compulsory acquisition will be taxable in the hands of Mr. Kumar.

Illustration 17

Will your answer be different if the land belonged to ABC Ltd. and not Mr. Kumar and compensation on compulsory acquisition was received by the company? Explain.

Solution

Section 10(37) exempts capital gains arising to an individual or a HUF from transfer of agricultural land by way of compulsory acquisition. Since the land belongs to ABC Ltd., a company, the provisions of this section are not attracted and the capital gains arising on such compulsory acquisition will be taxable in the hands of ABC Ltd.

(76) Exemption of long-term capital gains on sale of equity shares / units of an equity oriented fund [Section 10(38)]

(i) This clause exempts LTCG on sale of equity shares of a company or units of an equity oriented fund on or after 1.10.2004.

(ii) This exemption is available only if such transaction is chargeable to securities transaction tax.

(iii) However, such long term capital gains exempt under section 10(38) shall be taken into a account in computing the book profit and income tax payable under section 115JB.

(iv) "Equity oriented fund" means a fund –

(1) where the investible funds are invested by way of equity shares in domestic companies to the extent of more than 65% of the total proceeds of such fund; [The percentage of equity share holding of the fund should be computed with reference to the annual average of the monthly averages of the opening and closing figures], and

(2) which has been set up under a scheme of a Mutual Fund specified under clause (23D)

The percentage of equity share holding of the fund should be computed with reference to the annual average of the monthly averages of the opening and closing figures.

Illustration 18

Mr. Basu purchased 2,000 equity shares of ABC Ltd. (a listed company) on 1.4.2008 at Rs.20 per share. He sold all the shares on 1.6.2009 at Rs.50 per share. He also had to pay securities transaction tax (STT) on the same. Explain the taxability in the hands of Mr. Basu in the year of transfer i.e. A.Y. 2010-11.

Solution

In the given problem, since the listed equity shares of ABC Ltd. are being sold after 12 months, there is a long-term capital gains (LTCG) on the sale of these shares. Also, such LTCG has arisen after 1.10.2004 and STT has also been paid on these shares. Thus, as per section 10(38), the entire LTCG arising on such sale will be fully exempt and nothing is taxable in the hands of Mr.Basu in the year of sale i.e. A.Y.2010-11.

Illustration 19

Will your answer be different if these shares were preference shares and not equity shares? Explain.

Solution

As per section 10(38), LTCG on sale of eligible equity shares of a company on or after 1.10.2004 shall be exempt. Since the shares are preference shares and not equity shares, the provisions of this section are not attracted and the capital gains arising on such sale will be taxable in the hands of Mr. Basu in the A.Y. 2010-11.

Illustration 20

Will you answer be different if these shares were not listed in a recognised stock exchange? Explain.

Solution

As per section 10(38), LTCG on sale of equity shares of a company on or after 1.10.2004 shall be exempt. However, this exemption is available only if such transaction is chargeable to securities transaction tax. Since the shares are not listed in a recognised stock exchange, STT will not be chargeable, hence the provisions of this section are not attracted and the capital gains arising on such sale will be taxable in the hands of Mr. Basu in the A.Y.2010-11.

(77) Exemption of specified income arising from any international sporting event in India [Section 10(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.

(iii) Accordingly, in exercise of the powers conferred by section 10(39), the Central Government has notified the following:

(a) the Commonwealth Games Federation, London, United Kingdom as the person,

(b) the Commonwealth Games 2010 to be held in India, as the international sporting event,

(c) the income arising to Commonwealth Games Federation from Commonwealth Games 2010 on account of Host Fee, received or receivable from the Organising Committee Commonwealth Games 2010 Delhi, India amounting to 7.3 million GBP, as the specified income, for the purposes of exemption under section 10(39).

(78) 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 [Section 10(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).

(79) Exemption of any income from transfer of an asset of an undertaking engaged in the business of generation or transmission or distribution of power [Section 10(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).

(80) Exemption of specified income of certain bodies or authorities [Section 10(42)]

(i) This clause exempts income, of the nature and to the extent, arising to a body or authority, notified by the Central Government.

(ii) Such body or authority should have been established or constituted or appointed-

(a) under a treaty or an agreement entered into by the Central Government with two or more countries or a convention signed by the Central Government;

(b) not for the purposes of profit.

(81) Exemption of income received in a transaction of reverse mortgage [Section 10(43)]

The Finance Minister had, in his budget speech of Union Budget 2007-08, announced that the National Housing Bank would introduce the Reverse Mortgage scheme. This scheme is for

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

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

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

This is no doubt a noteworthy social security measure for the aged. However, the tax consequences of such reverse mortgage needed clarification.

Therefore, clause (xvi) of section 47 clarifies that any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government would not amount to a transfer for the purpose of capital gains.

Further, section 10(43) provides that the amount received by the senior citizen as a loan, either in lump sum or in installments, in a transaction of reverse mortgage would be exempt from income-tax.

Capital gains tax liability would be attracted only at the stage of alienation of the mortgaged property by the bank/housing finance company for the purposes of recovering the loan.

(82) Exemption of income received by any person on behalf of NPS Trust [Section 10(44)]

The New Pension System (NPS), operational since 1st January, 2004, is compulsory for all new recruits to the Central Government service from 1st January, 2004. Thereafter, it has been opened up for employees of State Government and private sector.

NPS Trust has been set-up on 27th February, 2008 as per the provisions of the Indian Trust Act, 1882 to manage the assets and funds under the NPS in the interest of the beneficiaries. The Finance (No.2) Act, 2009 has exempted the NPS Trust from the applicability of –

(i) *income-tax on any income received by any person for, or on behalf of, the NPS Trust [Section 10(44)]*

(ii) *dividend distribution tax in respect of dividend paid to any person for, or on behalf of, the NPS Trust; and*

(iii) *securities transaction tax on all purchases and sales of equity and derivatives by the NPS Trust.*

Further, the NPS Trust shall receive all income without any deduction of tax at source.

Thus, the NPS Trust, which was set up to manage the assets and funds under the New Pension System in the interest of the beneficiaries, would enjoy a "pass-through status".

Students should carefully note that all the items under section 10 listed above are altogether exempt from taxation and they are not even includible in the total income of the person concerned.

2. TAX HOLIDAY FOR UNDERTAKINGS IN FREE TRADE ZONES ETC. [SECTION 10A]

Section 10A of the Income-tax Act relates to special provision in respect of newly established undertakings in free trade zones, export processing zones, electronic hardware technology parks, software technology parks or special economic zones notified by the Central Government. The section exempts the profits and gains of such undertakings derived from the export of articles or things or computer software.

(1) Assessees who are eligible to claim exemption

The benefit of exemption under this section is available to all categories of assessees who derive any profits or gains from an undertaking engaged in export of articles or things or computer software. 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.

(2) Conditions to be satisfied for claiming exemption

This section applies to any undertaking which fulfills the following conditions:

(i) It has begun manufacture or production (include the cutting and polishing of precious and semi-precious stones) of articles, things or computer software during the previous year relevant to the:

(a) A.Y.1981-82 or thereafter in any FTZ; or

(b) A.Y.1994-95 or thereafter in any electronic hardware technology park (EHTP) or software technology park (STP); or

(c) A.Y.2001-2002 or thereafter in any SEZ.

(ii) It is not formed by the splitting up, or reconstruction, of a business already in existence. However, this condition shall not apply to an undertaking which is formed as a result of re-establishment, reconstruction or revival of the business of any undertaking falling under section 33B.

(iii) It is not formed by the transfer of machinery or plant previously used for any purpose. For the purposes of this clause, any machinery or plant used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose, if the following conditions are fulfilled:

(a) such machinery or plant was not, at any time previous to the date of installation by the assessee, used in India;

(b) such machinery or plant is imported into India from any country outside India; and

(c) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of this Act in computing the total income of any person prior to the date of installation of the machinery or plant by the assessee.

(d) Further, where in the case of an industrial undertaking, any machinery or plant or any part thereof previously used for any purpose is transferred to a new business, and the total value of the machinery, etc. transferred does not exceed 20% of the total value of the machinery and plant used for the business.

(iv) The sale proceeds of articles, things or computer software exported out of India must be brought into India in convertible foreign exchange within six months from the end of the previous year, or such further period as the competent authority may allow. For this purpose, "competent authority" means the RBI or such other authority as is authorised for regulating payments and dealings in foreign exchange.

Further, where the sale proceeds are credited to a separate account maintained by the assessee with any bank outside India with the approval of the RBI, such sale proceeds shall be deemed to have been received in India.

(v) In order to claim deduction under this section, the assessee should furnish an audit report from a chartered accountant in Form No.56F, along with the return of income,

certifying that the deduction has been correctly claimed. However, no deduction under section 10A shall be allowed to an assessee who does not furnish a return of his income on or before the due date specified under section 139(1).

(3) Period of tax holiday

No deduction shall be available for *A.Y.2012-13* and thereafter. i.e. Deduction shall be allowed maximum *upto A.Y.2011-12*. Such profits will be exempt 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, as the case may be.

Examples:

(i) If an undertaking is set up on 1.3.2002, then exemption shall be allowed for a period of 10 years beginning from A.Y.2002-03 upto A.Y.2011-12.

(ii) If an undertaking is set up on 1.3.2003, then exemption shall be allowed for a period of maximum 9 years beginning from A.Y.2003-04 upto A.Y.2011-12.

(iii) If an undertaking is set up on 1.3.2004, then exemption shall be allowed for a period of maximum 8 years beginning from A.Y.2004-05 upto A.Y.2011-12.

(4) Exemption in case of units established in SEZ on or after 1.4.2002 - Section 10A(1A)

In case of an undertaking in any SEZ, which begins to manufacture or produce articles or things or computer software on or after 1.4.2002, the exemption shall be as follows:

(i) 100% of the profits for 5 consecutive years beginning with the first assessment year in which it begins to manufacture, and

(ii) 50% of the profits for a further 2 assessment years.

(iii) In addition to the above, exemption for the next 3 years is provided of an amount not exceeding 50% of the profit debited to 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 "Special Economic Zone Re-investment Allowance Reserve Account". This Reserve is to be created and u tilised in the manner laid down under section 10A(1B).

(5) Utilisation of the reserve - Section 10A(1B)

The amount credited to the reserve account is to be utilised in the following manner –

(i) for the purposes of acquiring new machinery or plant which is first put to use within 3

years from the previous year in which the reserve was created; and

(ii) until the acquisition of new machinery or plant, the amount can be utilised for the purposes of the business of the undertaking other than for distribution by way of dividends or profits or for remittance outside India as profits or for the creation of any asset outside India.

The prescribed particulars in respect of new machinery or plant should be furnished by the assessee 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.

(6) Consequences of mis-utilisation / non-utilisation of reserve - Section 10A(1C)

If the amount credited to the reserve account has been utilised for any purpose other than those referred to under section 10A(1B), the amount so utilised shall be deemed to be the profits in the year in which the amount was so utilised. If any amount credited to the reserve account has not been utilised before the expiry of 3 years from the previous year in which the reserve was created, then the unutilised amount shall be deemed to be the profits in the year immediately following the said period of three years and shall be charged to tax accordingly.

(7) Computation of profit from exports of such undertakings – Section 10A(4)

The profit derived from export shall be the amount which bears to the profits of the business of the undertaking, the same proportion as the export turnover in respect of such articles, things or computer software bears to the total turnover of the business. i.e.

$$\text{Profits from business of the undertaking} \times \frac{\text{Export turnover of the undertaking of such articles or things or computer software}}{\text{Total turnover of the business carried on by the undertaking}}$$

Illustration 21

Big Ltd. exports articles and has furnished the following particulars for the P.Y.2009-10.

Export sales	Rs.60,00,000
Domestic sales	Rs.20,00,000
Total sales	Rs.80,00,000
Money brought to India in convertible foreign exchange	Rs.50,00,000
Profits from business	Rs.16,00,000

You are required to compute the exemption available under section 10A for the A.Y.2010-11.

Solution

The exemption available under section 10A is

$$\text{Profits from business} \times \frac{\text{Export turnover of the undertaking of such article}}{\text{Total turnover of the business}}$$

$$= \text{Rs.}16,00,000 \times \frac{\text{Rs.}50,00,000}{\text{Rs.}80,00,000} = \text{Rs.}10,00,000$$

(8) Restrictions on other tax benefits

In computing the total income of the assessee of the previous year relevant to the assessment year immediately succeeding the last of the relevant assessment year, the following provisions shall apply:

(i) In computing depreciation under section 32, the written down value (WDV) of any asset used for the business shall be computed as if the assessee had claimed and actually been allowed the deduction in respect of the relevant assessment year.

(ii) No deduction shall be allowed under section 80-IA or 80-IB.

(iii) 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 shall be allowed to be carried forward and set off in the subsequent assessment years.

The provisions of 80-IA(8) and 80-IA(10) shall apply in relation to the undertaking as they apply for the purposes of the undertaking referred to in that section.

(9) Exemption allowable in case of amalgamation / demerger

Where an undertaking of an Indian company is transferred to another company under a scheme of amalgamation or demerger, the deduction shall be allowable in the hands of the amalgamated or resulting company.

However, no deduction shall be admissible under these sections to the amalgamating company or the demerged company for the previous year in which amalgamation or demerger takes place.

(10) Declaration to be furnished for non-applicability of the section

This section is optional for the assessee. The provisions of this section shall not apply for any of the relevant assessment years where the assessee before the due date under section 139(1) furnishes to the Assessing Officer a declaration in writing that the provisions of this section may not be made applicable to him.

(11) Shifting of an undertaking from FTZ / EPZ to SEZ

Where an undertaking initially located in any free trade zone or export processing zone is subsequently located in a special economic zone by reason of conversion of such zones, the period of ten consecutive assessment years shall be reckoned from the assessment year relevant to the previous year in which the undertaking began manufacture or production in such free trade zone or export processing zone, as the case may be.

(12) Definitions for the purpose of this section

(i) "Computer software" means

(a) any computer programme recorded on any disc, tape, perforated media or other information storage device; or

(b) any customized electronic data or any product or service of similar nature, as may be notified by the Board.

which is transmitted or exported from India to any place outside India by any means.

(ii) "Export turnover" means the consideration in respect of export by the undertaking of articles or things or computer software received in, or brought into India by the assessee in convertible foreign exchange in accordance with sub-section (3), but does not include freight, telecommunication charges or insurance attributable to the delivery of the articles or things or computer software outside India or expenses, if any, incurred in foreign exchange in providing the technical services outside India.

Note: New units established in SEZ on or after 1.4.2005, shall not be allowed to take the benefit of exemption under section 10A. They shall be entitled to benefit under section 10AA.

3. TAX HOLIDAY FOR NEWLY ESTABLISHED UNITS IN SPECIAL ECONOMIC ZONES [SECTION 10AA]

A deduction of profits and gains which are derived by an assessee being an entrepreneur from the export of articles or things or providing any service, shall be allowed from the total income of the assessee.

(1) Assessees who are eligible for exemption

Exemption is available to all categories of assessees who derive any profits or gains from an undertaking being a unit engaged in the export of articles or things or providing any service. 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).

(2) Essential conditions to claim exemption

The exemption shall apply to an undertaking which fulfils the following conditions:

(i) It has begun or begins to manufacture or produce articles or things or provide any service on or after 1.4.2006 in any SEZ.

(ii) It should not be formed by splitting up or reconstruction of a business already in existence (except in circumstances provided in section 33B) or formed by transfer to a new business, of plant and machinery previously used for any purpose exceeding 20% of the total value of machinery and plant used in the business.

(iii) For this purpose, any machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose if the following conditions are fulfilled:

  (a) such machinery or plant was not at any time used in India;

  (b) such machinery or plant is imported into India from any country outside India; and

  (c) no deduction on account of depreciation has been allowed in respect of such machinery or plant to any person earlier.

(iv) The assessee should furnish in the prescribed form [Form No. 56F], alongwith the return of income, the report of a chartered accountant certifying that the deduction has been correctly claimed.

(v) The conditions laid down in sub-section (8) (relating to inter-unit transfer) and sub-section (10) (relating to showing excess profit from such unit) of section 80IA shall, so far as may be, apply in relation to the undertaking referred to in this section as they apply for the purposes of the undertaking referred to in section 80-IA.

(3) Period for which deduction is available

The unit of an entrepreneur, which begins to manufacture or produce any article or thing or provide any service in a SEZ on or after 1.4.2006, shall be allowed a deduction of:

(i) 100% of the 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, and

(ii) 50% of such profits and gains for further 5 assessment years.

(iii) A further deduction for next 5 consecutive years shall be 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 in the manner laid down under section 10AA(2).

Example: An undertaking is set up in a SEZ and begins manufacturing on 15.10.2005. The deduction under section 10AA shall be allowed as under:

(a) 100% of profits of such undertaking from exports from A.Y.2006- 07 to A.Y.2010-11.

(b) 50% of profits of such undertaking from exports from A.Y.2011-12 to A.Y. 2015-16.

(c) 50% of profits of such undertaking from exports from A.Y.2016-17 to A.Y.2020-21 provided certain conditions are satisfied.

(4) Conditions to be satisfied for claiming deduction for further 5 years (after 10 years) [Section 10AA(2)]

Sub-section (2) provides that the deduction under (3)(iii) 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.

(5) Consequences of mis-utilisation / non-utilisation of reserve [Section 10AA(3)]

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 utilised 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)].

(6) Computation of profit and gains from exports of such undertakings

The profits derived from 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 computer software bears to the total turnover of the business carried on by the *undertaking*. i.e.

$$\text{Profits from business of the undertaking being the unit} \times \left(\frac{\text{Export turnover of the undertaking of such articles or things or computer software}}{\text{Total turnover of the business carried on by the undertaking}} \right)$$

(7) Section 10A not applicable for units referred to under section 2(zc) of the SEZ Act, 2005

The provisions of section 10A shall not apply to any undertaking, being a Unit referred to under 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 relevant to the assessment year commencing on or after the 1.4.2006 in any SEZ.

"Unit" as per section 2(zc) of the SEZ Act, 2005 means unit set up by an entrepreneur in a Special Economic Zone and includes an existing Unit, an Offshore Banking Unit and a Unit in an International Financial Services Centre, whether established before or after the commencement of this Act.

(8) Conversion of EPZ / FTZ into SEZ

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.

However, 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 already completed the period of 10 consecutive assessment years, it shall not be eligible for further deduction from income w.e.f. 1.4.2006.

(9) Restriction on other tax benefits

(i) 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.

(ii) 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.

(iii) During the period of deduction, depreciation is deemed to have been allowed on the assets. Written down value shall accordingly be reduced.

(iv) No deduction under section 80-IA and 80-IB shall be allowed in relation to the profits and gains of the undertaking.

(v) 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 yeas.

(vi) 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.

(10) Deduction allowable in case of amalgamation and demerger

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.

4. TAX HOLIDAY FOR 100% EXPORT ORIENTED UNDERTAKINGS [SECTION 10B]

The section exempts the profits and gains of an undertaking derived from the export of articles or things or computer software.

Such profits will be exempt 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, as the case may be.

However, no deduction under this section would be available to any undertaking for *assessment year 2012-13* and subsequent years.

(1) Conditions for claiming exemption

(i) The sale proceeds of articles, things or computer software exported out of India must be brought into India in convertible foreign exchange within six months from the end of the previous year, or such further period as the competent authority may allow. For this purpose, "competent authority" means the Reserve Bank of India or such other authority as is authorised for regulating payments and dealings in foreign exchange.

(ii) Further, where the sale proceeds are credited to a separate account maintained by the assessee with any bank outside India with the approval of the RBI, such sale proceeds shall be deemed to have been received in India.

(iii) The assessee should furnish an audit report in Form 56G from a chartered accountant, etc. in the prescribed form along with the return of income, certifying that the deduction has been correctly claimed.

(iv) No deduction under this section shall be allowed to an assessee who does not furnish a return of his income on or before the due date specified under section 139(1).

(2) Computation of profit

The profit derived from export shall be the amount which bears to the profits of the business of the undertaking, the same proportion as the export turnover in respect of such articles, things or computer software bears to the total turnover of the business.

$$\text{Profits from business of the undertaking} \times \frac{\text{Export turnover of the undertaking of such articles or things or computer software}}{\text{Total turnover of the business carried on by the undertaking}}$$

For this purpose, 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.

For the purpose of this section, "manufacture or produce" shall include the cutting and polishing of precious and semi-precious stones.

(3) Restriction on other tax benefits

In computing the total income of the assessee of the previous year relevant to the assessment year immediately succeeding the last of the relevant assessment year, the following provisions shall apply:

(i) In computing depreciation under section 32, the written down value (WDV) of any asset used for the business shall be computed as if the assessee had claimed and actually been allowed the deduction in respect of the relevant assessment year.

(ii) No deduction shall be allowed under section 80-IA or 80-IB.

(iii) 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 shall be allowed to be carried forward and set off in the subsequent assessment years.

The provisions of 80-IA(8) and 80-IA(10) shall apply in relation to the undertaking as they apply for the purposes of the undertaking referred to in that section.

(4) Exemption allowable in case of amalgamation or demerger

(i) Sub-section (7A) provides that where an undertaking of an Indian company is transferred to another company under a scheme of amalgamation or demerger, the deduction shall be allowable in the hands of the amalgamated or resulting company, as the case may be, for the unexpired period.

(ii) However, no deduction shall be admissible under these sections to the amalgamating company or the demerged company for the previous year in which amalgamation or demerger takes place.

(5) Definitions for the purpose of this section

(i) "Computer software" means

(a) any computer programme recorded on any disc, tape perforated media or other information storage device; or

(b) any customized electronic data or any product or service of similar nature, as may be notified by the Board.

which is transmitted or exported from India to any place outside India by any means.

(ii) "Convertible foreign exchange" means foreign exchange which is for the time being treated by the Reserve Bank of India as convertible foreign exchange for the purposes of the Foreign Exchange Regulation Act, 1973 and any rules made there under or any other corresponding law for the time being in force.

(iii) "Export turnover" means the consideration in respect of export by the undertaking of articles or things or computer software received in, or brought into India by the assessee in convertible foreign exchange in accordance with sub-section (3), but does not include freight, telecommunication charges or insurance attributable to the delivery of the articles or things or computer software outside India or expenses, if any, incurred in foreign exchange in providing the technical services outside India.

(iv) "Hundred percent export oriented undertaking" means an undertaking which has been approved as a hundred percent export oriented undertaking by the Board appointed in this behalf by the Central Government in exercise of its powers conferred by section 14 of the Industries (Development and Regulation) Act, 1951 and its related rules.

(v) "Relevant assessment year" means any assessment year falling within a period of ten consecutive assessment years referred to in this section.

(6) Benefit of deduction under section 10B to be available to undertakings set up in Domestic Tariff Area (DTA) subsequently approved as a 100% Export Oriented Undertaking

The following clarifications have been issued regarding the scheme of tax holiday under section 10B vide Circular No. 1/2005, dated 6.1.2005–

If an undertaking set up in Domestic Tariff Area (DTA) and deriving profit from export of

articles or things or computer software manufactured or produced by it, is subsequently approved as a 100% EOU by the Board appointed by the Central Government in exercise of powers conferred under section 14 of the Industries (Development and Regulation) Act, 1951, it shall be eligible for deduction under section 10B.The deduction shall be available only from the year in which the undertaking has got the approval as a 100% EOU.

It shall be available only for remaining 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 articles or things or computer software, as a DTA unit.

Further, in the year of approval, the deduction shall be restricted to the profits derived from exports, from and after the date of approval of the DTA unit as 100% EOU.

Moreover, the deduction to such units in any case will not be available after A.Y.2011 -12 i.e. no deduction would be available w.e.f. A.Y.2012-13.

To clarify the above position, the following illustrations are given –

Different under-takings	**Year in which undertaking is set up in DTA**	**The year in which approval as 100% EOU is granted**	**P.Y. for which deduction is available under section 10B**
A	2001-02	2004-05	2004-05 to 2010-11
B	1996-97	2007-08	No deduction as the 10 year time-limit expires with the P.Y. 2005-06
C	2000-01	2002-03 (in 2002-03, it acquires more than 20% old plant and machinery to start development of computer software)	No deduction as there is transfer of old plant and machinery
D	2003-04	2006-07	2006-07 to 2010-11
E	1992-93	2004-05	No deduction as the 10 year time-limit has expired before 2004-05

5. CHARITABLE OR RELIGIOUS TRUSTS AND INSTITUTIONS [SECTIONS 11 TO 13]

(1) General discussion on trusts

Before considering the provisions of sections 11 to 13 which govern the exemption in respect of income from property held for charitable or religious purposes, let us see briefly what exactly the term trust signifies, the types of trusts and the manner of their creation. Though this aspect of the topic does not strictly fall within the purview of Income-tax, such a general knowledge would be useful in understanding the provisions of tax laws relating to charitable trusts.

A trust is an obligation annexed to the ownership and arising out of a confidence reposed in and accepted by the owner if declared and accepted by him for the benefit of another or of another and the owner. The person who reposes or declares the confidence is called the 'author of the trust'; the person who accepts the confidence is called the trustee; the person for whose benefit the confidence is accepted is called the 'beneficiary'; the subject matter of the trust is called the 'trust property'; the 'beneficial interest' or 'interest' of the beneficiary is his right against the trustees or owner of the trust property and the instrument, if any, by which trust is declared is called the 'instrument of trust'.

Trusts can be broadly classified into two groups - Public and Private. The distinction between a public and private trust is that, whereas in the former, the beneficiaries are the general public or a class thereof, in the latter they are specific individuals. While in the former the beneficiaries constitute a body which is incapable of ascertainment, in the latter they are persons who are ascertained or capable of being ascertained. In some cases, private trusts may enure for the benefit of the public. Some religious trust may also be in the nature of public-cum-private trust.

Private trusts are governed by the Indian Trust Act, 1882. This Act does not apply to the following :

(1) The rules of Mohammedan law as to wakf;

(2) The mutual relations of the members of undivided family as determined by any customary or personal law;

(3) Public or private religious or charitable endowments; and

(4) Trust to distribute prizes taken in war among the captors.

From the above, it will be clear that public charitable trusts are not governed by the Indian Trust Act.

There are three requirements for creation of a public trust. They are (1) a declaration of trust which is binding on the settlor, (2) setting apart definite property and depriving himself of the ownership, and (3) a statement of subjects for which the property is thereafter to be held. In the case of a private trust also, more or less similar requirements exist.

The word 'trust' as used in the context of sections 11 to 13 includes, in addition to the 'trust' as explained above, 'any other legal obligation'. This is made clear in *Explanation 1* to section 13. The words 'any other legal obligation' are wide enough to cover Muslim wakfs, Hindu endowments and dedications to deities. It would also cover a case in which the trustees of a settlement are to pay the income to other trustees who in their turn are bound to apply it for purposes which are religious or charitable.

(2) TAX EXEMPTION [SECTION 11]

(i) Subject to the provisions of sections 60 to 63, the income of a religious or charitable trust or institution, to the extent specified in the Act, is exempt from tax when certain prescribed conditions are fulfilled. The relevant income does not even form part of the total income of the trust or institution.

(ii) Section 11 deals with the exemption of income from property held in trust or other legal obligation for religious or charitable purposes wholly or in part. Section 12 deals with exemption of income derived by such a trust from voluntary contributions. Section 12A prescribe the conditions as to registration of trust etc. Section 13 enumerates the circumstances under which the exemption available under sections 11 to 12 will be denied.

(iii) Income from property held for charitable or religious purposes - The following income shall not be included in the total income of the previous year of the person in receipt of the income:

(a) Income derived from property held under trust wholly for charitable and religious purposes to the extent such income is applied in India for such purpose.

(b) Income derived from property held under trust in part only for such purpose, to the extent such income is applied in India for such purposes. However, the trust in question must have been created before 1.4.1962.

(c) Income derived from property held under trust, created on after 1.4.1952 for charitable purpose which tends to promote international welfare in which India is interested to the extent to which such income is applied to such purpose outside India. This does not cover religious trusts.

(d) Income derived from property held under a trust for charitable or religious purposes, created before 1.4.1952, to the extent to which such income is applied for such purposes outside India.

(e) Income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution.

Thus, it may be noted that only such income derived from property held under trust wholly for charitable or religious purposes is exempt. If the property is held in part only for such purposes, it is necessary that such a trust must have been created before the commencement of the Act. In both the cases, the exemption is limited to the extent such income is applied in India for such specified purposes.

(iv) Types of trusts - To get exemption in respect of income applied outside India, the trusts are divided into two types:

(a) If the object of the trust is to promote international welfare in which India is interested, such trust may have been created on or after 1.4.1952.

(b) If the trust is for any other charitable purpose it must have been created before 1.4.1952. Here also, the exemption is limited to the extent to which such income is applied outside India for such specified purposes. It is to be noted however that a direction from CBDT by a general or special order is necessary before such exemption can be claimed.

(v) Conditions for claiming exemption

(a) Property should be held under trust - The exemptions explained in the preceding paragraphs are available if and only if there is a valid trust or there is a legal obligation, under which the income derived from the property held under such trust or legal obligation is to be applied for charitable or religious purposes. If there is no trust nor any legal obligation, the income will not be exempt even if the whole of such income is applied to charitable or religious purposes. A mere creation of a trust for the income is not sufficient, there must be a trust of the property out of which the income is derived before one can consider any exemption under section 11.

(b) Income should be applied for charitable purposes - Section 2(15) states that 'charitable purpose' includes relief of the poor, education, medical relief, *preservation of environment (including watersheds, forests and wildlife) and preservation of monuments*

or places or objects of artistic or historic interest and the advancement of any other object of general public utility.

The definition of "charitable purpose" includes "any other object of general public utility" The question arises as to what is an object of "general public utility". This expression has not been defined anywhere in the Act.

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

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

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

(a) any activity in the nature of trade, commerce or business or,

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

for a fee or cess or any other consideration, irrespective of the nature of use or application of the income from such activity, or the retention of such income, by the concerned entity. This amendment would affect the ratio laid down in the cases cited above.

Circular No.11/2008 dated 19.12.2008

Exemption under section 11 in case of an assessee claiming both to be a charitable institution as well as a mutual organisation

The proviso to section 2(15) will apply only to entities whose purpose is advancement of any other object of general public utility i.e. the last limb of the definition of charitable purpose contained in section 2(15). Hence, such entities will not be eligible for exemption under section 11 or under section 10(23C) if they carry on commercial activities. Whether such an entity is carrying on an activity in the nature of trade, commerce or business is a question of fact which will be decided based on the nature, scope, extent and frequency of the activity.

There are industry and trade associations who claim exemption from tax under section 11 on the ground that their objects are for charitable purpose as these are covered under any other object of general public utility. Under the principle of mutuality, if trading takes place between persons who are associated together and contribute to a common fund for the financing of some venture or object and in this respect have no dealings or relations with any outside body, then any surplus returned to the persons forming such association is not chargeable to tax. In such cases, there must be complete identity between the contributors and the participants.

Therefore, where industry or trade associations claim both to be charitable institutions as well as mutual organizations and their activities are restricted to contributions from and participation of only their members, these would not fall under the purview of the proviso to section 2(15) owing to the principle of mutuality. However, if such organizations have dealings with non-members, their claim to be charitable organizations would now be governed by the additional conditions stipulated in the proviso to section 2(15).

In the final analysis, however, whether the assessee has for its object the advancement of any other object of general public utility is a question of fact. If such assessee is engaged in any activity in the nature of trade, commerce or business or renders any service in relation to trade, commerce or business, it would not be entitled to claim that its object is charitable purpose. In such a case, the object of general public utility will be only a mask or a device to hide the true purpose which is trade, commerce or business or the rendering of any service in relation to trade, commerce or business. Each case would, therefore, be decided on its own facts and no generalization is possible.

Circular No. 395, dated 24.9.1984 - Promotion of sports and games is considered to be charitable purposes within the meaning of section 2(15). Therefore, an association or

institution engaged in the promotion of games and sports can claim exemption under section 11 even if it is not approved under section 10(23).

A trust will be treated as a charitable trust under section 2(15) even if its object involves the carrying on of an activity for profit. Such a trust will not be denied exemption under section 11 on the ground that its objects are non-charitable.

(vi) Application and accumulation - We have seen that the exemption is limited to the extent to which such income is applied in India or outside India as the case may be. Is it necessary that the entire income should be so applied? The Act gives a concession here. It is possible to claim the exemption even if the trust or institution applies only 85 per cent of the income derived from the trust property for the purpose of the trust, during the relevant previous year.

An accumulation not exceeding 15 per cent of the income from such property is permissible. For computing this 15 per cent, voluntary contributions referred to in section 12 shall be deemed to be part of the income. It must be clearly noted that accumulation must be with the object of application of the accumulated amount to charitable or religious purpose in India at a later date. Such a facility for accumulation is not available for those trusts whose income is to be applied outside India.

(vii) Inability to apply in full 85 per cent of the income - It is clear from the above discussion that free accumulation not exceeding 15 per cent of income from property is permissible. Hence, the balance 85 per cent must be applied during the previous year for the purposes for which the trust has been created. However, it is possible that the trust is unable to apply the minimum of 85 per cent of its income during the previous year due to either of the following reasons.

(1) The whole or any part of the income has not been received during that year.

(2) Any other reason.

In the first class of cases, the period of application is extended to cover the previous year in which the income is actually received and the previous year immediately following the year. But the amount which may be so claimed to have been so applied during the subsequent previous year cannot exceed the amount of the income which had not been received earlier but received during a subsequent previous year.

Example 1 - During the previous year ending 31st March, 2010, a charitable trust earned an income of Rs.1,00,000 but it received only Rs.60,000 in that year. The balance of Rs.40,000 is received in the year ending 31-3-2011.

	Rs.
Total income earned during the P.Y.2009-10	1,00,000
Actual receipt in P.Y.2009-10	60,000
Permissible accumulation @15% of Rs.1,00,000	15,000
Balance to be applied during P.Y. 2009-10	45,000
Amount received in P.Y.2010-11 to be applied in P.Y.2010-11 or P.Y.2011-12	40,000

Since this amount of Rs.40,000 is received during the P.Y. 2010-11, this can be applied in the P.Y.2010-11 or in the P.Y. 2011-12. If the entire amount of Rs.40,000 is duly spent for charitable purposes in these two years, the exemption is fully available but if only part of the amount is so spent within the period, the exemption is restricted to that part only.

There may be a case where the inability springs from some other reason *e.g.* late receipt of the income making it impossible to spend it before the end of the year.

Example 2 - A trust receives a sum of Rs.50,000 on 30th March, 2010. Its previous year ends on 31-3-2010.

It is obvious that it is impossible to apply the requisite sum within one day. Therefore, it has been provided that such sum can be applied at any time during the immediately following previous year i.e. up to 31-3-2011.

(viii) Formalities: Exercise of option - To avail the facility of the extended period of application of income, the trust has to exercise an option in writing that the income applied later as prescribed may be deemed to be income applied to the relevant charitable purposes during the previous year in which the income was derived.

Such option has to be exercised before the expiry of the time allowed statutorily under section 139(1).

The income so deemed to have been applied shall not however be taken into account in calculating the amount of income applied to such purposes, during the previous year in which the income is actually received or during the immediately following previous year as the case may be. Thus, in the Example I given above, the amount of Rs.40,000, received subsequently in the year 2010-11 and applied to charitable purposes in the year 2010-11, will by virtue of the option exercised by the trust, be deemed to be applied for charitable purposes in the year 2009-10 itself. Therefore, such an amount will not be taken into consideration in determining the amount of income applied for charitable purposes in the year 2010-11.

Sub-section (1B) of section 11 provides that where the income for which an option has been exercised as discussed above, is not actually applied, it is to be treated as the income of the previous year immediately following the year of receipt or the previous year in which it was derived as the case may be.

(ix) Conditional accumulation - Apart from the provision for accumulation upto 15 per cent, a trust has also got the rights for conditional accumulation. The relevant provisions are contained in section 11(2).

Where eighty-five per cent of the income is not applied or is not deemed to have been applied to charitable or religious purposes in India but is accumulated or set apart either wholly or in part for application to such purposes in India, such income shall not be included in the total income of the previous year if the following conditions are satisfied.

(a) A notice in writing is given to the Assessing Officer in the prescribed manner specifying the purpose for accumulation and the period for which the income is to be accumulated or set a part. Such period should not exceed five years.

Any amount credited or paid, out of income which is accumulated or set apart, to any trust or institution registered under section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) of sub-clause (vi) or sub-clause (via) of clause (23C) of section 10, shall not be treated as application of income for charitable or religious purposes, either during the period of accumulation or thereafter.

(b) The money so accumulated or set apart should be invested or deposited in the following modes specified in section 11(5):

(1) Investment in Government Saving Certificates.

(2) Deposits with Post Office Savings Banks.

(3) Deposit with Scheduled Banks or Co-operative Banks.

(4) Investment in units of the Unit Trust of India.

(5) Investment in Central or State Government Securities.

(6) Investments in debentures issued by or on behalf of any company or corporation. However, both the principal and interest thereon must have been guaranteed by the Central or the State Government.

(7) Investment or deposits in any public sector company.

Where an investment is made in the shares of any public sector company and such public sector company ceases to be a public sector company, the investment so made shall be deemed to be an investment made for a period of three years from the date of such cessation and in the case of any other investment or deposit, till the date of its maturity.

(8) Investment in bonds of approved financial corporation providing long term finance for industrial development in India and eligible for deduction under section 36(1)(viii).

(9) Investment in bonds of approved public companies whose principal object is to provide long-term finance for construction or purchase of houses in India for residential purposes and eligible for deduction under section 36(1)(viii).

(10) Deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for urban infrastructure in India.

"Long-term finance" means any loan or advance where the terms under which moneys are loaned or advanced provide for repayment along with interest thereof during a period of not less than five years.

"Urban infrastructure" means a project for providing potable water supply, sanitation and sewerage, drainage, solid waste management, road, bridges and flyovers or urban transport.

(11) Investment in immovable property excluding plant and machinery, not being plant and machinery installed in a building for the convenient occupation thereof.

(12) Deposits with Industrial Development Bank of India.

(13) Any other mode of investment or deposit as may be prescribed. Rule 17C specifies the following other modes: (1) Investments in units issued under any scheme of mutual fund referred to in section 10(23D); (2) Any transfer of deposits to Public Account of India; (3) Deposits made with an authority constituted in India or under any law enacted either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages, or for both; (4) investment by way of acquiring equity shares of a 'depository'; (5) investment by a recognized Stock Exchange, in the equity shares of a company

promoted by it to acquire the membership rights of other stock exchanges, where at least 51% of the paid-up share capital is held by the Stock Exchange and the balance is held by its members; (6) investment by way of acquiring equity shares of an incubatee by an incubator.

Where the income of the trust -

(a) is applied for purposes other than charitable or religious purposes; or

(b) ceases to be accumulated or set apart for application thereto; or

(c) ceases to remain invested or deposited in any modes mentioned under section 11(5) above; or

(d) is not utilised for the purpose for which it is so accumulated or set apart during the period specified (not exceeding 5 years) or in the year immediately following thereof.

However, in computing the aforesaid period of 5 years, the period during which the income could not be applied for the purposes for which it is so accumulated or set apart due to an order or injunction of any Court shall be excluded.

(e) accumulated or set apart for application to charitable and religious purposes in India, is credited or paid to any trust or institution registered under section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or (v) or (vi) or (via) of clause (23C) of section 10,

such income shall be deemed to be the income of the previous year –

(a) in which it is so applied; or

(b) in which it ceases to be accumulated or set apart; or

(c) in which it ceases to remain so invested or deposited; or

(d) immediately following the expiry of the period aforesaid; or

(e) in which it is paid or credited.

It is possible that due to circumstances beyond the control of the person in receipt of the income, any income invested or deposited in approved modes cannot be applied for the purpose for which it was accumulated or set apart. In such a case, an application may be made to the Assessing Officer specifying such other purposes as are in conformity with the objects of the trust. The Assessing Officer may allow the application of income to such

other purposes. If such a permission is granted by the Assessing Officer, the new purposes will be deemed to be purposes specified in the written notice given to the Assessing Officer.

It is to be noted that the Assessing Officer cannot allow transfer of any such accumulated income to other charitable trusts/institutions as application of income towards charitable purposes. This has created genuine problems for those trusts and institutions which are wound up. However, in case of a trust or institution which has invested or deposited its income in any of the forms mentioned in section 11(5), the Assessing Officer can allow application of such income for crediting or payment to any trust or institution registered under section 12AA or any fund or institution or trust or university or education institution or hospital or medical institution covered by section 10(23C). Such application can be allowed only in the year in which such trust or institution is dissolved.

(x) Cases where trust property consists of a business undertaking - Section 11(4) clarifies that for the purposes of section 11, property held under trust may consist of a business undertaking so held. If that be so, the trustees may claim that the income of such undertaking enjoys exemption under section 11. Section 11(4) provides for two things -

(1) The Assessing Officer shall have the power to determine the income of the undertaking in accordance with the provisions of the Act relating to assessment, and

(2) Where the income determined by the Assessing Officer is in excess of that shown in the books of the undertaking, such excess shall be deemed to be applied to purposes other than charitable or religious purposes and accordingly be deemed to be the income of the previous year in which it has been deemed to have been so applied.

(xi) Charitable trust engaged in business activity [Section 11(4A)] - Consequently, a charitable trust engaged in business activity will be liable to any tax on income from the activity. However, exemption would be available to the trust in respect of income earned from such business activity if –

(i) such business is incidental to the attainment of the objects of the trust/institution; and

(ii) separate books of account are maintained by such trust/institution in respect of such business.

Note – Profits derived by a trust/institution referred to in clauses (21), (23A), (23B), (23BB) and (23C) of section 10 will continue to be exempt from income-tax, since section 11(4A) does not override the provisions of section 10.

(xii) Instances where capital gains would be deemed to have been applied for charitable purposes [Section 11(1A)]

(a) Transfer of a capital asset held under trust wholly for charitable or religious purposes [Section 11(1A)(a)] - Where the whole of the net consideration from the transfer of the capital asset is utilised for acquiring a new capital asset which is held under trust wholly for charitable or religious purposes, the entire amount of capital gains arising from the transfer would be deemed to have been applied for charitable or religious purposes. If, however, only a part of the net consideration is utilised in acquiring the new capital asset, the amount of capital gains deemed to have been utilised for charitable or religious purposes shall be equal to the excess of the proceeds utilised over the cost of the asset transferred.

Example

Original cost of capital asset transferred	Rs.1,00,000
Consideration for which it is transferred	Rs.1,50,000
Situation 1 Cost of new capital asset acquired	Rs.1,50,000
Situation 2 Cost of new capital asset acquired	Rs.1,20,000

Amount that will be deemed to have been applied for charitable purposes.

Situation 1	Rs.50,000
Situation 2	Rs.20,000

(b) Transfer of a capital asset held under trust in part only for charitable and religious purposes [Section 11(1A)(b)] - Where only a part of a capital asset has been transferred, only the "appropriate fraction" of the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes. Where the whole of the net consideration is utilised in acquiring the new capital asset, the whole of the appropriate fraction of such capital gain will be deemed to have been so applied. In any other case, the exemption will be limited to so much of the appropriate fraction of the amount utilised for acquiring the new asset as exceeds the appropriate fraction of the cost of the transferred asset.

"Appropriate fraction" means the fraction which represents the extent to which the income derived from the capital asset transferred was applicable to charitable or religious purposes before such transfer.

Example: A capital asset is being held under trust. Two-thirds of the income derived from such capital asset are being utilised for the charitable purposes of the trust. The asset is being transferred.

Cost of transferred asset	Rs.1,20,000
Net consideration	Rs.1,80,000
Cost of new asset acquired	Rs.1,50,000
Capital gains	Rs. 60,000 [Rs.1,80,000 – Rs.1,20,000]
Appropriate fraction	2/3rd

Income represented by 'appropriate fraction' = 2/3rds of Rs.60,000 = Rs.40,000

Since the entire net consideration has not been utilised in acquiring the new asset, the amount deemed to have been utilised for charitable purpose will be (2/3rds of Rs.1,50,000) – (2/3rds of Rs.1,20,000) = Rs.1,00,000 – Rs.80,000 = Rs.20,000.

(xiii) Voluntary Contributions [Section 12] - Any voluntary contribution received by a trust created wholly for charitable or religious purposes or by an institution established wholly for such purposes shall for the purposes of section 11, be deemed to be income derived from property held under trust wholly for charitable or religious purposes. However, corpus donations (i.e. contributions made with a specific direction that they shall from part of the corpus of the trust or institution) shall not be treated as income. Such corpus donations are treated as capital receipts not chargeable to tax. Other voluntary contributions would be treated as income. However, exemption can be claimed in respect of such income subject to fulfillment of the conditions mentioned below –

(i) The trust should be registered under section 12AA with the Commissioner of Income-tax;

(ii) If the total income of the trust exceeds the basic exemption limit, the accounts of the trust should be audited.

(iii) The trust should apply at least 85% of its income for the approved purposes.

(iv) The balance should be invested or deposited in specified forms or modes.

Note – It may be noted that the corpus donations are to be considered for the purpose of determining whether the accounts of the trust are to be audited. Further, corpus donations have to be invested only in the investments approved under section 11(5). If invested elsewhere, the income from unapproved investment would be chargeable to tax.

(3) CONDITIONS FOR APPLICABILITY OF SECTIONS 11 & 12 [SECTION 12A]

(i) The exemption provisions contained in section 11 and 12 as explained above shall not apply in relation to the income of any trust or institution unless the following conditions are satisfied:

(a) A charitable or religious trust or institution is required to make an application for registration in the prescribed form and in the prescribed manner to the Commissioner. The trust should be registered under section 12AA. In such cases, the exemption provisions of section 11 and 12 would apply from the date of creation of the trust or establishment of the institution [Section 12A(1)].

This requirement of filing an application for registration under section 12A within one year of creation of the religious or charitable trust or institution has been removed. The application can be filed at any time now.

Accordingly, in respect of applications filed on or after 1st June, 2007, the provisions of sections 11 and 12 shall apply from the assessment year relevant to the financial year in which the application is made i.e. the exemption would be available only with effect from the assessment year relevant to the previous year in which the application is filed. It would not be available in respect of any earlier assessment year [Section 12A(2)].

(b) **Audit -** Where the total income of the trust without giving effect to the provisions of section 11 and 12 exceeds the maximum amount which is not chargeable to income-tax in any previous year, the accounts of the trust must be audited by a chartered accountant the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such prescribed particulars, should be furnished along with the return.

(ii) Procedure for Registration [Section 12AA] - Accordingly, the Commissioner, on receipt of an application for registration of a trust or institution made under section 12A(1) shall proceed as follows :

(a) He would call for such documents or information from the trust or institution as he thinks necessary in order to satisfy himself about the genuineness of activities of the trust or institution and may also make such enquiries as he may deem necessary in this behalf.

(b) After satisfying himself about the objects of the trust or institution and the genuineness of its activities, he shall pass an order in writing registering the trust or institution.

(c) If he is not satisfied, he shall pass an order in writing refusing to register the trust or institution.

(d) A copy of such an order issued under (b) or (c) above shall be sent to the applicant. However, an order under (c) shall not be passed unless the applicant has been given a reasonable opportunity of being heard.

(e) Every order granting or refusing registration shall be passed within six months from the end of the month in which the application for registration of trust or institution is received by the Commissioner.

(f) Where a trust or an institution has been granted registration and subsequently, if the Commissioner of Income-tax is satisfied that the activities of any trust or institution are not genuine or are not being carried out in accordance with the objects of the trust or institution, he can pass an order in writing canceling the registration granted under the said section. However, the trust or institution should be given a reasonable opportunity of being heard.

(g) Any order passed by the Commissioner of Income-tax under section 12AA refusing registration is appealable under section 253 to the Income-tax Appellate Tribunal.

(4) DENIAL OF EXEMPTION [SECTION 13]

(i) The following incomes of charitable or religious trusts and institutions would not be eligible for exemption under sections 11 and 12:

(a) Where the property is held under a trust for private religious purposes, no part of the income will be exempt if it does not enure for the benefit of the public [Section 13(1)(a)].

(b) Where a trust has been established for the benefit of any particular religious community or caste, the income thereof will not be eligible for exemption. However, a trust or institution created or established for the benefit of scheduled caste, backward classes, scheduled tribes or women and children shall not be treated as a tust or institution created or established for the benefit of a religious community or caste within the meaning of section 13(1)(b).

(c) Where the trust or the institution has been created or established after 31.3.1962, if any part of its income enures directly or indirectly for the benefit of any person referred to in section 13(3) [Section 13(1)(c)].

(d) Irrespective of the date of the creation of the trust or the establishment of the institution, if any part of its income or any property belonging to it during the relevant previous year is used or applied directly or indirectly for the benefit of any person referred to in section 13(3) [Section 13(1)(c)].

(e) Any income of a trust or institution, if –

(i) its funds are invested or deposited otherwise than in the forms or modes specified in section 11(5);

(ii) it holds shares in a company other than -

(1) a public sector company; or

(2) shares prescribed as a form or mode of investment under section 11(5)(xii).

However, these restrictions do not apply in respect of :

(i) any assets forming part of the trust as on 1-6-1973.

(ii) Any accretion to the corpus shares by way of bonus shares allotted to the trust.

(iii) debentures issued by or on behalf of any company or corporation and acquired by the trust before March 1, 1983.

(iv) any asset not covered under section 11(5), where such asset is held for not more than one year from the end of the previous year in which such asset is acquired.

(v) any funds representing the profits and gains of business, being profits and gains of any previous year relevant to the assessment year 1984-85 or any subsequent assessment year. However, such relaxation of the restriction will be denied unless the trust keeps separate accounts for the business. As already noted, subject to certain exceptions, such business profits are no longer eligible for exemption under section 11.

(ii) Prohibited use or application - We have noted above that when any part of the income or any property of the trust whenever created, is, during the previous year, used or applied directly, for the benefit of any person referred to in section 13(3), the denial of exemption operates. Section 13(2) specifies a few particular instances where the income or the property is to be deemed to have been used for the benefit of a person referred to in section 13(3). It should be noted that those particular instances do not in any way restrict the general meaning of the expression "used or applied for the benefit of a person". The provisions of section 13(2) are as follows:

The income or the property of the trust or institution or any part of such income or property is to be deemed to have been used or applied for the benefit of a person referred to in section 13(3) in the following cases:

(a) Loan without adequate interest or adequate security - If any part of the income or the property of the trust or institution is or continues to be lent to any person referred to in section 13(3) for any period during the previous year without either adequate security or adequate interest or both.

(b) Allowing use of property without adequate rent - If any land, building or other property of the trust or institution is or continues to be, made available, for the use of any person referred to in section 13(3) for any period during the previous year without charging adequate rent or other compensation.

(c) **Excess payment for services -** If any amount is paid out of the resources of the trust or institution to any of the persons referred to in section 13(3) for services rendered to the trust or institution but such amount is in excess of a reasonable sum payable for such services.

(d) **Inadequate remuneration for services rendered -** If the services of the trust or institution are made available to any person referred to section 13(3) without adequate remuneration or other compensation.

(e) **Excess payment for purchase of property -** If any share, security or other property is purchased by or on behalf of the trust or institution from any person referred to in section 13(3) during the previous year for a consideration which is more than adequate.

(f) **Inadequate consideration for property sold -** If any share, security or other property is sold by or on behalf of the trust or institution to any person referred to in section 13(3) during the previous year for a consideration which is less than adequate.

(g) **Diversion of income or property exceeding Rs.1,000 -** If any income or property of the trust or institution is diverted during the previous year in favour of any person referred to in section 13(3) provided the aggregate value of such income and property diverted exceeds Rs.1,000.

(h) **Investment in substantial interest concerns -** If any funds of the trust or institution are, or continue to remain, invested for any period during the previous year in any concern in which any person referred to in section 13(3) has a substantial interest.

Section 13(4) provides some respite where the aggregate of the funds invested in the said concern does not exceed five per cent of the capital of that concern. In such a case, the exemption under section 11 will be denied only in relation to such income as arises out of the said investment.

(iii) Exemption not to be denied to charitable trusts providing educational or medical facilities to specified persons [Section 13(6)]

A charitable or religious trust running an educational institution or a medical institution or a hospital shall not be denied the benefit of exemption under section 11 merely due to the reason that the benefit of educational or medical facilities have been provided to the specified persons referred to in section 13(3). However, the value of such facilities provided to such specified persons either free of cost or at a concessional rate would be deemed to be the income of the trust. Such income would not be eligible for exemption under section 11.

(iv) Anonymous donations [Section 13(7)]

The exemption provisions contained in section 11 or section 12 shall not be applicable in

respect of any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of that section. For example, section 11(1)(d) of the Act provides that any income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the total income of such trust/institution for the relevant previous year. However, if a trust or institution established wholly for charitable purposes receives an anonymous donation with a specific direction that the donation shall form part of the corpus of the trust or institution, such anonymous donation would not be exempt by virtue of section 11(1)(d). It would be taxable at 30% as provided in section 115BBC.

(v) Prohibited category of persons - Section 13(3) gives the list of persons, use or application of the income or property of a trust for whose direct or indirect benefit results in a denial of the exemption contemplated in section 11 for a charitable or religious trust or institution. The said persons are:

(1) The author of the trust or the founder of the institution.

(2) Any person who has made a substantial contribution to the trust or institution, that is, any person whose total contribution up to the end of the relevant previous year exceeds Rs.50,000.

(3) Where the author, founder or the person making a substantial contribution is a HUF, any member of the family.

(4) Any trustee of the trust or manager (by whatever name called) of the institution.

(5) Any relative of any such author, founder, person, member, trustee or manager as referred to above.

(6) Any concern in which any of the persons referred to in clauses (1) to (5) above has a substantial interest.

Relative - The expression "relative", in relation to an individual, means -

(a) spouse of the individual;

(b) brother or sister of the individual;

(c) brother or sister of the spouse of the individual;

(d) any lineal ascendant or descendant of the individual;

(e) any lineal ascendant or descendant of the spouse of the individual;

(f) spouse of a person referred to in (b), (c), (d) or (e) above;

(g) any lineal descendant of a brother or sister of either the individual or the spouse of the individual;

Substantial interest in a concern - Section 13(2)(h), section 13(3) and section 13(4) refers to cases where a person has a substantial interest in a concern. These references occur where the "Prohibited use or application" and "Prohibited category of persons" have been described. The circumstances, in which a person shall be deemed to have a substantial interest in a concern, have been laid down in Explanation 3 to section 13. Accordingly, a person shall be deemed to have a substantial interest in a concern -

(i) Where the concern is a company, if its shares, other than preference shares, carrying not less than 20 per cent of the voting power are, at any time during the previous year, owned beneficially by him alone or partly by him and partly by one or more of the other persons referred to in section 13(3).

(ii) When the concern is not a company, if he is entitled or he and one or more of the other persons referred to in section 13(3) are entitled in the aggregate, at any time during the previous year, to not less than 20 per cent of the profits of such concern.

(5) ANONYMOUS DONATIONS RECEIVED BY CHARITABLE TRUSTS/INSTITUTIONS TO BE SUBJECT TO TAX [SECTION 115BBC]

(i) As per the provisions of the Income-tax Act, 1961, tax exemption under section 10(23C) and section 11 are available to certain entities, as briefed in the table below, on fulfillment of the conditions prescribed under the relevant sections –

Entity	Applicable section
Charitable or religious trusts/institutions	11
Universities and other educational institutions	10(23C)(iiiad) and (vi)
Hospitals and other medical institutions	10(23C) (iiiae) and (via)
Notified funds or institutions established for charitable purposes	10(23C)(iv)
Notified trusts or institutions established wholly for public religious purposes or wholly for public religious and charitable purposes	10(23C)(v)

(ii) Section 115BBC has been inserted to tax anonymous donations received by the above entities at 30%.

(*iii*) *In order to provide relief to these trusts and institutions and to reduce their compliance burden, an exemption limit has been introduced, and only the anonymous donations in excess of this limit would be subject to tax@30% under section 115BBC.*

(iv) The exemption limit is the higher of the following–

(1) 5% of the total donations received by the assessee; or

(2) Rs.1 lakh.

(v) The total tax payable by such institutions would be –

(1) tax@30% on anonymous donations exceeding the exemption limit as calculated above; and

(2) tax on the balance income i.e. total income as reduced by the aggregate of anonymous donations received.

(v) The following table illustrates the calculation of anonymous donations liable to tax @30% under section 115BBC –

Situation	*Total donations during the year (Rs.)*	*Anonymous donations received during the year (Rs.)*	*Exemption (Rs.)*	*Anonymous donations taxable@30% (Rs.)*
1	*15,00,000*	*4,00,000*	*1,00,000*	*3,00,000*
2	*30,00,000*	*7,00,000*	*1,50,000*	*5,50,000*
3	*40,00,000*	*10,00,000*	*2,00,000*	*8,00,000*

(vi) For this purpose, "anonymous donation" means any voluntary contribution referred to in section 2(24)(iia), where the person receiving such contribution does not maintain a record of the identity indicating the name and address of the person making such contribution and such other particulars as may be prescribed.

(vii) However, the above provision does not apply to a trust or institution created or established wholly for religious purposes.

(viii) Further, anonymous donations to trusts/institutions created or established wholly for religious and charitable purposes (i.e. partly charitable and partly religious institutions/trusts) would be taxed only if such anonymous donation is made with a specific direction that such donation is for any university or other educational institution or any hospital or other medical institution run by such trust or institution. Other anonymous donations received by such trusts/institutions are not taxable.

(ix) Section 13(7) provides that the exemption provisions contained in section 11 or

section 12 shall not be applicable in respect of any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of that section.

(x) For example, section 11(1)(d) of the Act provides that any income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the total income of such trust/institution for the relevant previous year. However, if a trust or institution established wholly for charitable purposes receives an anonymous donation with a specific direction that the donation shall form part of the corpus of the trust or institution, such anonymous donation would not be exempt by virtue of section 11(1)(d). It would be taxable at 30% as provided in section 115BBC.

(xi) Similarly, section 10(23C) provides that any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of the said section shall be included in the total income. The amendments to section 10(23C) and 13 are consequential amendments to provide that any income by way of any anonymous donation which is taxable under the provisions of section 115BBC shall not be excluded from the total income of the trust or institution.

(6) TAX EXEMPTION TO POLITICAL PARTIES

Section 13A of the Income-tax Act grants exemption from tax to political parties in respect of their income specified below:

(i) Income from house property;

(ii) Income from other sources;

(iii) Capital gains; and

(iv) Income by way of voluntary contributions received by the political parties from any person.

The aforesaid categories of income would qualify for exemption without any monetary or other limit and the income so exempted would not even be includible in the total income of the political party for the purpose of assessment. The tax exemption will be applicable only if the following conditions are fulfilled:

(i) The political party must keep and maintain such books and other documents as would enable the Assessing Officer to properly deduce the income of the political party from those accounts.

(ii) The political party must keep and maintain records in `respect of each such voluntary

contribution which is in excess of Rs.20,000 giving details of the amount received, the name and address of the person who has made the contribution, the date of receipt and such other details as may be relevant or appropriate. However, this does not mean that the political party need not disclose smaller contributions in its accounts which are maintained by it. The obligation to maintain proper record of voluntary contribution in excess of Rs.20,000 is over and above the obligation to maintain proper records and books of accounts in respect of all the income and expenses of the party.

(iii) The accounts of the political party must be audited by a Chartered Accountant.

(iv) A report under section 29C(3) of the Representation of People Act, 1951 has to be submitted by the treasurer of such political party or any other person authorised by the political party in this behalf for every financial year. If there is a failure to submit the above report, no exemption under this section shall be available for the political party for that financial year.

For the purposes of this section, "political party" means a political party registered under section 29A of the Representation of the People Act, 1951.

(7) EXEMPTION FOR VOLUNTARY CONTRIBUTIONS RECEIVED BY ELECTORAL TRUSTS [SECTION 13B]

(i) Any voluntary contribution received by an electoral trust (as may be approved by the CBDT in accordance with the scheme to be made by the Central Government) shall be treated as its income under section 2(24), but shall be exempt under new section 13B, if the trust distributes to a registered political party during the year, 95% of the aggregate donations received by it during the year along with the surplus if any, brought forward from any earlier previous year.

(ii) Another condition for availing the benefit under this section is that the electoral trust should function in accordance with the rules made by the Central Government.

Self-examination questions

1. The maximum ceiling limit for exemption under section 10(10) in respect of gratuity for employees covered by the Payment of Gratuity Act, 1972 is -
   a) 3,00,000
   b) 3,50,000
   c) 5,00,000

2. The maximum ceiling limit for exemption under section 10(10C) with respect to compensation received on voluntary retirement is -

   a) 3,00,000

   b) 3,50,000

   c) 5,00,000

3. The HRA paid to an employee residing in Patna is exempt up to the lower of actual HRA, excess of rent paid over 10% of salary and -

   a) 40% of salary

   b) 50% of salary

   c) 60% of salary

4. Anirudh stays in New Delhi. His basic salary is Rs.10,000 p.m., D.A. (60% of which forms part of pay) is 6,000 p.m., HRA is Rs.5,000 p.m. and he is entitled to a commission of 1% on the turnover achieved by him. Anirudh pays a rent of Rs.5,500 p.m. The turnover achieved by him during the current year is 12 lakhs. The amount of HRA exempt under section 10(13A) is –

   a) Rs.48,480

   b) Rs.45,600

   c) Rs.49,680

5. In case of a trade union registered under the Trade Unions Act, 1926 formed for regulating relations between workmen and employers or between workmen and workmen, the following incomes are exempt from tax -

   a) Capital gains and Income from other sources.

   b) Income from house property and capital gains.

   c) Income from house property and income from other sources.

6. Voluntary contributions received by electoral trusts during the P.Y.2009-10 is -

   a) Fully taxable

   b) Fully exempt from tax

   c) Exempt only if the trust distributes to a registered political party during the year, 95% of the aggregate donations received by it

7. The income derived from property held under trust wholly for charitable or religious purpose is exempt from tax under section 11 subject to fulfillment of certain conditions. One of the conditions is that -

a) At least 75% of the income is required to be applied for the approved purposes.

b) At least 85% of the income is required to be applied for the approved purposes.

c) The entire income is required to be applied for the approved purposes.

8. Income by way of voluntary contributions of political parties is exempt provided -

a) the political party keeps and maintains a record of each such voluntary contribution in excess of Rs.10,000 and of the name and address of the person who made such contribution;

b) the political party keeps and maintains a record of each such voluntary contribution in excess of Rs.20,000 and of the name and address of the person who made such contribution;

c) the political party keeps and maintains a record of each such voluntary contribution in excess of Rs.30,000 and of the name and address of the person who made such contribution;

9. For an employee in receipt of hostel expenditure allowance for his three children, the maximum annual allowance exempt under section 10(14) is

a) Rs.10,800

b) Rs.7,200

c) Rs.3,600.

10. The Income-tax Act grants exemption from tax to political parties in respect of their income. State the incomes so exempted as per the provisions of the Act.

11. Explain the meaning of the following terms in the context of section 10AA inserted by the Special Economic Zones Act, 2005 -

(a) Export;

(b) Export turnover;

(c) Manufacture.

12. Is benefit of deduction under section 10B available to undertakings set up in domestic tariff area (DTA) subsequently approved as a 100% export oriented undertaking (100% EOU)? If yes, from which year and for what period is such deduction available?

13. (a) Discuss the exemption available under the Income-tax Act in respect of specified income arising from any international sporting event in India.

(b) What are the exemptions available under section 10 in respect of companies engaged in the business of generation or transmission or distribution of power

and subsidiaries of such companies? What are the conditions to be fulfilled to avail such exemptions?

14. Explain about aggregation of agricultural income for rate purposes. How will income-tax be computed where an individual derives agricultural as well as non-agricultural income?

15. When can a charitable trust avail benefits under section 11 & 12 of the Income-tax Act, 1961?

Answers

1. b; **2.** c; **3.** a; **4.** a; **5.** c; **6.** c; **7.** b; **8.** b; **9.** b

CHAPTER 4

HEADS OF INCOME

UNIT-1 : INCOME FROM SALARIES

Learning objectives

After reading this unit, you will be able to understand:

- when the salary income is chargeable to tax
- the concept of profits in lieu of salary
- the various retirement benefits which will be charged as salary
- the concepts of allowances and perquisites
- the admissible deductions from salary

1.1 SALARY

The meaning of the term 'salary' for purposes of income tax is much wider than what is normally understood. Every payment made by an employer to his employee for service rendered would be chargeable to tax as income from salaries. The term 'salary' for the purposes of Income-tax Act will include both monetary payments (e.g. basic salary, bonus, commission, allowances etc.) as well as non-monetary facilities (e.g. housing accommodation, medical facility, interest free loans etc).

(1) Employer-employee relationship : Before an income can become chargeable under the head 'salaries', it is vital that there should exist between the payer and the payee, the relationship of an employer and an employee. Consider the following examples:

(a) Sujatha, an actress, is employed in Chopra Films, where she is paid a monthly remuneration of Rs.2 lakh. She acts in various films produced by various producers. The remuneration for acting in such films is directly paid to Chopra Films by the different producers. In this case, Rs.2 lakh will constitute salary in the hands of Sujatha, since the relationship of employer and employee exists between Chopra Films and Sujatha.

(b) In the above example, if Sujatha acts in various films and gets fees from different

producers, the same income will be chargeable as income from profession since the relationship of employer and employee does not exist between Sujatha and the film producers.

(c) Commission received by a Director from a company is salary if the Director is an employee of the company. If, however, the Director is not an employee of the company, the said commission cannot be charged as salary but has to be charged either as income from business or as income from other sources depending upon the facts.

(d) Salary paid to a partner by a firm is nothing but an appropriation of profits. Any salary, bonus, commission or remuneration by whatever name called due to or received by partner of a firm shall not be regarded as salary. The same is to be charged as income from profits and gains of business or profession. This is primarily because the relationship between the firm and its partners is not that of an employer and employee.

(2) Full-time or part-time employment: It does not matter whether the employee is a full-time employee or a part-time one. Once the relationship of employer and employee exists, the income is to be charged under the head "salaries". If, for example, an employee works with more than one employer, salaries received from all the employers should be clubbed and brought to charge for the relevant previous years.

(3) Foregoing of salary: Once salary accrues, the subsequent waiver by the employee does not absolve him from liability to income-tax. Such waiver is only an application and hence, chargeable to tax.

Example: Mr. A, an employee instructs his employer that he is not interested in receiving the salary for April 2009 and the same might be donated to a charitable institution. In this case, Mr. A cannot claim that he cannot be charged in respect of the salary for April 2009. It is only due to his instruction that the donation was made to a charitable institution by his employer. It is only an application of income. Hence, the salary for the month of April 2009 will be taxable in the hands of Mr. A. He is however, entitled to claim a deduction under section 80G for the amount donated to the institution. [The concept of deductions is explained in detail in Chapter 7].

(4) Surrender of salary: However, if an employee surrenders his salary to the Central Government under section 2 of the Voluntary Surrender of Salaries (Exemption from Taxation) Act, 1961, the salary so surrendered would be exempt while computing his taxable income.

(5) Salary paid tax-free: This, in other words, means that the employer bears the burden of the tax on the salary of the employee. In such a case, the income from salaries in the hands of the employee will consist of his salary income and also the tax on this salary paid by the employer.

1.2 DEFINITION OF SALARY

The term 'salary' has been defined differently for different purposes in the Act. The definition as to what constitutes salary is very wide. As already discussed earlier, it is an inclusive definition and includes monetary as well as non-monetary items. There are different definitions of 'salary' say for calculating exemption in respect of gratuity, house rent allowance etc.

'Salary' under section 17(1), includes the following:

(i) wages,

(ii) any annuity or pension,

(iii) any gratuity,

(iv) any fees, commission, perquisite or profits in lieu of or in addition to any salary or wages,

(v) any advance of salary,

(vi) any payment received in respect of any period of leave not availed by him i.e. leave salary or leave encashment,

(vii) the portion of the annual accretion in any previous year to the balance at the credit of an employee participating in a recognised provident fund to the extent it is taxable and

(viii) transferred balance in recognized provident fund to the extent it is taxable,

(ix) the contribution made by the Central Government or any other employer in the previous year to the account of an employee under a pension scheme referred to in section 80CCD.

1.3 BASIS OF CHARGE

1. Section 15 deals with the basis of charge. Salary is chargeable to tax either on 'due' basis or on 'receipt' basis whichever is earlier.

2. However, where any salary, paid in advance, is assessed in the year of payment, it cannot be subsequently brought to tax in the year in which it becomes due.

3. If the salary paid in arrears has already been assessed on due basis, the same cannot be taxed again when it is paid.

Examples:

i. If A draws his salary in advance for the month of April 2010 in the month of March 2010 itself, the same becomes chargeable on **receipt basis** and is to be assessed as income of

the P.Y.2009-10 i.e., A.Y.2010-11. However, the salary for the A.Y.2011-12 will not include that of April 2010.

ii. If the salary due for March 2010 is received by A later in the month of April 2010 only, it is still chargeable as income of the P.Y.2009-10 i.e. A.Y.2010-11 on **due basis.** Obviously, salary for the A.Y.2011-12 will not include that of March 2010.

1.4 PLACE OF ACCRUAL OF SALARY

Under section 9(1)(ii), salary earned in India is deemed to accrue or arise in India even if it is paid outside India or it is paid or payable after the contract of employment in India comes to an end.

Example: If an employee gets pension paid abroad in respect of services rendered in India, the same will be deemed to accrue in India. Similarly, leave salary paid abroad in respect of leave earned in India is deemed to accrue or arise in India.

Suppose, for example, A, a citizen of India is posted in the United States as our Ambassador. Obviously, he renders his services outside India. He also receives his salary outside India. He is also a non-resident. The question, therefore, arises whether he can claim exemption in respect of his salary paid by the Government of India to him outside India. Under general principles of income tax such salary cannot be charged in his hands. For this purpose, section 9(1)(iii) provides that salaries payable by the Government to a citizen of India for services outside India shall be deemed to accrue or arise in India. However, by virtue of section 10(7), any allowance or perquisites paid or allowed outside India by the Government to a citizen of India for rendering services outside India will be fully exempt.

1.5 PROFITS IN LIEU OF SALARY

It includes the following:

(i) The amount of any compensation due to or received by an assessee from his employer or former employer at or in connection with the termination of his employment.

(ii) The amount of any compensation due to or received by an assessee from his employer or former employer at or in connection with the modification of the terms and conditions of employment. Usually, such compensation is treated as a capital receipt. However, by virtue of this provision, the same is treated as a revenue receipt and is chargeable as salary.

Note: It is to be noted that merely because a payment is made by an employer to a person who is his employee does not automatically fall within the scope of the above provisions. The payment must be arising due to master-servant relationship between the

payer and the payee. If it is not on that account, but due to considerations totally unconnected with employment, such payment is not profit in lieu of salary.

Example: A was an employee in a company in Pakistan. At the time of partition, he migrated to India. He suffered loss of personal movable property in Pakistan due to partition. He applied to his employer for compensating him for such loss. Certain payments were given to him as compensation. It was held that such payments should not be taxed as 'profit in lieu of salary' - *Lachman Dass Vs. CIT [1980] 124 ITR 706 (Delhi).*

(iii) Any payment due to or received by an assessee from his employer or former employer from an unrecognised provident fund or from an unrecognized superannuation fund to the extent to which it does not consist of employee's contributions or interest on such contributions.

Example: If any sum is paid to an employee from an unrecognised provident fund it is to be dealt with as follows :

(a) that part of the sum which represents the employer's contribution to the fund and interest thereon is taxable under salaries.

(b) that part of the sum which represents employee's contribution and interest thereon is not chargeable to tax since the same have already been taxed under the head 'salaries' and 'other sources' respectively on an yearly basis.

Note: It does not include exempt payments from superannuation fund, gratuity, commuted pension, retrenchment compensation, HRA.

(iv) Any payment due to or received by an assessee under a Keyman Insurance policy including the sum allocated by way of bonus on such policy.

(v) Any amount, whether in lumpsum or otherwise, due to the assessee or received by him, from any person -

(a) before joining employment with that person, or

(b) after cessation of his employment with that person.

(vi) Any other sum received by the employee from the employer.

For a better and simpler understanding, this chapter has been discussed under three broad categories: Payments, Allowances and Perquisites.

1.6 ADVANCE SALARY

Advance salary is taxable when it is received by the employee irrespective of the fact whether it is due or not. It may so happen that when advance salary is included and charged in a particular previous year, the rate of tax at which the employee is assessed may be higher than

the normal rate of tax to which he would have been assessed. Section 89(1) provides for relief in these types of cases. [The concept of relief under section 89(1) is explained in para 1.23 of this Chapter].

1.7 LOAN OR ADVANCE AGAINST SALARY

Loan is different from salary. When an employee takes a loan from his employer, which is repayable in certain specified installments, the loan amount cannot be brought to tax as salary of the employee.

Similarly, advance against salary is different from advance salary. It is an advance taken by the employee from his employer. This advance is generally adjusted with his salary over a specified time period. It cannot be taxed as salary.

1.8 SALARY ARREARS

Normally speaking, salary arrears must be charged on due basis. However, there are circumstances when it may not be possible to bring the same to charge on due basis. For example if the Pay Commission is appointed by the Central Government and it recommends revision of salaries of employees, the arrears received in that connection will be charged on receipt basis. Here, also relief under section 89(1) is available.

1.9 ANNUITY

1. As per the definition, 'annuity' is treated as salary. Annuity is a sum payable in respect of a particular year. It is a yearly grant. If a person invests some money entitling him to series of equal annual sums, such annual sums are annuities in the hands of the investor.
2. Annuity received by a present employer is to be taxed as salary. It does not matter whether it is paid in pursuance of a contractual obligation or voluntarily.
3. Annuity received from a past employer is taxable as profit in lieu of salary.
4. Annuity received from person other than an employer is taxable as "income from other sources".

1.10 GRATUITY [SECTION 10(10)]

Gratuity is a voluntary payment made by an employer in appreciation of services rendered by the employee. Now-a-days gratuity has become a normal payment applicable to all employees. In fact, Payment of Gratuity Act, 1972 is a statutory recognition of the concept of gratuity. Almost all employers enter into an agreement with employees to pay gratuity. For details refer to Chapter 3.

1.11 PENSION

Concise Oxford Dictionary defines 'pension' as a periodic payment made especially by Government or a company or other employers to the employee in consideration of past service payable after his retirement.

Commuted pension: Commutation means inter-change. Many persons convert their future right to receive pension into a lumpsum amount receivable immediately. For example, suppose a person is entitled to receive a pension of say Rs.2000 p.m. for the rest of his life. He may commute ¼th i.e. 25% of this amount and get a lumpsum of say Rs.30,000. After commutation, his pension will now be the balance 75% of Rs.2,000 p.m. = Rs.1,500 p.m.

For details refer to Chapter 3.

1.12 LEAVE SALARY [SECTION 10(10AA)]

For details refer to Chapter 3.

1.13 RETRENCHMENT COMPENSATION [SECTION 10(10B)]

For details refer to Chapter 3.

1.14 COMPENSATION RECEIVED ON VOLUNTARY RETIREMENT [SECTION 10(10C)]

Any compensation received by an employee of a public sector company or of any other company or other specified bodies at the time of his voluntary retirement or termination of his service is exempt upto a maximum limit of Rs.5,00,000. However, such payment should be in accordance with a scheme of voluntary retirement or in the case of a public sector company, a scheme of voluntary separation. Such schemes should be in accordance with prescribed guidelines. These guidelines may include economic viability as one of the criteria.

For details refer to Chapter 3.

1.15 PROVIDENT FUND

Provident fund scheme is a scheme intended to give substantial benefits to an employee at the time of his retirement. Under this scheme, a specified sum is deducted from the salary of the employee as his contribution towards the fund. The employer also generally contributes the same amount out of his pocket, to the fund. The contribution of the employer and the employee are invested in approved securities. Interest earned thereon is also credited to the account of the employee. Thus, the credit balance in a provident fund account of an employee consists of the following:

(i) employee's contribution

(ii) interest on employee's contribution

(iii) employer's contribution

(iv) interest on employer's contribution.

The accumulated balance is paid to the employee at the time of his retirement or resignation. In the case of death of the employee, the same is paid to his legal heirs.

The provident fund represents an important source of small savings available to the Government. Hence, the Income-tax Act gives certain *deductions* on savings in a provident fund account.

There are four types of provident funds :

(i) Statutory Provident Fund (SPF)

(ii) Recognised Provident Fund (RPF)

(iii) Unrecognised Provident Fund (UPF)

(iv) Public Provident Fund (PPF)

The tax treatment is given below:

Particulars	Recognized PF	Unrecognized PF	Statutory PF	Public PF
Employer's Contribution	Amount in excess of 12% of salary is taxable	Not taxable yearly	Fully exempt	Not applicable as there is only assessee's own contribution
Employee's Contribution	Eligible for deduction u/s 80C	Not eligible for deduction	Eligible for deduction u/s 80C	Eligible for deduction u/s 80C
Interest Credited	Amount in excess of 9.5% p.a. is taxable	Not taxable yearly	Fully exempt	Fully exempt
Amount received on retirement, etc.	See Note (1)	See Note (3)	Fully exempt u/s 10(11).	Fully exempt u/s 10(11)

Notes:

(1) Amount received on the maturity of RPF is fully exempt in case of an employee who has rendered continuous service for a period of 5 years or more. In case the maturity of RPF takes place within 5 years then the amount received would be fully exempt only if the

service had been terminated due to employee's ill-health or discontinuance or contraction of employer's business or other reason beyond control of the employee. In any other case, the amount received will be taxable in the same manner as that of an URPF.

(2) If, after termination of his employment with one employer, the employee obtains employment under another employer, then, only so much of the accumulated balance in his provident fund account will be exempt which is transferred to his individual account in a recognised provident fund maintained by the new employer. In such a case, for exemption of payment of accumulated balance by the new employer, the period of service with the former employer shall also be taken into account for computing the period of five years' continuous service.

(3) Employee's contribution is not taxable but interest thereon is taxable under 'Income from Other Sources'. Employer's contribution and interest thereon is taxed as Salary.

(4) Salary for this purpose means basic salary and dearness allowance - if provided in the terms of employment for retirement benefits and commission as a percentage of turnover.

(1) Statutory Provident Fund (SPF): The SPF is governed by Provident Funds Act, 1925. It applies to employees of government, railways, semi-government institutions, local bodies, universities and all recognised educational institutions. Under the Income-tax Act, the rules governing the SPF are as follows:

(2) Recognised Provident Fund (RPF): Recognised provident fund means a provident fund recognised by the Commissioner of Income-tax for the purposes of income-tax. It is governed by Part A of Schedule IV to the Income-tax Act. This schedule contains various rules regarding the following:

(a) Recognition of the fund

(b) Employee's and employer's contribution to the fund

(c) Treatment of accumulated balance etc.

A fund constituted under the Employees's Provident Fund and Miscellaneous Provisions Act, 1952 will also be a Recognised Provident Fund.

(3) Unrecognised Provident Fund (URPF): A fund not recognised by the Commissioner of Income-tax is Unrecognised Provident Fund.

(4) Public Provident Fund (PPF): Public provident fund is operated under the Public Provident Fund Act, 1968. A membership of the fund is open to every individual though it is ideally suited to self-employed people. A salaried employee may also contribute to PPF in

addition to the fund operated by his employer. An individual may contribute to the fund on his own behalf as also on behalf of a minor of whom he is the guardian.

For getting a deduction under section 80C, a member is required to contribute to the PPF a minimum of Rs.500 in a year. A maximum amount that may qualify for deduction on this account is Rs.70,000 as per PPF rules.

A member of PPF may deposit his contribution in as many installments in multiples of Rs.500 as is convenient to him. The sums contributed to PPF earn interest at 8%. The amount of contribution may be paid at any of the offices or branch offices of the State Bank of India or its subsidiaries and specified branches of Nationalised Banks or any Head Post Office.

Illustration 1

Mr. A retires from service on December 31, 2009, after 25 years of service. Following are the particulars of his income/investments for the previous year 2009-10:

Particulars	**Rs.**
Basic pay @ Rs.16,000 per month for 9 months	1,44,000
Dearness pay (50% forms part of the retirement benefits) Rs.8,000 per month for 9 months	72,000
Lumpsum payment received from the Unrecognised Provident Fund	6,00,000
Deposits in the PPF account	40,000

Out of the amount received from the provident fund, the employer's share was Rs.2,20,000 and the interest thereon Rs.50,000. The employee's share was Rs.2,70,000 and the interest thereon Rs.60,000.

What is the taxable portion of the amount received from the unrecognized provident fund in the hands of Mr. A for the assessment year 2010-11?

Solution

Taxable portion of the amount received from the URPF in the hands of Mr. A for the AY. 2010-11 is computed hereunder:

Amount taxable under the head "Salaries":

Employer's share in the payment received from the Unrecognized Provident Fund	Rs.2,20,000
Interest on the employer's share	Rs. 50,000
Total	Rs.2,70,000

Amount taxable under the head "Income from Other Sources" :

Interest on the employee's share	Rs. 60,000
Total amount taxable from the amount received from the fund	Rs.3,30,000

Note: Since the employee is not eligible for deduction under section 80C for contribution to URPF at the time of such contribution, the employee's share received from the URPF is not taxable at the time of withdrawal as this amount has already been taxed as his salary income.

Illustration 2

Will your answer be any different if the fund mentioned above was a recognised provident fund?

Solution

Since the fund is a recognised one, and the maturity is taking place after a service of 25 years, the entire amount received on the maturity of the RPF will be fully exempt from tax.

Illustration 3

Mr. B is working in XYZ Ltd. and has given the details of his income for the P.Y. 2009-10. You are required to compute his gross salary from the details given below:

Basic Salary	Rs.10,000 p.m.
D.A. (50% is for retirement benefits)	Rs.8,000 p.m.
Commission as a percentage of turnover	1%
Turnover during the year	Rs.5,00,000
Bonus	Rs.40,000
Gratuity	Rs.25,000
His own contribution in the RPF	Rs.20,000
Employer's contribution to RPF	20% of his basic salary
Interest accrued in the RPF @ 13% p.a.	Rs.13,000

Solution

Computation of Gross Salary of Mr. B for the A.Y.2010-11

Particulars	Rs.	Rs.
Basic Salary [Rs.10,000 × 12]		1,20,000
Dearness Allowance [Rs.8,000 × 12]		96,000

Commission on turnover [1% × Rs.5,00,000]		5,000
Bonus		40,000
Gratuity [Note 1]		25,000
Employee's contribution to RPF [Note 2]		-
Employers contribution to RPF [20% of Rs.1,20,000]	24,000	
Less : Exempt [Note 3]	20,760	3,240
Interest accrued in the RPF @ 13% p.a.	13,000	
Less : Exempt @ 9.5% p.a.	9,500	3,500
Gross Salary		**2,92,740**

Note 1 : Gratuity received during service is fully taxable.

Note 2 : Employee's contribution to RPF is not taxable. It is eligible for deduction under section 80C.

Note 3 : Employers contribution in the RPF is exempt up to 12% of the salary.

i.e. 12% of [B.S + D.A. for retirement benefits + Commission based on turnover]

= 12% of [Rs.1,20,000 + (50% × Rs.96,000) + Rs.5,000]

= 12% of Rs.1,73,000

= Rs.20,760

1.16 APPROVED SUPERANNUATION FUND

It means a superannuation fund which has been and continues to be approved by the Commissioner in accordance with the rules contained in Part B of the VIth Schedule to the Income-tax Act.

The tax treatment of contribution and exemption of payment from tax are as follows:

(i) Employer's contribution is exempt from tax in the hands of employee but taxable in the hands of the employer (only in respect of such contribution exceeding Rs.1,00,000 per employee per annum) under the provisions of fringe benefit tax;

(ii) Employee's contribution qualifies for deduction under section 80C;

(iii) Interest on accumulated balance is exempt from tax.

Section 10(13) grants exemption in respect of payment from the fund—

(a) to the legal heirs on the death of beneficiary (e.g. payment to widow of the beneficiary) or

(b) to an employee in lieu of or in commutation of an annuity on his retirement at or after the specified age or on his becoming incapacitated prior to such retirement, or

(c) by way of refund of contribution on the death of the beneficiary or,

(d) by way of refund of contribution to an employee on his leaving the service in connection with which the fund is established otherwise than in the circumstances mentioned in (b), to the extent to which such payment does not exceed the contribution made prior to April 1, 1962. For example, where the amount received by an employee does not include any contribution made prior to 1-4-62, the whole amount is taxable.

1.17 SALARY FROM UNITED NATIONS ORGANISATION

Section 2 of the United Nations (Privileges and Immunities) Act, 1947 grants exemption from income-tax to salaries and emoluments paid by the United Nations to its officials. Besides salary, any pension covered under the United Nations (Privileges and Immunities) Act and received from UNO is also exempt from tax.

1.18 ALLOWANCES

Different types of allowances are given to employees by their employers. Generally allowances are given to employees to meet some particular requirements like house rent, expenses on uniform, conveyance etc. Under the Income-tax Act, allowance is taxable on due or receipt basis, whichever is earlier. Various types of allowances normally in vogue are discussed below:

Allowances		
Fully Taxable	**Partly Taxable**	**Fully Exempt**
(i) Entertainment Allowance	(i) House Rent Allowance [u/s 10(13A)]	(i) Allowance granted to Government employees outside India.
(ii) Dearness Allowance	(ii) Special Allowances [u/s 10(14)]	(ii) Sumptuary allowance granted to High Court or Supreme Court Judges
(iii) Overtime Allowance		(iii) Allowance paid by the United Nations Organization.
(iv) Fixed Medical Allowance		(iv) Compensatory Allowance received by a judge
(v) City Compensatory Allowance		
(vi) Interim Allowance (to meet increased cost of living in cities)		

(vii) Servant Allowance (viii) Project Allowance (ix) Tiffin/Lunch/Dinner Allowance (x) Any other cash allowance (xi) Warden Allowance (xii) Non-practicing Allowance		

Allowances which are fully taxable

(1) City compensatory allowance: City Compensatory Allowance is normally intended to compensate the employees for the higher cost of living in cities. It is taxable irrespective of the fact whether it is given as compensation for performing his duties in a particular place or under special circumstances.

(2) Entertainment allowance: This allowance is given to employees to meet the expenses towards hospitality in receiving customers etc. The Act gives a deduction towards entertainment allowance only to a Government employee. The details of deduction permissible are discussed later on in this Unit.

Allowances which are partially taxable

(1) House rent allowance [Section 10(13A)] – Refer to Chapter 3 for detailed discussion.

(2) Special allowances [Section 10(14)] : Refer to Chapter 3 for details.

Allowances which are fully exempt:

(1) Allowance to High Court Judges: Any allowance paid to a Judge of a High Court under section 22A(2) of the High Court Judges (Conditions of Service) Act, 1954 is not taxable.

(2) Allowance received from United Nations Organisation (UNO): Allowance paid by the UNO to its employees is not taxable by virtue of section 2 of the United Nations (Privileges and Immunities) Act, 1974.

(3) Compensatory allowance under Article 222(2) of the Constitution: Compensatory allowance received by judge under Article 222(2) of the Constitution is not taxable since it is neither salary not perquisite—*Bishamber Dayal Vs. CIT* [1976] 103 ITR 813 (MP).

(4) Sumptuary allowance : Sumptuary allowance given to High Court Judges under section 22C of the High Court Judges (Conditions of Service) Act, 1954 and Supreme Court Judges under section 23B of the Supreme Court Judges (Conditions of Service) Act, 1958 is not chargeable to tax.

1.19 PERQUISITES

(1) The term 'perquisite' indicates some extra benefit in addition to the amount that may be legally due by way of contract for services rendered. In modern times, the salary package of an employee normally includes monetary salary and perquisite like housing, car etc.

(2) Perquisite may be provided in cash or in kind.

(3) Reimbursement of expenses incurred in the official discharge of duties is not a perquisite.

(4) Perquisite may arise in the course of employment or in the course of profession. If it arises from a relationship of employer-employee, then the value of the perquisite is taxable as salary. However, if it arises during the course of profession, the value of such perquisite is chargeable as profits and gains of business or profession.

(5) Perquisite will become taxable only if it has a legal origin. An unauthorised advantage taken by an employee without his employer's sanction cannot be considered as a perquisite under the Act. For example, suppose A, an employee, is given a house by his employer. On 31.3.2010, he is terminated from service. But he continues to occupy the house without the permission of the employer for six more months after which he is evicted by the employer. The question arises whether the value of the benefit enjoyed by him during the six months period can be considered as a perquisite and be charged to salary. It cannot be done since the relationship of employer-employee ceased to exist after 31-3-2010. However, the definition of income is wide enough to bring the value of the benefit enjoyed by employee to tax as "income from other sources".

(6) Income-tax paid by the employer out of his pocket on the salary of the employee is a perquisite in the hands of the employee whether the payment is contractual or voluntary.

Definition: Under the Act, the term 'perquisite' is defined by section 17(2) to include the following:

(a) the value of rent free accommodation provided to the assessee by his employer-section 17(2)(i);

(b) The value of any concession in the matter of rent respecting any accommodation provided to the assessee by his employer—section 17(2)(ii);

(i) Under section 17(2)(ii), the value of any concession in the matter of rent arising to an employee in respect of any accommodation provided by his employer is considered as "perquisite" chargeable to tax in the hands of the employee.

(ii) Rule 3(1) of the Income-tax Rules provides the basis of valuation of perquisites in respect of accommodation provided to an employee, as under:

(a) 15% of salary in cities having population exceeding 25 lakh

(b) 10% of salary in cities having population above 10 lakh up to 25 lakh

(b) 7.5% of salary in cities having population up to 10 lakh.

(iii) In case of furnished accommodation provided by an employer, the value arrived as above was to be further increased by 10 percent of the cost of furniture, where the same is owned by the employer, or the actual hire charges paid by the employer in case the furniture is hired.

(iv) This method of perquisite valuation resulted in genuine hardship to employees availing facility of residential accommodation in remote areas, as the value of perquisite was determined as a percentage of salary of the employee, irrespective of the fair rental value of the property (which may be much lower than 15%/10%/7.5% of salary in such cases).

(v) Rule 3(1) was challenged as *ultra vires* before the Supreme Court in the case of *Arun Kumar v. UOI (2006) 286 ITR 89*. The Apex court, while holding that the provisions of Rule 3(1) were constitutionally valid, observed that the same would be applicable only if 'concession in the matter of rent' with respect to the accommodation provided by an employer accrues to the employee under the substantive provisions of section 17(2)(ii). The Assessing Officer, before applying Rule 3(1), was required to establish that there was 'concession in the matter of rent' provided to the employee.

(vi) Further, as per the Apex court, the difference between the value as per Rule 3(1) and the rent recovered from the employee, could not per se be considered as 'concession in the matter of rent' provided to the employee.

(vii) In order to clarify the correct intent of law, Explanations have been inserted in section 17(2)(ii) to provide that the difference between the specified rate (as shown in column 2 of the table below) and the amount of rent recoverable/recovered from the employee would be deemed to be the concession in the matter of rent in case of accommodation owned by the employer. In case of accommodation taken on lease or rent by the employer, the difference between the actual lease rent or 15% of salary, whichever is lower, and rent recovered/recoverable from the employee would be deemed to be the concession in the matter of rent.

(1)	(2)
Type of accommodation	**Deemed concession in the matter of rent**
Accommodation owned by the employer	
In cities having a population exceeding 25 lakh	15% of salary minus rent recoverable from the employee.
In cities having a population exceeding 10 lakh but not exceeding 25 lakh	10% of salary minus rent recoverable from the employee.
In other cities	7½% of salary minus rent recoverable from employee.
Accommodation taken on lease by the employer	Rent paid by the employer or 15% of salary, whichever is lower, minus rent recoverable from the employee.

(viii) This deeming provision is applicable to employees other than Government employees. In case of furnished accommodation provided to such employees, the excess of hire charges paid or 10% p.a. of cost of furniture, as the case may be, over and above the charges paid or payable by the employee would be added to the value determined in column (2) above for determining whether there is a concession in the matter of rent.

Note – Once there is a deemed concession, the provisions of Rule 3(1) would be applicable in computing the taxable perquisite.

(ix) "Salary" includes pay, allowances, bonus or commission payable monthly or otherwise or any monetary payment, by whatever name called, from one or more employers, as the case may be. However, it does not include the following, namely–

(1) dearness allowance or dearness pay unless it enters into the computation of superannuation or retirement benefits of the employee concerned;

(2) employer's contribution to the provident fund account of the employee;

(3) allowances which are exempted from the payment of tax;

(4) value of the perquisites specified in section 17(2);

(5) any payment or expenditure specifically excluded under the proviso to section 17(2) i.e., medical expenditure/payment of medical insurance premium specified therein.

(x) In case of Government employees, the excess of licence fees determined by the employer as increased by the value of furniture and fixture over and above the rent recovered/recoverable from the employee and the charges paid or payable for furniture by the employee would be deemed to be the concession in the matter of rent.

(c) The value of any benefit or amenity granted or provided free of cost or at concessional rate in any of the following cases (i.e. in case of specified employees):

(i) by a company to an employee in which he is a director;

(ii) by a company to an employee being a person who has substantial interest in the company (i.e. 20% or more of the voting rights of the company);

(iii) by any employer (including a company) to an employee to whom the provisions of (i) & (ii) do not apply and whose income under the head 'salaries' (whether due from, or paid or allowed by, one or more employers) exclusive of the value of all benefits or amenities not provided for by way of monetary benefits exceeds Rs.50,000 - section 17(2)(iii);

(d) Any sum paid by the employer in respect of any obligation which, but for such payment, would have been payable by the assessee - section 17(2)(iv);

(e) Any sum payable by the employer whether directly or through a fund, other than a recognised provident fund or approved superannuation fund or deposit- linked insurance fund to effect an assurance on the life of the assessee or to effect a contract for an annuity - section 17(2)(v).

(f) *the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer or former employer, free of cost or at concessional rate to the assessee – section 17(2)(vi).*

Specified security means "securities" as defined in section 2(h) of the Securities Contracts (Regulation) Act, 1956. It also includes the securities offered under employees stock option plan or scheme. Sweat equity shares means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

The value of specified security or sweat equity shares shall be the fair market value of such security or shares on the date on which the option is exercised by the assessee, as reduced by any amount actually paid by, or recovered from, the assessee in respect of such security or shares. The fair market value means the value determined in accordance with the method as may be prescribed by the CBDT. "Option" means a right but not an obligation granted to an employee to apply for the specified security or sweat equity shares at a pre-determined price.

(g) the amount of any contribution to an approved superannuation fund by the employer in respect of the assessee, to the extent it exceeds Rs.1 lakh – section 17(2)(vii).

(h) the value of any other fringe benefit or amenity as may be prescribed by the CBDT – section 17(2)(viii).

It can be noted that the aforesaid definition of perquisite is an inclusive one. More terms can be added in.

Types of perquisites: Perquisites may be divided into three broad categories:

(1) Perquisites taxable in the case of all employees

(2) Perquisites exempt from tax in the case of all employees

(3) Perquisites taxable only in the hands of specified employees.

(1) Perquisites taxable in the case of all employees: The following perquisites are chargeable to tax in all cases.

(i) Value of rent-free accommodation provided to the assessee by his employer [Section 17(2)(i)].

Exception: Rent-free official residence provided to a Judge of a High Court or to a Judge of the Supreme Court is not taxable. Similarly, rent-free furnished house provided to an Officer of Parliament, is not taxable. [For valuation, refer to para 1.20]

(ii) Value of concession in rent in respect of accommodation provided to the assessee by his employer [Section 17(2)(ii)].

(iii) Amount paid by an employer in respect of any obligation which otherwise would have been payable by the employee [Section 17(2)(iv)]. For example, if a domestic servant is engaged by an employee and the employer reimburses the salary paid to the servant, it becomes an obligation which the employee would have discharged even if the employer did not reimburse the same. This perquisite will be covered by section 17(2)(iv) and will be taxable in the hands of all employees.

(iv) Amount payable by an employer directly or indirectly to effect an assurance on the life of the assessee or to effect a contract for an annuity, other than payment made to RPF or approved superannuation fund or deposit-linked insurance fund established under the Coal Mines Provident Fund or Employees' Provident Fund Act. However, there are schemes like group annuity scheme, employees state insurance scheme and fidelity insurance scheme, under which insurance premium is paid by employer on behalf of the employees. Such payments are not regarded as perquisite in view of the fact that the employees have only an expectancy of the benefit in such schemes.

(v) the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer or former employer, free of cost or at concessional rate to the assessee.

(vi) the amount of any contribution to an approved superannuation fund by the employer in respect of the assessee, to the extent it exceeds Rs.1 lakh.

(vii) The value of any other fringe benefit or amenity as may be prescribed by the CBDT.

(2) Perquisites exempt from tax in all cases: The following perquisites are exempt from tax in all cases -

(1) Telephone provided by an employer to an employee at his residence;

(2) Goods sold by an employer to his employees at concessional rates;

(3) Transport facility provided by an employer engaged in the business of carrying of passengers or goods to his employees either free of charge or at concessional rate;

(4) Privilege passes and privilege ticket orders granted by Indian Railways to its employees;

(5) Perquisites allowed outside India by the Government to a citizen of India for rendering services outside India;

(6) Sum payable by an employer to a RPF or an approved superannuation fund or deposit-linked insurance fund established under the Coal Mines Provident Fund or the Employees' Provident Fund Act;

(7) Employer's contribution to staff group insurance scheme;

(8) Leave travel concession;

(9) Payment of annual premium by employer on personal accident policy effected by him on the life of the employee;

(10) Refreshment provided to all employees during working hours in office premises;

(11) Subsidized lunch or dinner provided to an employee;

(12) Recreational facilities, including club facilities, extended to employees in general *i.e.,* not restricted to a few select employees;

(13) Amount spent by the employer on training of employees or amount paid for refresher management course including expenses on boarding and lodging;

(14) Medical facilities subject to certain prescribed limits; [Refer to point 11 of para 1.20]

(15) Rent-free official residence provided to a Judge of a High Court or the Supreme Court;

(16) Rent-free furnished residence including maintenance provided to an Officer of Parliament, Union Minister and a Leader of Opposition in Parliament;

(17) Conveyance facility provided to High Court Judges under section 22B of the High Court Judges (Conditions of Service) Act, 1954 and Supreme Court Judges under section 23A of the Supreme Court Judges (Conditions of Service) Act, 1958.

(3) Perquisites taxable only in the hands of specified employees [Section 17(2)(iii)]: The value of any benefit or amenity granted or provided free of cost or at concessional rate which have not been included in 1 & 2 above will be taxable in the hands of specified employees:

Specified employees are:

(i) Director employee: An employee of a company who is also a director is a specified employee. It is immaterial whether he is a full-time director or part-time director. It also does not matter whether he is a nominee of the management, workers, financial institutions or the Government. It is also not material whether or not he is a director throughout the previous year.

(ii) An employee who has substantial interest in the company: An employee of a company who has substantial interest in that company is a specified employee. A person has a substantial interest in a company if he is a beneficial owner of equity shares carrying 20% or more of the voting power in the company.

Beneficial and legal ownership: In order to determine whether a person has a substantial interest in a company, it is rather the beneficial ownership of equity shares carrying 20% or more of the voting power that is relevant rather than the legal ownership.

Example: A, Karta of a HUF, is a registered shareholder of Bright Ltd. The amount for purchasing the shares is financed by the HUF. The dividend is also received by the HUF. Supposing further that A is the director in Bright Ltd., the question arises whether he is a specified employee. In this case, he cannot be called, a specified person since he has no beneficial interest in the shares registered in his name. It is only for the purpose of satisfying the statutory requirements that the shares are registered in the name of A. All the benefits arising from the shareholding goes to the HUF. Conversely, it may be noted that an employee who is not a registered shareholder will be considered as a specified employee if he has beneficial interest in 20% or more of the equity shares in the company.

(iii) Employee drawing in excess of Rs.50,000: An employee other than an employee described in (i) & (ii) above, whose income chargeable under the head 'salaries' exceeds Rs.50,000 is a specified employee. The above salary is to be considered exclusive of the value of all benefits or amenities not provided by way of monetary payments.

In other words, for computing the limit of Rs.50,000, the following items have to be excluded or deducted:

(a) all non-monetary benefits;

(b) monetary benefits which are exempt under section 10. This is because the exemptions provided under section 10 are excluded completely from salaries. For example, HRA or education allowance or hostel allowance are not to be included in salary to the extent to which they are exempt under section 10.

(c) Deduction for entertainment allowance [under section 16(ii)] and deduction toward professional tax [under section 16(iii)] are also to be excluded.

If an employee is employed with more than one employer, the aggregate of the salary received from all employers is to be taken into account in determining the above ceiling limit of Rs.50,000, i.e. Salary for this purpose

= Basic Salary + D.A. + Commission, whether payable monthly or turnover based + Bonus + Fees + Any other taxable payment + Any taxable allowances + Any other monetary benefits – Deductions under section 16]

1.20 VALUATION OF PERQUISITES

The Income-tax Rules, 1962 contain the provisions for valuation of perquisites. It is important to note that only those perquisites which the employee actually enjoys have to be valued and taxed in his hand. For example, suppose a company offers a housing accommodation rent-free to an employee but the latter declines to accept it, then the value of such accommodation obviously cannot be evaluated and taxed in the hands of the employees. Rule 3 of the Income-tax Rules, 1962 contains the guidelines for the purpose of valuation of perquisites:

(1) Valuation of unfurnished accommodation: There are two ways in which a rent-free accommodation may be made available by an employer to his employee. He may own the housing accommodation and may give the same to the employee free of rent. He may also hire an accommodation on rent and give the same to the employee free of rent. In both the cases, the effect is that the employee gets rent-free accommodation. Provision of rent-free accommodation is a perquisite which **is taxable in the hands of all employees whether specified or non-specified.**

Note**:** "Accommodation" includes fixed structures like a house, flat, farm house or part thereof, or accommodation in a hotel, motel, service apartment, guest house, and floating structures like caravan, mobile home, ship or any other floating structure.

For the purpose of valuation of the perquisite in respect of unfurnished accommodation the employees are divided into two categories:

(A) Central and State Government employees (including military personnel):

The following employees come under this category:

(i) Central and State Government employees;

(ii) Government employees whose services have been lent to public sector undertaking or a Government body. In this case, the undertaking should have allotted the accommodation to employee.

Where accommodation is provided by Union or State Government to their employees either

holding office or post in connection with the affairs of Union or State or serving with any body or undertaking under the control of such Government on deputation, the value of the perquisite will be equal to the licence fee determined by Union or State Government in respect of accommodation in accordance with the rules framed by that government as reduced by the rent actually paid by the employee.

∴ Value of perquisite = Licence Fees determined by Union / State Government – Rent actually paid by the employee.

Note: This provision does not include employees of a local authority (like port commission or Municipal Corporation) and foreign Government.

(B) Private sector employees - Those employees who are not covered under the earlier category mentioned above will be covered under this category for the purpose of determining the perquisite value of the accommodation.

Employee	Value of perquisite
Where the accommodation is owned by the employer.	Where accommodation is provided in a city where population as per 2001 census is: (a) 10 lakh or less – 7.5% of salary; (b) More than 10 lakh upto 25 lakh -10% of salary. (c) More than 25 lakh – 15% of salary in respect of the period during which the said accommodation was occupied by the employee during the previous year as reduced by the rent, if any, actually paid by the employee.
Where the accommodation is taken on lease or rent by the employer and provided to the employee	The value of perquisite would be the lower of the following: (a) Actual amount of lease rental paid or payable by the employer ; or (b) 15% of salary. This value would be reduced by the rent, if any, actually paid by the employee.

"Salary" for this purpose includes the basic pay, dearness allowance which forms part of salary for retirement benefits, taxable allowances, bonus or commission payable monthly or otherwise or any monetary payment, by whatever name called from one or more employers.

It does not include the following, namely:-

(a) dearness allowance, unless it enters into the computation of superannuation or retirement benefits of the employee concerned;

(b) Employer's contribution to the provident fund account of the employee;

(c) Allowances which are exempted from payment of tax;

(d) The value of perquisites specified under section 17(2) of the Income-tax Act;

(e) Any payment or expenditure in the nature of allotment of shares, debentures or warrants under ESOP or any other scheme;

(f) Any allowance in the nature of medical facility to the extent not taxable.

For computing salary, for the purpose of valuation of perquisite in respect of rent-free accommodation, basic salary, bonus etc. are to be considered on due basis.

Illustration 4

Mr. C is a Finance Manager in ABC Ltd. The company has provided him with rent-free unfurnished accommodation in Mumbai. He gives you the following particulars:

Basic salary	Rs.6,000 p.m.
Advance salary for April 2010	Rs.5,000
Dearness Allowance	Rs.2,000 p.m. (30% is for retirement benefits)
Bonus	Rs.1,500 p.m.

Even though the company allotted the house to him on 1.4.09, he occupied the same only from 1.11.09. Calculate the taxable value of the perquisite for A.Y. 2010-11.

Solution

Value of the rent free unfurnished accommodation

= 15% of salary for the relevant period

= 15% of [(Rs.6000 × 5) + (Rs.2,000 × 30% × 5) + (Rs.1,500 × 5)] [See Note below]

= 15% of Rs.40,500

= Rs.6,075.

Note: Since, Mr.C occupies the house only from 1.11.09, we have to include the salary due to him only in respect of months during which he has occupied the accommodation. Hence salary for 5 months (i.e. from 1.11.09 to 31.03.10) will be considered. Advance salary for April 2010

drawn during this year is not to be considered because it falls in respect of a period beyond the relevant previous year.

Illustration 5

Using the data given in the previous illustration 4, compute the value of the perquisite if Mr. C is required to pay a rent of Rs.1,000 p.m. to the company, for the use of this accommodation.

Solution

First of all, we have to see whether there is a concession in the matter of rent. In the case of accommodation owned by the employer in cities having a population exceeding Rs.25 lakh, there would be deemed to be a concession in the matter of rent if 15% of salary exceeds rent recoverable from the employee.

In this case, 15% of salary would be Rs.6,075 (i.e. 15% of Rs.40,500). The rent paid by the employee is Rs.5,000 (i.e. Rs.1,000 x 5). Since 15% of salary exceeds the rent recovered from the employee, there is a deemed concession in the matter of rent. Once there is a deemed concession, the provisions of Rule 3(1) would be applicable in computing the taxable perquisite.

Value of the rent free unfurnished accommodation	= Rs.6,075
Less : Rent paid by the employee (Rs.1,000 × 5)	= Rs.5,000
Perquisite value of unfurnished accommodation given at concessional rent	= Rs.1,075

Illustration 6

Using the data given in illustration 4, compute the value of the perquisite if ABC Ltd. has taken this accommodation on a lease rent of Rs.1,200 p.m. and Mr. C is required to pay a rent of Rs.1,000 p.m. to the company, for the use of this accommodation.

Solution

Here again, we have to see whether there is a concession in the matter of rent. In the case of accommodation taken on lease by the employer, there would be deemed to be a concession in the matter of rent if the rent paid by the employer or 15% of salary, whichever is lower, exceeds rent recoverable from the employee.

In this case, 15% of salary is Rs.6,075 (i.e. 15% of Rs.40,500). Rent paid by the employer is Rs.6,000 (i.e. Rs.1,200 x 5). The lower of the two is Rs.6,000, which exceeds the rent paid by the employee i.e. Rs.5,000 (Rs.1,000 x 5). Therefore, there is a deemed concession in the matter of rent. Once there is a deemed concession, the provisions of

Rule 3(1) would be applicable in computing the taxable perquisite.

Value of the rent free unfurnished accommodation [Note1] = Rs.6,000

Less: Rent paid by the employee (Rs.1,000 × 5) = Rs.5,000

∴ Value of unfurnished accommodation given at concessional rent = Rs.1,000

Note 1 : Value of the rent free unfurnished accommodation is lower of

(i) Lease rent paid by the company for relevant period = Rs.1,200 × 5 = Rs.6,000

(ii) 15% of salary for the relevant period (computed earlier) = Rs.6,075

(2) Valuation of furnished accommodation: When the accommodation provided to the employee is furnished by the employer, the computation of the value of the perquisite has to be done in the following manner:—

Step 1: Compute the value of the perquisite as if the accommodation is unfurnished.

Step 2: To the value arrived at in Step 1 above, add the value of furniture as follows:

(a) If the furniture is owned by the employer, then value of furniture is to be added on the basis of 10% p.a. of the original cost of the furniture, or

(b) If the employer has taken the furniture on hire, then value of furniture is the actual hire charges borne by the employer.

Note:

1. This addition in respect of furnished accommodation is applicable to all categories of employees.

2. In this context, the term 'furniture' will include TV sets, radio sets, refrigerators and other household appliances, air-conditioning plant or equipment or other similar appliances or gadgets.

Illustration 7

Using the data given in illustration 4, compute the value of the perquisite if ABC Ltd. has provided a television (WDV Rs.10,000; Cost Rs.25,000) and two air conditioners. The rent paid by the company for the air conditioners is Rs.400 p.m. each. The television was provided on 1.1.10. However, Mr. C is required to pay a rent of Rs.1,000 p.m. to the company, for the use of this furnished accommodation.

Solution

Here again, we have to see whether there is a concession in the matter of rent. In the case of accommodation owned by the employer in a city having a population exceeding

Rs.25 lakh, there would be deemed to be a concession in the matter of rent if 15% of salary exceeds rent recoverable from the employee. In case of furnished accommodation, the excess of hire charges paid or 10% p.a. of the cost of furniture, as the case may be, over and above the charges paid or payable by the employee has to be added to the value arrived at above to determine whether there is a concession in the matter of rent.

In this case, 15% of salary is Rs.6,075 (i.e. 15% of Rs.40,500). The rent paid by the employee is Rs.5,000 (i.e. Rs.1,000 x 5). The value of furniture (see Note 1 below) to be added to 15% of salary is Rs.4,625. The deemed concession in the matter of rent is Rs.6,075+Rs.4,625-Rs.5,000 = Rs.5,700. Once there is a deemed concession, the provisions of Rule 3(1) would be applicable in computing the taxable perquisite.

Value of the rent free unfurnished accommodation (computed earlier)	= Rs.6,075
Add: Value of furniture provided by the employer [Note 1]	= Rs.4,625
Value of rent free furnished accommodation	= Rs.10,700
Less: Rent paid by the employee (Rs.1,000 × 5)	= Rs. 5,000
Value of furnished accommodation given at concessional rent	= Rs.5,700

Note 1: Value of the furniture provided

= (Rs.400 p.m. × 2 × 5 months) + (Rs.25,000 × 10% p.a. for 3 months)

= Rs.4,000 + Rs.625

= Rs.4,625

Illustration 8

Using the data given in illustration 7 above, compute the value of the perquisite if Mr. C is a government employee. The licence fees determined by the Government for this accommodation was Rs.700 p.m.

Solution

In the case of Government employees, the excess of licence fees determined by the employer as increased by the value of furniture and fixture over and above the rent recovered/recoverable from the employee and the charges paid or payable for furniture by the employee would be deemed to be the concession in the matter of rent. Therefore, the deemed concession in the matter of rent is Rs.3,125 [i.e. Rs.3,500 (licence fees: 700 x 5) + Rs.4,625 (Value of furniture) – Rs.5,000 (Rs.1,000 × 5)]. Once there is a deemed concession, the provisions of Rule 3(1) would be applicable in computing the taxable perquisite.

Value of the rent free unfurnished accommodation (Rs.700 × 5)	= Rs.3,500
Add: Value of furniture provided by the employer (computed earlier)	= Rs.4,625
Value of rent free furnished accommodation	= Rs.8,125
Less: Rent paid by the employee (Rs.1,000 × 5)	= Rs.5,000
Perquisite value of furnished accommodation given at concessional rent	= Rs.3,125

(3) Valuation of accommodation provided in a hotel: Where the accommodation is provided by the employer (Government or other employer) in a hotel, the value of the perquisite will be lower of:

a. 24% of salary paid or payable for the previous year or

b. the actual charges paid or payable to such hotel for the period during which such accommodation is provided.

The above value is reduced by the rent, if any, actually paid or payable by the employee.

Note: 1. The value of this perquisite will not be calculated if the employee is provided such accommodation for a period not exceeding in aggregate 15 days on the transfer from one place to another.

2. "Hotel" includes licensed accommodation in the nature of motel, service apartment or guest house.

(4) Accommodation provided at the time of transfer:

Where on account of his transfer from one place to another, the employee is provided with accommodation at the new place of posting while retaining the accommodation at the other place, the value of perquisite shall be determined with reference to only one such accommodation which has the lower value (as determined according to the above provisions) for a period not exceeding 90 days and thereafter the value of perquisite shall be charged for both such accommodations in accordance with the valuation rules.

Exceptions:

However, none of the above valuation rules would be applicable to any accommodation provided to an employee working at a mining site/onshore oil exploration site/project execution site/dam site/power generation site/offshore site which, -

(i) being of a temporary nature and having plinth area not exceeding 800 sq. feet, is located at least 8 kms away from the local limits of any municipality or cantonment board; or

(ii) is located in a remote area. [Remote area means an area that is located at least 40 kms away from a town having a population not exceeding 20,000 based on latest published all India census].

Thus, the abovementioned accommodation shall be a tax-free perquisite.

(5) Motor Car [Sub-rule (2) of Rule 3]

Sl. No.	Circumstances	Where cubic capacity of engine does not exceed 1.6 litres	Where cubic capacity of engine exceeds 1.6 litres
(1)	(2)	(3)	(4)
(1)	Where the motor car is owned or hired by the employer and		
	(a) is used wholly and exclusively in the performance of his official duties;	No value, provided the documents specified in Note 2 below this table are maintained by the employer.	No value, provided the documents specified in Note 2 below this table are maintained by the employer.
	(b) is used exclusively for the private or personal purposes of the employee or any member of his household and the running and maintenance expenses are met or reimbursed by the employer;	Actual amount of expenditure incurred by the employer on the running and maintenance of motor car during the relevant previous year including remuneration, if any, paid by the employer to the chauffeur as increased by the amount representing normal wear and tear of the motor car and as reduced by any amount charged from the employee for such use.	Actual amount of expenditure incurred by the employer on the running and maintenance of motor car during the relevant previous year including remuneration, if any, paid by the employer to the chauffeur as increased by the amount representing normal wear and tear of the motor car and as reduced by any amount charged from the employee for such use.
	(c) is used partly in the performance of duties and partly for private or personal purposes of his own or any member of his household and		
	(i) the expenses on maintenance and running	Rs.1,200 (plus Rs.600, if chauffeur is also provided to run the motor car)	Rs.1,600 (plus Rs.600, if chauffeur is also provided to run the motor car)

	are met or reimbursed by the employer,		
	(ii) the expenses on running and maintenance for such private or personal use are fully met by the assessee.	Rs.400 (plus Rs.600, if chauffeur is provided by the employer to run the motor car)	Rs.600 (plus Rs.600, if chauffeur is also provided to run the motor car)
(2)	Where the employee owns a motor car but the actual running and maintenance charges (including remuneration of the chauffeur, if any) are met or reimbursed to him by the employer and		
	(i) such reimbursement is for the use of the vehicle wholly and exclusively for official purposes,	No value, provided that the documents specified in Note 2 below this table are maintained by the employer.	No value, provided that the documents specified in Note 2 below this table are maintained by the employer.
	(ii) such reimbursement is for the use of the vehicle partly for official purposes and partly for personal or private purposes of the employee or any member of his household.	The actual amount of expenditure incurred by the employer as reduced by Rs.1,200 (plus Rs.600, if chauffeur is also provided to run the motor car). However, the documents specified in Note 2 below this table should be maintained by the employer.	The actual amount of expenditure incurred by the employer as reduced by Rs.1,600 (plus Rs.600, if chauffeur is also provided to run the motor car). However, the documents specified in Note 2 below this table should be maintained by the employer.
(3)	Where the employee owns any other automotive conveyance but the actual running and maintenance charges are met or		

reimbursed to him by the employer and			
(i)	such reimbursement is for the use of the vehicle wholly and exclusively for official purposes,	No value, provided that the documents specified in Note 2 below this table are maintained by the employer.	Not applicable
(ii)	such reimbursement is for the use of the vehicle partly for official purposes and partly for personal or private purposes of the employee.	The actual amount of expenditure incurred by the employer as reduced by an amount of Rs.600, provided the documents specified in Note 2 below this table are maintained by the employer.	

Note -

(1) Where one or more motor-cars are owned or hired by the employer and the employee or any member of his household are allowed the use of such motor-car or all or any of such motor-cars (otherwise than wholly and exclusively in the performance of his duties), the value of perquisite shall be the amount calculated in respect of one car in accordance with Sl. No. (1)(c)(i) of the above Table as if the employee had been provided one motor-car for use partly in the performance of his duties and partly for his private or personal purposes and the amount calculated in respect of the other car or cars in accordance with Sl. No. (1)(b) of the above Table as if he had been provided with such car or cars exclusively for his private or personal purposes.

(2) Where the employer or the employee claims that the motor-car is used wholly and exclusively in the performance of official duty or that the actual expenses on the running and maintenance of the motor-car owned by the employee for official purposes is more than the amounts deductible in Sl. No. 2(ii) or 3(ii) of the above Table, he may claim a higher amount attributable to such official use and the value of perquisite in such a case shall be the actual amount of charges met or reimbursed by the employer as reduced by such higher amount attributable to official use of the vehicle provided that the following conditions are fulfilled:

(a) the employer has maintained complete details of journey undertaken for official purpose which may include date of journey, destination, mileage, and the amount of expenditure incurred thereon;

(b) the employer gives a certificate to the effect that the expenditure was incurred wholly and exclusively for the performance of official duties.

(3) The normal wear and tear of a motor-car shall be taken at 10 per cent per annum of the actual cost of the motor-car or cars.

(6) Valuation of provision for domestic servants [Sub-rule (3) of Rule 3]

The value of perquisite is determined as under:

Servant appointed by	Servant's salary paid by	Value of perquisite	Taxable in the hands of
Employee	Employee	Nil	Not applicable
Employee	Employer	Actual cost incurred by the employer on the servant	All employees
Employer	Employer	Actual cost incurred by the employer on the servant	Specified employee
Employer	Employee	Nil	Not applicable

Note: Where the employee is paying any amount in respect of such servant facility, the amount so paid shall be deducted from the value of perquisite determined above.

(7) Valuation of supply of gas, electricity or water supplied by employer [Sub-rule (4) of Rule 3]

The value of perquisite is determined as under:

Facility in the name of	Value of perquisite		Taxable in the hands of
	Provided from own source	Provided from outside	
Employee	Manufacturing cost to the employer	Amount paid to the supplier	All employees
Employer	Manufacturing cost to the employer	Amount paid to the supplier	Specified employees

Note: Where the employee is paying any amount in respect of such services, the amount so paid shall be deducted from the value of perquisite determined above.

(8) Valuation of free or concessional educational facilities [Sub-rule (5) of Rule 3]

The value of perquisite is determined as under:

Facility provided to	Value of perquisite		Taxable in the hands of
	Provided in a school owned by the employer	Provided in any other school	
Children	Cost of such education in similar school (There would be no perquisite if the cost of education does not exceed Rs.1,000 p.m. per child)	Cost of such education (There would be no perquisite if the cost of education does not exceed Rs.1,000 p.m. per child)	Specified employee
Other household member	Cost of such education in similar school	Cost of such education incurred	Specified employee

Note:

1. If the employee incurs the expenditure of school fees and the same is reimbursed by the employer, then the entire amount of reimbursement so made, shall be fully taxable in the hands of all employees.
2. Child includes step child as well as the adopted child of the employee.
3. "Household member" shall include -
   (a) spouse
   (b) children and their spouses
   (c) parents
   (d) servants and dependants.

(9) Free or concessional tickets [Sub-rule (6) of Rule 3]

The value of any benefit or amenity resulting from the provision by an employer engaged in the carriage of passengers or goods to any employee or to any member of his household for personal or private journey free of cost or concessional fare in any conveyance owned, leased or made available by any other arrangement shall be the value at which such benefit or amenity is offered by such employer to the public. Any amount recovered from the employee for such benefit or amenity shall be reduced in determining the value of the perquisite.

However, this sub-rule shall not apply to the employees of an airline or the railways.

(10) Valuation of other fringe benefits and amenities [Sub-rule (7) of Rule 3]

In terms of provisions contained under the erstwhile section 17(2)(vi) **[now section 17(2)(viii)]**, the following other fringe benefits or amenities are hereby prescribed and the value thereof shall be determined in the manner provided hereunder :-

(i) Interest-free or concessional loan [Sub-rule 7(i) of Rule 3]

The value of the benefit to the assessee resulting from the provision of interest-free or concessional loan made available to the employee or any member of his household during the relevant previous year by the employer or any person on his behalf shall be determined as the sum equal to the interest computed at the rate charged per annum by the State Bank of India (SBI) as on the 1st day of the relevant previous year in respect of loans for the same purpose advanced by it. This rate should be applied on the maximum outstanding monthly balance and the resulting amount should be reduced by the interest, if any, actually paid by him or any member of his household.

i.e. value of perquisite = Interest computed as per SBI rates – Interest recovered by the employer from the employee

Notes:

1. Nothing is taxable if such loans are made available for medical treatment in respect of diseases specified in rule 3A of the Income Tax rules or where the amount of loans are petty not exceeding in the aggregate Rs.20,000 .
2. Where loans are made available for medical treatment, referred to above, the exemption shall not apply to so much of the loan as has been reimbursed to the employee under any medical insurance scheme.
3. "Maximum outstanding monthly balance" means the aggregate outstanding balance for each loan as on the last day of each month.

(ii) Travelling, touring and accommodation [Sub-rule 7(ii) of Rule 3]

The value of travelling, touring, stay and other expenses borne by the employer for any holiday availed by the employee or any member of his household shall be the amount of the expenditure incurred by the employer. This provision applies in respect of trips other than those which are exempt under section 10(5) read with Rule 2B. If the facility is maintained by the employer and it is not available uniformly to all employees, the value of benefit shall be taken to be the value at which such facilities are offered by other agencies to the public.

Where the employee is on official tour and the expenses are incurred in respect of any member of his household accompanying him, the amount of expenditure so incurred shall also be a fringe benefit or amenity. However, if the official tour is extended as a vacation,

the value of such fringe benefit will be limited to the expenses incurred in relation to such extended period of stay or vacation. The amount so determined shall be reduced by the amount, if any, paid or recovered from the employee for such benefit or amenity.

(iii) Free or concessional food and non-alcoholic beverages [Sub-rule 7(iii) of Rule 3]

The value of free food and non-alcoholic beverages provided by the employer shall be the amount of expenditure incurred by the employer as reduced by the amount, if any, paid or recovered from the employee for such benefit or amenity. However, the following shall not be chargeable as perquisites:

(a) Free food and non-alcoholic beverages provided by the employer during the working hours at office or business premises up to Rs.50 per meal;

(b) Free food and non-alcoholic beverages provided through paid vouchers which are not transferable and usable only at eating joints if the value thereof is up to Rs.50 per meal;

(c) Tea or snacks provided during working hours; and

(d) Free food and non-alcoholic beverages during working hours provided in a remote area or an offshore installation.

(iv) Value of gift, voucher or token in lieu of such gift [Sub-rule 7(iv) of Rule 3]

The value of any gift, or voucher or token in lieu of which such gift may be received by the employee or by member of his household on ceremonial occasions or otherwise from the employer shall be the sum equal to the amount of such gift. If the value of such gift, voucher or token is below Rs. 5,000 in the aggregate during the previous year, the value of perquisite shall be taken as nil.

(v) Credit card expenses [Sub-rule 7(v) of Rule 3]

The amount of expenses including membership fees and annual fees incurred by the employee or any member of his household which is charged to a credit card (including add-on-card) provided by the employer or otherwise, paid for or reimbursed by the employer shall be taken to be the value of perquisite chargeable to tax. The amount so determined shall be reduced by the amount, if any, paid or recovered from the employee for such benefit or amenity. However, such expenses incurred wholly and exclusively for official purposes would not be treated as a perquisite if the following conditions are satisfied:

(a) complete details in respect of such expenditure are maintained by the employer which may, inter alia, include the date of expenditure and the nature of expenditure;

(b) the employer gives the certificate for such expenditure to the effect that the same was incurred wholly and exclusively for the performance of official duties;

(vi) Club expenditure [Sub-rule 7(vi) of Rule 3]

If employer reimburses or makes payment of any expenditure incurred in a club including the amount of annual or periodical fee for the employee or any member of household, the actual amount of such expenditure shall be the value of perquisite. The amount so determined shall be reduced by the amount, if any, paid or recovered from the employee for such benefit or amenity. Where the employer has obtained corporate membership of the club and the facility is enjoyed by the employee or any member of his household, the value of perquisite shall not include the initial fee paid for acquiring such corporate membership.

If the employer provides uniformly to all employees the use of health club, sports and similar facilities, there will be no taxable perquisite in respect of such facilities. Besides, there will be no taxable perquisite if the club expenditure is incurred wholly and exclusively for business purposes and the following conditions are fulfilled:

(a) complete details in respect of such expenditure are maintained by the employer which may, *inter alia*, include the date of expenditure and the nature of expenditure and its business expediency;

(b) the employer gives a certificate for such expenditure to the effect that the same was incurred wholly and exclusively for the performance of official duties.

(vii) Use of moveable assets [Sub-rule 7(vii) of Rule 3]

Value of perquisite is determined as under:

Asset given	Value of benefit
(a) Use of laptops and computers	Nil
(b) Movable assets, other than	
(i) laptops and computers; and	(i) 10% p.a. of the actual cost of such asset, or
(ii) assets already specified	(ii) the amount of rent or charge paid, or payable by the employer as the case may be

Note: Where the employee is paying any amount in respect of such asset, the amount so paid shall be deducted from the value of perquisite determined above.

(viii) Transfer of moveable assets [Sub-rule 7(viii) of Rule 3]

Value of perquisite is determined as under:

Assets transferred	Value of perquisite
Computers and electronic items	Depreciated value of asset [depreciation is computed @ 50% on WDV for each completed year of usage]
Motor cars	Depreciated value of asset [depreciation is computed @ 20% on WDV for each completed year of usage]
Any other asset	Depreciated value of asset [depreciation is computed @ 10% on SLM for each completed year of usage]

Note: Where the employee is paying any amount in respect of such asset, the amount so paid shall be deducted from the value of perquisite determined above.

(ix) Other benefit or amenity [Sub-rule 7(ix) of Rule 3]

The value of any other benefit or amenity, service, right or privilege provided by the employer shall be determined on the basis of cost to the employer under an arms' length transaction as reduced by the employee's contribution, if any. However, there will be no taxable perquisite in respect of expenses on telephones including mobile phone actually incurred on behalf of the employee by the employer i.e., if an employer pays or reimburses telephone bills or mobile phone charges of employee, there will be no taxable perquisite.

Note – The new perquisite valuation rules would be notified by the CBDT consequent to withdrawal of Fringe Benefit Tax. Since the new rules have not been notified up to 31st October, 2009, they would not be applicable for May 2010 examination, even if they are subsequently notified with retrospective effect. When such rules are notified, they would be hosted on the website of the Institute www.icai.org and would be made applicable for November 2010 examination. The new rules would also be given in the Revision Test Paper for November 2010 examination.

Rule 3(7), providing for valuation of "other fringe benefits and amenities" is based on the terms of the provisions contained in the erstwhile clause (vi) of section 17(2). The Finance (No.2) Act, 2009 has amended section 17(2) by including certain other perquisites under clauses (vi) and (vii) of section 17(2). Consequently, the residual clause, namely, clause (viii) of section 17(2), now provides for taxing the value of any other fringe benefit or amenity as may be prescribed. However, since the new perquisite rules are yet to be notified, therefore, Rule 3(7), prescribing the fringe benefits or amenities in terms of the erstwhile clause (vi) [now clause (viii)] of section 17(2) have been given in this study material and would be applicable for May 2010 examination.

(11) Medical facilities

The following medical facilities will not amount to a perquisite:

(i) The value of any medical treatment provided to an employee or any member of his family in any hospital maintained by the employer;

(ii) Any sum paid by the employer in respect of any expenditure actually incurred by the employee on his medical treatment or treatment of any member of his family in any hospital maintained by the Government/local authority/any other hospital approved by the Government for the purpose of medical treatment of its employees;

(iii) Any sum paid by the employer in respect of any expenditure actually incurred by the employee on his medical treatment or treatment of any member of his family in respect of the prescribed disease or ailments in any hospital approved by the Chief Commissioner having regard to the prescribed guidelines. However, in order to claim this benefit, the employee shall attach with his return of income a certificate from the hospital specifying the disease or ailment for which medical treatment was required and the receipt for the amount paid to the hospital.

Thus two types of facilities are covered:

(a) payment by the employer for treatment in a Government hospital and

(b) payment by an employer for treatment of prescribed diseases in any hospital approved by the Chief Commissioner.

(iv) Any premium paid by an employer in relation to an employee to effect an insurance on the health of such employee. However, any such scheme should be approved by the Central Government or the Insurance Regulatory Development Authority (IRDA) for the purposes of section 36(1)(ib).

(v) Any sum paid by the employer in respect of any premium paid by the employee to effect an insurance on his family under any scheme approved by the Central Government for the purposes of section 80D.

(vi) Any sum paid by the employer in respect of any expenditure actually incurred by the employee on his medical treatment or treatment of any member of his family to the extent of Rs.15,000 in the previous year.

Note: It is important to note that this expenditure need not be incurred either in the government hospital or in a hospital approved by the Chief Commissioner.

(vii) Any expenditure incurred by the employer on the following:

(a) medical treatment of the employee or any member of the family of such employee outside India;

(b) travel and stay abroad of the employee or any member of the family of such employee for medical treatment;

(c) travel and stay abroad of one attendant who accompanies the patient in connection with such treatment.

Conditions:

1. The perquisite element in respect of expenditure on medical treatment and stay abroad will be exempt only to the extent permitted by the RBI.
2. The expenses in respect of traveling of the patient and the attendant will be exempt if the employee's gross total income as computed before including the said expenditure does not exceed Rs.2 lakh.

   Note: For this purpose, family means spouse and children of the individual. Children may be dependant or independent, married or unmarried. It also includes parents, brothers and sisters of the individual if they are wholly or mainly dependant upon him.

Illustration 9

Compute the taxable value of the perquisite in respect of medical facilities received by Mr. G from his employer during the P.Y.2009-10:

Medical premium paid for insuring health of Mr. G	Rs.7,000
Treatment of Mr. G by his family doctor	Rs.5,000
Treatment of Mrs. G in a Government hospital	Rs.25,000
Treatment of Mr. G's grandfather in a private clinic	Rs.12,000
Treatment of Mr. G's mother (68 years and dependant) by family doctor	Rs.8,000
Treatment of Mr. G's sister (dependant) in a nursing home	Rs.3,000
Treatment of Mr. G's brother (independent)	Rs.6,000
Treatment of Mr. G's father (75 years and dependant) abroad	Rs.50,000
Expenses of staying abroad of the patient and attendant	Rs.30,000

Limit specified by RBI Rs.75,000

Solution

Computation of taxable value of perquisite in the hands of Mr. G

Particulars	Rs.	Rs.
Treatment of Mrs. G in a Government hospital		-
Treatment of Mr. G's father (75 years and dependant) abroad	50,000	

Expenses of staying abroad of the patient and attendant	30,000	
	80,000	
Less : Exempt up to limit specified by RBI	75,000	5,000
Medical premium paid for insuring health of Mr. G		-
Treatment of Mr. G by his family doctor	5,000	
Treatment of Mr. G's mother (dependant) by family doctor	8,000	
Treatment of Mr. G's sister (dependant) in a nursing home	3,000	
	16,000	
Less: Exempt upto Rs.15,000	15,000	1,000
Add: Treatment of Mr. G's grandfather in a private clinic		12,000
Add: Treatment of Mr. G's brother (independent)		6,000
Taxable value of perquisite		24,000

Note: Grandfather and independent brother are not included within the meaning of family of Mr. G.

(12) Payment of premium on personal accident insurance policies

If an employer takes personal accident insurance policies on the lives of employees and pays the insurance premium, no immediate benefit would become payable and benefit will accrue at a future date only if certain events take place.

Moreover, the employers would be taking such policy in their business interest only, so as to indemnify themselves from payment of any compensation. Therefore, the premium so paid will not constitute taxable perquisites in the employees' hands - *CIT vs. Lala Shri Dhar [1972] 84 ITR 19 (Del.).*

1.21 DEDUCTIONS FROM SALARY

The income chargeable under the head 'salaries' is computed after making the following deductions:

(1) Entertainment allowance [section 16(ii)]

(2) Professional tax [section 16(iii)]

(1) Entertainment allowance:

Entertainment allowance received is fully taxable and is first to be included in the salary and thereafter the following deduction is to be made:

However deduction in respect of entertainment allowance is available in case of Government

employees. The amount of deduction will be lower of:

i. One-fifth of his basic salary or

ii. Rs.5,000 or

iii. Entertainment allowance received.

Deduction is permissible even if the amount received as entertainment allowance is not proved to have been spent - *CIT vs. Kamal Devi [1971] 81 ITR 773 (Delhi).*

Amount actually spent by the employee towards entertainment out of the entertainment allowance received by him is not a relevant consideration at all.

(2) Professional tax on employment:

Professional tax or taxes on employment levied by a State under Article 276 of the Constitution is allowed as deduction only when it is actually paid by the employee during the previous year.

If professional tax is reimbursed or directly paid by the employer on behalf of the employee, the amount so paid is first included as salary income and then allowed as a deduction under section 16.

Illustration 10

Mr. Goyal receives the following emoluments during the previous year ending 31.03.10.

Basic pay	Rs.40,000
Dearness Allowance	Rs.15,000
Commission	Rs.10,000
Entertainment allowance	Rs.4,000
Medical expenses reimbursed	Rs.25,000
Professional tax paid	Rs.3,000 (Rs.2,000 was paid by his employer)

Mr. Goyal contributes Rs.5000 towards recognized provident fund. He has no other income. Determine the income from salary for A.Y. 2010-11, if Mr. Goyal is a State Government employee.

Solution

Computation of salary of Mr. Goyal for the A.Y. 2010-11

Particulars	Rs.	Rs.
Basic Salary		40,000
Dearness Allowance		15,000

Commission		10,000
Entertainment Allowance received		4,000
Employee's contribution to RPF [Note]		-
Medical expenses reimbursed	25,000	
Less : Exempt medical expenses	15,000	10,000
Professional Tax paid by the employer		2,000
Gross Salary		**81,000**
Less: Deductions		
under section 16(ii) Entertainment allowance being lower of :		
(a) Allowance received	4,000	
(b) One fifth of basic salary [1/5 × 40,000]	8,000	
(c) Statutory amount	5,000	4,000
- under section 16(iii) Professional Tax paid		3,000
Income from Salary		**74,000**

Note: Employee's contribution to RPF is not taxable. It is eligible for deduction under section 80C.

1.22 DEDUCTION UNDER SECTION 80C

Under the provisions of section 80C, an assessee will be entitled to a deduction from gross total income of the amount invested in LIC policies, provident funds, payment of tuition fees, repayment of housing loans, investment in infrastructure bonds etc. subject to a maximum of Rs.1,00,000.

Students may refer to Chapter 7 on 'Deduction from Gross Total Income' for a detailed discussion.

1.23 RELIEF UNDER SECTION 89

(1) Where by reason of any portion of an assessee's salary being paid in arrears or in advance or by reason of his having received in any one financial year, salary for more than twelve months or a payment of profit in lieu of salary under section 17(3), his income is assessed at a rate higher than that at which it would otherwise have been assessed, the Assessing Officer shall, on an application made to him in this behalf, grant such relief as prescribed. The procedure for computing the relief i s given in rule 21A.

(2) Similar tax relief is extended to assessees who receive arrears of family pension as

defined in the *Explanation* to clause (iia) of section 57. For the purpose of clause (iia) of section 57, "family pension" means a regular monthly amount payable by the employer to a person belonging to the family of an employee in the event of his death.

(3) No relief shall be granted in respect of any amount received or receivable by an assessee on his voluntary retirement or termination of his service, in accordance with any scheme or schemes of voluntary retirement or a scheme of voluntary separation (in the case of a public sector company), if exemption under section 10(10C) in respect of such compensation received on voluntary retirement or termination of his service or voluntary separation has been claimed by the assessee in respect of the same assessment year or any other assessment year.

Illustration 11

In the case of Mr. Hari, you are informed that the salary for the previous year 2009-10 is Rs.6,20,000 and arrears of salary received is Rs.80,000. Further, you are given the following details relating to the earlier years to which the arrears of salary received is attributable to:

Previous year	Taxable Salary	Arrears now received (Rs.)
2000 - 2001	75,000	15,000
2001 - 2002	80,000	25,000
2002 - 2003	90,000	40,000

Compute the relief available under section 89 of the Income-tax Act and the tax payable for the A.Y. 2010-11.

Note 1:

a) Rates of Taxes:

For A.Y. 2001-02; 2002-03 & 2003-04

Upto 50,000 – Nil; 50,000 to 60,000 – 10% ;

60,001 to 1,50,000 – 20% ; above 1,50,000 –30%

b) Surcharge:

A.Y. 2001-02	-12% (if total income exceeds Rs.60,000)
	-17% (if total income exceeds Rs.1,50,000)
A.Y. 2002-03	- 2% (if total income exceeds Rs.60,000)
A.Y. 2003-04	- 5% (if total income exceeds Rs.60,000)

Solution

Computation of tax payable by Mr. Hari for the A.Y 2010-11

Particulars	Incl. arrears of salary	Excl. arrears of salary
Current year salary	6,20,000	6,20,000
Add: Arrears of salary	80,000	
Taxable Salary	7,00,000	6,20,000
Income-tax thereon	1,14,000	90,000
Add : Education cess @ 2% plus secondary and higher education cess @1%	3,420	2,700
Total payable	**1,17,420**	**92,700**

Computation of tax payable on arrears of salary if charged to tax in the respective assessment years

Particulars	A.Y. 2001-02		A.Y. 2002-03		A.Y. 2003-04	
	Incl. arrears	Excl. arrears	Incl. arrears	Excl. arrears	Incl. arrears	Excl. arrears
Taxable salary	75,000	75,000	80,000	80,000	90,000	90,000
Add: Arrears of salary	15,000	---	25,000	---	40,000	---
Taxable salary	90,000	75,000	1,05,000	80,000	1,30,000	90,000
Tax on the above	7,000	4,000	10,000	5,000	15,000	7,000
Add: Surcharge	840	480	200	100	750	350
Tax payable	**7,840**	**4,480**	**10,200**	**5,100**	**15,750**	**7,350**

Computation of relief under section 89

	Particulars	Rs.	Rs.
i)	Tax payable in A.Y. 2010-11 on arrears :		
	Tax on income including arrears	1,17,420	
	Less : Tax on income excluding arrears	92,700	24,720
ii)	Tax payable in respective years on arrears :		
	Tax on income including arrears (Rs.7,840+Rs.10,200+Rs.15,750)	33,790	

Less : Tax on income excluding arrears (Rs.4,480+Rs.5,100+Rs.7,350)	16,930	16,860
Relief under section 89 - difference between tax on arrears in A.Y 2010-11 and tax on arrears in the respective years		**7,860**

Tax payable for A.Y 2010-11 after relief under section 89

Particulars	**Rs.**
Income-tax payable on total income including arrears of salary	1,17,420
Less : Relief under section 89 as computed above	7,860
Tax payable after claiming relief	**1,09,560**

Illustration 12

Mr. X is employed with AB Ltd. on a monthly salary of Rs.25,000 per month and an entertainment allowance and commission of Rs.1,000 p.m. each. The company provides him with the following benefits:

1. A company owned accommodation is provided to him in Delhi. Furniture costing Rs.2,40,000 was provided on 1.8.2009.
2. A personal loan of Rs.5,00,000 on 1.7.2009 on which it charges interest @ 6.75% p.a. The entire loan is still outstanding. (Assume SBI rate of interest to be 12.75% p.a.)
3. His son is allowed to use a motor cycle belonging to the company. The company had purchased this motor cycle for Rs.60,000 on 1.5.2006. The motor cycle was finally sold to him on 1.8.2009 for Rs.30,000.
4. Mr. X is provided with free electricity. Cost to the employer is Rs.10,000
5. Professional Tax paid by Mr. X is Rs.2,000.

Compute the income from salary of Mr. X for the A.Y.2010-11.

Solution

Computation of Income from Salary of Mr. X for the A.Y. 2010-11

Particulars	**Rs.**	**Rs.**
Basic Salary [Rs.25,000 × 12]		3,00,000
Commission [Rs.1,000 × 12]		12,000
Entertainment Allowance [Rs.1,000 × 12]		12,000

Rent free accommodation [Note 1]	48,600	
Add : Value of furniture [Rs.2,40,000 × 10% p.a. for 8 months]	16,000	64,600
Interest on Personal loan [Note 2]		22,500
Use of motor cycle [Rs.60,000 × 10% p.a. for 4 months]		2,000
Transfer of motor cycle [Note 3]		12,000
Free electricity facility [Note 4]		10,000
Gross Salary		**4,35,100**
Less : Deductions		
- under section 16(iii) Professional Tax paid		2,000
Income from Salary		**4,33,100**

Note 1: Value of rent free unfurnished accommodation

= 15% of salary for the relevant period

= 15% of (Rs.3,00,000 + Rs.12,000 + Rs.12,000)

= Rs.48,600

Note 2: SBI rate of Interest on personal loan = 12.75% p.a.

Value of perquisite for interest on personal loan

= [Rs.5,00,000 × (12.75% - 6.75%) for 9 months]

= Rs.22,500

Note 3: Depreciated value of the motor cycle

= Original cost – Depreciation @ 10% p.a. for 3 completed years.

= Rs.60,000 – (Rs.60,000 × 10% p.a. × 3 years)

= Rs.42,000.

Perquisite = Rs.42,000 – Rs.30,000 = Rs.12,000.

Note 4: Free electricity facility provided to the employee will be taxable only if he is a specified employee. Salary for the purpose of specified employee is -

= Rs. [3,00,000 + 12,000 + 12,000 – 2,000]

= Rs.3,22,000 > Rs.50,000 p.a.

He is a specified employee and so electricity facility is taxable.

Self-examination questions

1. Where there is a decision to increase the D.A. in March, 2010 with retrospective effect from 1.4.2007, and the increased D.A. is received in April, 2010, the increase is taxable -
   a) in the previous year 2009-10
   b) in the previous year 2010-11
   c) in the respective years to which they relate.
2. The entertainment allowance received by a Government employee is exempt up to the lower of the actual entertainment allowance received, 1/5th of basic salary and -
   a) Rs.4,000
   b) Rs.6,000
   c) Rs.5,000.
3. Rajesh is provided with a rent free unfurnished accommodation, which is owned by his employer, XY Pvt. Ltd., in New Delhi. The value of perquisite in the hands of Rajesh is -
   a) 20% of salary
   b) 15% of salary
   c) 10% of salary
4. Anirudh is provided with furniture to the value of Rs.70,000 along with house from February, 2009. The actual hire charges paid by his employer are Rs.5,000 p.a. The value of furniture to be included along with value of unfurnished house for A.Y.2010-11 is-
   a) Rs.5,000
   b) Rs.7,000
   c) Rs.14,000
5. Employer's contribution to superannuation fund during the previous year 2009-10 is -
   a) subject to fringe benefits in the hands of the employer
   b) fully taxable as perquisite in the hands of the employee
   c) taxable as perquisite in the hands of the employee if it exceeds Rs.1 lakh.
6. Distinguish between foregoing of salary and surrender of salary.
7. Write short notes on -
   a) Profits in lieu of salary
   b) Specified employees

8. Is retrenchment compensation received by workmen taxable under the Act? If yes, to what extent is it taxable?
9. When is provision of medical facilities or assistance by an employer not treated as a perquisite in the hands of the employee? Discuss.
10. Can an assessee claim relief under section 89 in respect of VRS compensation of Rs.6 lakh received by him from his employer, if he has claimed exemption of Rs.5 lakh in respect of the same under section 10(10C)? Discuss.

Answers

1. a; **2.** c; **3.** b; **4.** a; **5.** c

UNIT – 2 : INCOME FROM HOUSE PROPERTY

Learning Objectives

After studying this unit, you would be able to understand –

- when income is chargeable under the head "Income from house property"
- what are the conditions to be satisfied for income to be chargeable under this head.
- what is composite rent and what is the tax treatment for the same.
- how to determine annual value of different categories of house property
- the tax treatment for unrealized rent
- what are the admissible deductions from annual value
- what are the inadmissible deductions while computing income from house property
- how to compute income from house property for different categories of house property
- what is the tax treatment on recovery of unrealized rent and arrears of rent
- what is meant my co-ownership and what is the tax treatment in respect of the same.
- who are the deemed owners of house property
- the cases where income from house property is exempt from tax.

2.1 CHARGEABILITY [SECTION 22]

(i) The process of computation of income under the head "Income from house property" starts with the determination of annual value of the property. The concept of annual value and the method of determination is laid down in section 23.

(ii) The annual value of any property comprising of building or land appurtenant thereto, of which the assessee is the owner, is chargeable to tax under the head "Income from house property".

2.2 CONDITIONS FOR CHARGEABILITY

(i) Property should consist of any building or land appurtenant thereto.

(a) Buildings include not only residential buildings, but also factory buildings, offices, shops, godowns and other commercial premises.

(b) Land appurtenant means land connected with the building like garden, garage etc.

(c) Income from letting out of vacant land is, however, taxable under the head "Income from other sources".

(ii) Assessee must be the owner of the property

(a) Owner is the person who is entitled to receive income from the property in his own right.

(b) The requirement of registration of the sale deed is not warranted.

(c) Ownership includes both free-hold and lease-hold rights.

(d) Ownership includes deemed ownership (discussed later in para 2.12)

(e) The person who owns the building need not also be the owner of the land upon which it stands.

(f) The assessee must be the owner of the house property during the previous year. It is not material whether he is the owner in the assessment year.

(g) If the title of the ownership of the property is under dispute in a court of law, the decision as to who will be the owner chargeable to income-tax under section 22 will be of the Income-tax Department till the court gives its decision to the suit filed in respect of such property.

(iii) The property may be used for any purpose, but it should not be used by the owner for the purpose of any business or profession carried on by him, the profit of which is chargeable to tax.

(iv) Property held as stock-in-trade etc.

Annual value of house property will be charged under the head "Income from house property" in the following cases also –

(a) Where it is held by the assessee as stock-in-trade of a business;

(b) Where the assessee is engaged in the business of letting out of property on rent;

Exceptions

(a) Letting out is supplementary to the main business

(i) Where the property is let out with the object of carrying on the business of the assessee in an efficient manner, then the rental income is taxable as business income, provided letting is not the main business but it is supplementary to the main business.

(ii) In such a case, the letting out of the property is supplementary to the main business of the assessee and deductions/allowances have to be calculated as relating to profits/gains of business and not relating to house property.

(b) Letting out of building along with other facilities

(i) Where income is derived from letting out of building along with other facilities like

furniture, the income cannot be said to be derived from mere ownership of house property but also because of facilities and services rendered and hence assessable as income from business.

(ii) Where a commercial property is let out along with machinery e.g. a cotton mill including the building and the two lettings are inseparable, the income will either be assessed as business income or as income from other sources, as the case may be.

2.3 COMPOSITE RENT

(i) Meaning of composite rent

The owner of a property may sometimes receive rent in respect of building as well as –

(1) other assets like say, furniture, plant and machinery.

(2) for different services provided in the building, for eg. –

(a) Lifts;

(b) Security;

(c) Power backup;

The amount so received is known as "composite rent".

(ii) Tax treatment of composite rent

(1) Where composite rent includes rent of building and charges for different services (lifts, security etc.), the composite rent is has to be split up in the following manner -

(a) the sum attributable to use of property is to be assessed under section 22 as income from house property;

(b) the sum attributable to use of services is to charged to tax under the head "Profits and gains of business or profession" or under the head "Income from other sources".

(2) Where composite rent is received from letting out of building and other assets (like furniture) and the two lettings are not separable –

(a) If the letting out of building and other assets are not separable i.e. the other party does not accept letting out of buildings without other assets, then the rent is taxable either as business income or income from other sources;

(b) This is applicable even if sum receivable for the two lettings is fixed separately.

(3) Where composite rent is received from letting out of buildings and other assets and the two lettings are separable –

(a) If building is let out along with other assets, but the two lettings are separable i.e. letting out of one is acceptable to the other party without letting out of the other, then income

from letting out of building is taxable under "Income from house property";

(b) Income from letting out of other assets is taxable as business income or income from other sources;

(c) This is applicable even if a composite rent is received by the assessee from his tenant for the two lettings.

2.4 INCOME FROM HOUSE PROPERTY SITUATED OUTSIDE INDIA

(i) In case of a resident in India (resident and ordinarily resident in case of individuals and HUF), income from property situated outside India is taxable, whether such income is brought into India or not.

(ii) In case of a non-resident or resident but not ordinarily resident in India, income from a property situated outside India is taxable only if it is received in India.

2.5 DETERMINATION OF ANNUAL VALUE [SECTION 23]

This involves three steps :

Step 1 - Determination of Gross Annual Value (GAV).

Step 2 – From the gross annual value computed in step 1, deduct municipal tax paid by the owner during the previous year.

Step 3 – The balance will be the Net Annual Value (NAV), which as per the Income-tax Act is the annual value.

(i) Determination of annual value for different types of house properties

(1) Where the property is let out throughout the previous year [Section 23(1)(a)/(b)]

Where the property is let out for the whole year, then the GAV would be the higher of -

(a) Annual Letting Value (ALV) and

(b) Actual rent received or receivable during the year

- The ALV is the higher of fair rent (FR) and municipal value (MV), but restricted to standard rent (SR).

  For example, let us say the higher of FR and MV is X. Then ALV = SR, if X>SR. However, if X<SR, ALV = X.

- ALV as per section 23(1)(a) cannot exceed standard rent (SR) but it can be lower than standard rent, in a case where standard rent is more than the higher of MV and FR.

- Municipal value is the value determined by the municipal authorities for levying municipal taxes on house property.
- Fair rent means rent which similar property in the same locality would fetch.
- The standard rent is fixed by the Rent Control Act.
- From the GAV computed above, municipal taxes paid by the owner during the previous year is to be deducted to arrive at the NAV.

Illustration 1

Jayashree owns five houses in Chennai, all of which are let-out. Compute the GAV of each house from the information given below–

Particulars	House I	House II	House III	House IV	House V
Municipal Value	80,000	55,000	65,000	24,000	75,000
Fair Rent	90,000	60,000	65,000	25,000	80,000
Standard Rent	N.A.	75,000	58,000	N.A.	78,000
Actual rent received/ receivable	72,000	72,000	60,000	30,000	72,000
Solution					
GAV	90,000	72,000	60,000	30,000	78,000

(2) Where let out property is vacant for part of the year [Section 23(1)(c)]

Where let out property is vacant for part of the year and owing to vacancy, the actual rent is lower than the ALV, then the actual rent received or receivable will be the GAV of the property.

(3) In case of self-occupied property or unoccupied property [Section 23(2)]

(a) Where the property is self-occupied for own residence or unoccupied throughout the previous year, its Annual Value will be Nil, provided no other benefit is derived by the owner from such property.

(b) The benefit of exemption of one self-occupied house is available only to an individual/HUF.

(c) The expression "Unoccupied property" refers to a property which cannot be occupied by the owner by reason of his employment, business or profession at a different place and he resides at such other place in a building not belonging to him.

(d) No deduction for municipal taxes is allowed in respect of such property.

(4) Where a house property is let-out for part of the year and self-occupied for part of the year [Section 23(3)]

(a) If a single unit of a property is self-occupied for part of the year and let-out for the remaining part of the year, then the ALV for the whole year shall be taken into account for determining the GAV.

(b) The ALV for the whole year shall be compared with the actual rent for the let out period and whichever is higher shall be adopted as the GAV.

(c) However, property taxes for the whole year is allowed as deduction provided it is paid by the owner during the previous year.

(5) In case of deemed to be let out property [Section 23(4)]

(a) Where the assessee owns more than one property for self-occupation, then the income from any one such property, at the option of the assessee, shall be computed under the self-occupied property category and its annual value will be nil. The other self-occupied/unoccupied properties shall be treated as "deemed let out properties".

(b) This option can be changed year after year in a manner beneficial to the assessee.

(c) In case of deemed let-out property, the ALV shall be taken as the GAV.

(d) The question of considering actual rent received/receivable does not arise. Consequently, no adjustment is necessary on account of property remaining vacant or unrealized rent.

(e) Municipal taxes actually paid by the owner during the previous year can be claimed as deduction.

(6) In case of a house property, a portion let out and a portion self-occupied

(a) Income from any portion or part of a property which is let out shall be computed separately under the "let out property" category and the other portion or part which is self-occupied shall be computed under the "self-occupied property" category.

(b) There is no need to treat the whole property as a single unit for computation of income from house property.

(c) Municipal valuation/fair rent/standard rent, if not given separately, shall be apportioned between the let-out portion and self-occupied portion either on plinth area or built-up floor space or on such other reasonable basis.

(d) Property taxes, if given on a consolidated basis can be bifurcated as attributable to each portion or floor on a reasonable basis.

Notional income instead of real income

Thus, under this head of income, there are circumstances where notional income is charged to tax instead of real income. For example –

- Where the assessee owns more than one house property for the purpose of self-occupation, the annual value of any one of those properties, at the option of the assessee, will be nil and the other properties are deemed to be let-out and income has to be computed on a notional basis by taking the ALV as the GAV.
- In the case of let-out property also, if the ALV exceeds the actual rent, the ALV is taken as the GAV.

(ii) Treatment of unrealised rent [*Explanation* to section 23(1)]

(1) The Actual rent received/receivable should not include any amount of rent which is not capable of being realised.

(2) However the conditions prescribed in Rule 4 should be satisfied. They are –

(a) the tenancy is *bona fide*;

(b) the defaulting tenant has vacated, or steps have been taken to compel him to vacate the property;

(c) the defaulting tenant is not in occupation of any other property of the assessee;

(d) the assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfies the Assessing Officer that legal proceedings would be useless.

(iii) Property taxes (Municipal taxes)

(1) Property taxes are allowable as deduction from the GAV subject to the following two conditions:

(a) It should be borne by the assessee (owner); and

(b) It should be actually paid during the previous year.

(2) If property taxes levied by a local authority for a particular previous year is not paid during that year, no deduction shall be allowed in the computation of income from house property for that year.

(3) However, if in any subsequent year the arrears are paid, then the amount so paid is allowed as deduction in computation of income from house property for that year.

(4) Thus, we find that irrespective of the previous year in which the liability to pay such taxes arise according to the method of accounting regularly employed by the owner, the deduction in

respect of such taxes will be allowed only in the year of actual payment.

(5) In case of property situated outside India, taxes levied by local authority of the country in which the property is situated is deductible. *[CIT v. R. Venugopala Reddiar* (1965) 58 ITR 439 (Mad).*]*

Illustration 2

Rajesh, a British national, is a resident and ordinarily resident in India during the P.Y.2009-10. He owns a house in London, which he has let out at £ 10,000 p.m. The muncipal taxes paid to the Municipal Corporation of London is £ 8,000 during the P.Y.2009-10. The value of one £ in Indian rupee to be taken at Rs.82.50. Compute Rajesh's taxable income for the A.Y. 2010-11.

Solution

For the P.Y.2009-10, Mr. Rajesh, a British national, is resident and ordinarily resident in India. Therefore, income received by him by way of rent of the house property located in London is to be included in the total income in India. Municipal taxes paid in London is be to allowed as deduction from the gross annual value.

Computation of Income from house property of Mr. Rajesh for A.Y.2010-11

Particulars	**Rs.**
Gross Annual Value (*£ 10,000 × 12 × 82.50)*	99,00,000
Less: Municipal taxes paid (*£ 8,000 × 82.50)*	6,60,000
Net Annual Value (NAV)	**92,40,000**
Less: Deduction u/s 24	
(a) 30% of NAV = 30% of Rs.92,40,000	27,72,000
Income from house property	**64,68,000**

2.6 DEDUCTIONS FROM ANNUAL VALUE [SECTION 24]

(i) There are two deductions from annual value. They are –

(1) 30% of NAV; and

(2) interest on borrowed capital

(1) 30% of NAV is allowed as deduction under section 24(a)

(a) This is a flat deduction and is allowed irrespective of the actual expenditure incurred.

(b) In case of self-occupied property where the annual value is nil, the assessee will not be entitled to deduction of 30%, as the annual value itself is nil.

(2) Interest on borrowed capital is allowed as deduction under section 24(b)

(a) Interest payable on loans borrowed for the purpose of acquisition, construction, repairs, renewal or reconstruction can be claimed as deduction.

(b) Interest payable on a fresh loan taken to repay the original loan raised earlier for the aforesaid purposes is also admissible as a deduction.

(c) Interest relating to the year of completion of construction can be fully claimed in that year irrespective of the date of completion.

(d) Interest payable on borrowed capital for the period prior to the previous year in which the property has been acquired or constructed, can be claimed as deduction over a period of 5 years in equal annual installments commencing from the year of acquisition or completion of construction.

Illustration 3

Arvind had taken a loan of Rs.5,00,000 for construction of property on 1.10.2008. Interest was payable @ 10% p.a. The construction was completed on 30.6.2009. No principal repayment has been made up to 31.3.2010. Compute the interest allowable as deduction under section 24 for the A.Y.2010-11.

Solution

Interest for the year (1.4.09 to 31.3.10) = 10% of Rs.5,00,000 = Rs.50,000

Pre-construction interest = 10% of Rs.5,00,000 for 6 months (from 1.10.08 to 31.3.09) = 25,000

Pre-construction interest to be allowed in 5 equal annual installments of Rs.5,000 from the year of completion of construction i.e. in this case, P.Y.2009-10.

Therefore, total interest deduction under section 24 = 50,000+5000 = Rs.55,000.

(ii) Deduction in respect of one self-occupied property where annual value is nil

(1) In this case, the assessee will be allowed a deduction on account of interest (including 1/5th of the accumulated interest of pre-construction period) as under –

(a)	Where the property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital before 1.4.99.	Actual interest payable subject to maximum of Rs.30,000.

(b)	Where the property is acquired or constructed with capital borrowed on or after 1.4.99 and such acquisition or construction is completed within 3 years from the end of the financial year in which the capital was borrowed.	Actual interest payable subject to maximum of Rs.1,50,000, if certificate mentioned in (2) below is obtained.
(c)	Where the property is repaired, renewed or reconstructed with capital borrowed on or after 1.4.99.	Actual interest payable subject to a maximum of Rs.30,000.

(2) For the purpose of claiming deduction of Rs.1,50,000 as per 1(b) in the table given above, the assessee should furnish a certificate from the person to whom any interest is payable on the capital borrowed, specifying the amount of interest payable by the assessee for the purpose of such acquisition or construction of the property.

(3) The ceiling prescribed for one self-occupied property as above in respect of interest on loan borrowed does not apply to a deemed let-out property.

(4) Deduction under section 24(b) for interest is available on accrual basis. Therefore interest accrued but not paid during the year can also be claimed as deduction.

(5) Where a buyer enters into an arrangement with a seller to pay the sale price in installments along with interest due thereon, the seller becomes the lender in relation to the unpaid purchase price and the buyer becomes the borrower. In such a case, unpaid purchase price can be treated as capital borrowed for acquiring property and interest paid thereon can be allowed as deduction under section 24.

(6) Interest on unpaid interest is not deductible.

2.7 COMPUTATION OF INCOME FROM HOUSE PROPERTY FOR DIFFERENT CATEGORIES OF PROPERTY

(i) Property let out throughout the previous year

PARTICULARS		Amount
Computation of GAV		
Step 1	Compute ALV	
	ALV = Higher of MV and FR, but restricted to SR	
Step 2	Compute Actual rent received/receivable	
	Actual rent received/receivable less unrealized rent as per Rule 4	
Step 3	Compare ALV and Actual rent received/receivable	

Step 4	GAV is the higher of ALV and Actual rent received/receivable		
Gross Annual Value (GAV)			A
Less:	Municipal taxes (paid by the owner during the previous year)		B
Net Annual Value (NAV) = (A-B)			C
Less:	**Deductions u/s 24**		
	(a) 30% of NAV	D	
	(b) Interest on borrowed capital (actual without any ceiling limit)	E	
Income from house property (C-D-E)			F

Illustration 4

Anirudh has a property whose municipal valuation is Rs.1,30,000 p.a. The fair rent is Rs.1,10,000 p.a. and the standard rent fixed by the Rent Control Act is Rs.1,20,000 p.a. The property was let out for a rent of Rs.11,000 p.m. throughout the previous year. Unrealised rent was Rs.11,000 and all conditions prescribed by Rule 4 are satisfied. He paid municipal taxes @10% of municipal valuation. Interest on borrowed capital was Rs.40,000 for the year. Compute the income from house property of Anirudh.

Solution

Computation of Income from house property of Mr. Anirudh for A.Y. 2009-10

Particulars		**Amount in Rs.**
Computation of GAV		
Step 1	Compute ALV	
	ALV = Higher of MV of Rs.1,30,000 p.a. and FR of Rs.1,10,000 p.a., but restricted to SR of Rs.1,20,000 p.a.	1,20,000
Step 2	Compute actual rent received/receivable	
	Actual rent received/receivable less unrealized rent as per Rule 4 = 1,32,000-11,000	1,21,000
Step 3	Compare ALV of Rs.1,20,000 and Actual rent received/receivable of Rs.1,21,000.	

Step 4	GAV is the higher of ALV and Actual rent received/receivable	1,21,000	
Gross Annual Value (GAV)			**1,21,000**
Less:	Municipal taxes (paid by the owner during the previous year) = 10% of Rs.1,30,000		13,000
Net Annual Value (NAV) = 1,21,000-13,000			**1,08,000**
Less:	**Deductions u/s 24**		
	(a) 30% of NAV	32,400	
	(b) Interest on borrowed capital (actual without any ceiling limit)	40,000	72,400
Income from house property (1,08,000-32,400-40,000)			**35,600**

(ii) Let out property vacant for part of the year

Particulars	**Amount**
Computation of GAV	
Step 1 Compute ALV	
ALV = Higher of MV and FR, but restricted to SR	
Step 2 Compute Actual rent received/receivable	
Actual rent received/receivable for let out period less unrealized rent as per Rule 4	
Step 3 Compare ALV and Actual rent received/receivable	
Step 4 If Actual rent is lower than ALV owing to vacancy, then Actual rent is the GAV.	
If Actual rent is lower than ALV due to other reasons, then ALV is the GAV.	
However, in spite of vacancy, if the actual rent is higher than the ALV, then Actual rent is the GAV.	

Gross Annual Value (GAV)			A
Less:	Municipal taxes (paid by the owner during the previous year)		B
Net Annual Value (NAV) = (A-B)			C
Less:	**Deductions u/s 24**		
	(a) 30% of NAV	D	
	(b) Interest on borrowed capital (actual without any ceiling limit)	E	
Income from house property (C-D-E)			F

Illustration 5

Ganesh has a property whose municipal valuation is Rs.2,50,000 p.a. The fair rent is Rs.2,00,000 p.a. and the standard rent fixed by the Rent Control Act is Rs.2,10,000 p.a. The property was let out for a rent of Rs.20,000 p.m. However, the tenant vacated the property on 31.1.10. Unrealised rent was Rs.20,000 and all conditions prescribed by Rule 4 are satisfied. He paid municipal taxes @8% of municipal valuation. Interest on borrowed capital was Rs.65,000 for the year. Compute the income from house property of Ganesh for A.Y.2010-11.

Solution

Computation of income from house property of Ganesh for A.Y.2010-11

Particulars		**Amount in Rs.**
Computation of GAV		
Step 1	Compute ALV	
	ALV = Higher of MV of Rs.2,50,000 p.a. and FR of Rs.2,00,000 p.a., but restricted to SR of Rs.2,10,000 p.a.	2,10,000
Step 2	Compute Actual rent received/receivable	
	Actual rent received/receivable for let out period less unrealized rent as per Rule 4 =2,00,000-20,000	1,80,000
Step 3	Compare ALV and Actual rent received/receivable	

Step 4	In this case the actual rent of Rs.1,80,000 is lower than ALV of Rs.2,10,000 owing to vacancy, since, had the property not been vacant the actual rent would have been Rs.2,20,000 (Rs.1,80,000 + Rs.40,000). Therefore, actual rent is the GAV.	1,80,000	
Gross Annual Value (GAV)			**1,80,000**
Less:	Municipal taxes (paid by the owner during the previous year) = 8% of Rs.2,50,000 =		20,000
Net Annual Value (NAV) = (1,80,000-20,000)			**1,60,000**
Less:	**Deductions u/s 24**		
	(a) 30% of NAV = 30% of Rs.1,60,000	48,000	
	(b) Interest on borrowed capital		
	(actual without any ceiling limit)	65,000	1,13,000
Income from house property =(1,60,000-48,000-65,000)			**47,000**

(iii) Self-occupied property or Unoccupied property

Particulars		**Amount**
Annual value under section 23(2)		Nil
Less:	**Deduction under section 24**	
	Interest on borrowed capital	E
	Interest on loan taken for acquisition or construction of house on or after 1.4.99 and same was completed within 3 years from the end of the financial year in which capital was borrowed, interest paid or payable subject to a maximum of Rs.1,50,000 (including apportioned pre-construction interest).	
	(ii) In case of loan for acquisition or construction taken prior to 1.4.99 or loan taken for repair, renovation or reconstruction at any point of time, interest paid or payable subject to a maximum of Rs.30,000.	
Income from house property		-E

Illustration 6

Poorna has one house property at Indra Nagar in Bangalore. She stays with her family in the house. The rent of similar property in the neighbourhood is Rs.25,000 p.m. The municipal valuation is Rs.23,000 p.m. Municipal taxes paid is Rs.8,000. The house was constructed in the year 2003 with a loan of Rs.20,00,000 taken from SBI Housing Finance Ltd. The construction was completed on 30.11.2006. The accumulated interest up to 31.3.2006 is Rs.1,50,000. During the previous year 2009-10, Poorna paid Rs.1,88,000 which included Rs.1,44,000 as interest. Compute Poorna's income from house property for A.Y. 2010-11.

Solution

Computation of income from house property of Smt.Poorna for A.Y.2010-11

Particulars		**Amount**
Annual Value of one house used for self-occupation under section 23(2)		Nil
Less:	**Deduction under section 24**	
	Interest on borrowed capital	
	Interest on loan was taken for construction of house on or after 1.4.99 and same was completed within 3 years - interest paid or payable subject to a maximum of Rs.1,50,000 (including apportioned pre-construction interest) will be allowed as deduction.	1,50,000
	In this case the total interest is Rs.1,44,000 + Rs.30,000 (Being 1/5th of Rs.1,50,000) = Rs.1,74,000. However, the interest deduction is restricted to Rs.1,50,000.	
Loss from house property		-1,50,000

(iv) House property let-out for part of the year and self-occupied for part of the year

Particulars	**Amount**
Computation of GAV	
Step 1 Compute ALV for the whole year	
ALV = Higher of MV and FR, but restricted to SR	

Step 2	Compute Actual rent received/receivable		
	Actual rent received/receivable for the period let out less unrealized rent as per Rule 4		
Step 3	Compare ALV for the whole year with the actual rent received/receivable for the let out period		
Step 4	GAV is the higher of ALV computed for the whole year and Actual rent received/receivable computed for the let-out period.		
Gross Annual Value (GAV)			A
Less:	Municipal taxes (paid by the owner during the previous year)		B
Net Annual Value (NAV) = (A-B)			C
Less:	**Deductions u/s 24**		
	(a) 30% of NAV	D	
	(b) Interest on borrowed capital (actual without any ceiling limit)	E	
Income from house property (C-D-E)			F

Illustration 7

Smt.Rajalakshmi owns a house property at Adyar in Chennai. The municipal value of the property is Rs.5,00,000, fair rent is Rs.4,20,000 and standard rent is Rs.4,80,000. The property was let-out for Rs.50,000 p.m. up to December 2009. Thereafter, the tenant vacated the property and Smt. Rajalakshmi used the house for self-occupation. Rent for the months of November and December 2009 could not be realised in spite of the owner's efforts. All the conditions prescribed under Rule 4 are satisfied. She paid municipal taxes @12% during the year. She had paid interest of Rs.25,000 during the year for amount borrowed for repairs for the house property. Compute her income from house property for the A.Y. 2010-11.

Solution

Computation of income from house property of Smt. Rajalakshmi for the A.Y.2010-11

Particulars	**Amount in rupees**
Computation of GAV	
Step 1 Compute ALV for the whole year	

	ALV = Higher of MV of Rs.5,00,000 and FR of Rs.4,20,000, but restricted to SR of Rs.4,80,000	4,80,000	
Step 2	Compute Actual rent received/receivable		
	Actual rent received/receivable for the period let out less unrealized rent as per Rule 4 = (50000×9)-(50000×2)=4,50,000-1,00,000=	3,50,000	
Step 3	Compare ALV for the whole year with the actual rent received/receivable for the let out period i.e. 4,80,000 and 3,50,000		
Step 4	GAV is the higher of ALV computed for the whole year and Actual rent received/receivable computed for the let-out period.	4,80,000	
Gross Annual Value (GAV)			**4,80,000**
Less:	Municipal taxes (paid by the owner during the previous year) = 12% of Rs.5,00,000		60,000
Net Annual Value (NAV) = 4,80,000-60,000			**4,20,000**
Less:	**Deductions u/s 24**		
	(a) 30% of NAV = 30% of Rs.4,20,000	1,26,000	
	(b) Interest on borrowed capital	25,000	1,51,000
Income from house property (4,20,000-1,26,000-25,000)			**2,69,000**

(v) Deemed to be let out property

Particulars			**Amount**
Gross Annual Value (GAV)			A
	ALV is the GAV of house property ALV = Higher of MV and FR, but restricted to SR		
Less:	Municipal taxes (paid by the owner during the previous year)		B
Net Annual Value (NAV) = (A-B)			C
Less:	**Deductions under section 24**		
	(a) 30% of NAV	D	
	(b) Interest on borrowed capital (actual without any ceiling limit)	E	
Income from house property (C-D-E)			F

Illustration 8

Ganesh has two houses, both of which are self-occupied. The particulars of the houses for the P.Y.2009-10 are as under:

Particulars	House I	House II
Municipal valuation p.a.	1,00,000	1,50,000
Fair rent p.a.	75,000	1,75,000
Standard rent p.a.	90,000	1,60,000
Date of completion	31.3.1999	31.3.2001
Municipal taxes paid during the year	12%	8%
Interest on money borrowed for repair of property during the current year	-	55,000

Compute Ganesh's income from house property for A.Y.2010-11 and suggest which house should be opted by Ganesh to be assessed as self-occupied so that his tax liability is minimum.

Solution

Computation of income from house property of Ganesh for the A.Y. 2010-11

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

Particulars	Amount in Rs.	
	House I	House II
Gross Annual Value (GAV)		
ALV is the GAV of house property		
ALV = Higher of MV and FR, but restricted to SR	90,000	1,60,000
Less: Municipal taxes (paid by the owner during the previous year)	12,000	12,000
Net Annual Value (NAV)	**78,000**	**1,48,000**
Less: Deductions under section 24		
(a) 30% of NAV	23,400	44,400
(b) Interest on borrowed capital	-	55,000
Income from house property	**54,600**	**48,600**

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

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

Particulars	Amount in Rs.
House I (Self-occupied)	Nil
House II (Deemed to be let-out)	48,600
Income from house property	**48,600**

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

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

Particulars	Amount in Rs.
House I (Deemed to be let-out)	54,600
House II (Self-occupied)	-30,000
(interest deduction restricted to Rs.30,000)	
Income from house property	**24,600**

Since Option 2 is more beneficial, Ganesh should opt to treat House II as self-occupied and House I as deemed to be let out. His income from house property would be Rs.24,600 for the A.Y. 2010-11.

(vi) House property, a portion let out and a portion self-occupied

Illustration 9

Prem owns a house in Madras. During the previous year 2009-10, 2/3rd portion of the house was self-occupied and 1/3rd portion was let out for residential purposes at a rent of Rs.8,000 p.m. Municipal value of the property is Rs.3,00,000 p.a., fair rent is Rs.2,70,000 p.a. and standard rent is Rs.3,30,000. He paid municipal taxes @10% of municipal value during the year. A loan of Rs.25,00,000 was taken by him during the year 2007 for acquiring the property. Interest on loan paid during the previous year 2009-10 was Rs.1,20,000. Compute Prem's income from house property for the A.Y. 2010-11.

Solution

There are two units of the house. Unit I with 2/3rd area is used by Prem for self-occupation throughout the year and no benefit is derived from that unit, hence it will be treated as self-

occupied and its annual value will be nil. Unit 2 with 1/3rd area is let-out through out the previous year and its annual value has to be determined as per section 23(1).

Computation of Income from house property of Mr. Prem for A.Y. 2010-11

Particulars		Amount in rupees
Unit I (2/3rd area – self-occupied)		
Annual Value		Nil
Less: Deduction u/s 24(b)		
2/3rd of Rs.1,20,000		80,000
Income from Unit I (self-occupied)		**-80,000**
Unit II (1/3rd area – let out)		
Computation of GAV		
Step I – Compute ALV		
ALV = Higher of MV and FR, restricted to SR. However, in this case, SR of Rs.1,10,000 (1/3rd of Rs.3,30,000) is more than the higher of MV of Rs.1,00,000 (1/3rd of Rs.3,00,000) and FR of Rs.90,000 (1/3rd of Rs.2,70,000). Hence the higher of MV and FR is the ALV. In this case, it is the MV.	1,00,000	
Step 2 – Compute actual rent received/ receivable		
8,000×12 = 96,000	96,000	
Step 3 – GAV is the higher of ALV and actual rent received/receivable i.e. higher of Rs.1,00,000 and Rs.96,000	1,00,000	
Gross Annual Value(GAV)		**1,00,000**
Less: Municipal taxes paid by the owner during the previous year relating to let-out portion		
1/3rd of (10% of Rs.3,00,000) = 30000/3 = 10,000		10,000
Net Annual Value(NAV) = (1,00,000-10,000)		**90,000**

Less: Deductions under section 24		
(a) 30% of NAV = 30% of Rs.90,000	27,000	
(b) Interest paid on borrowed capital (relating to let out portion)		
1/3 rd of Rs.1,20,000	40,000	67,000
Income from Unit II (let-out)		**23,000**
Loss under the head "Income from house property" = -80,000 + 23,000		**-57000**

2.8 INADMISSIBLE DEDUCTIONS [SECTION 25]

Interest chargeable under this Act which is payable outside India shall not be deducted if –

(a) tax has not been paid or deducted from such interest and

(b) there is no person in India who may be treated as an agent under section 163.

2.9 TAXABILITY OF RECOVERY OF UNREALISED RENT & ARREARS OF RENT RECEIVED

(i) Unrealised rent is deducted from actual rent in determination of annual value under section 23, subject to fulfillment of conditions under Rule 4. Subsequently, when the amount is realised it gets taxed under section 25AA in the year of receipt.

(ii) If the assessee has increased the rent payable by the tenant and the same has been in dispute and later on the assessee receives the increase in rent as arrears, such arrears is assessable under section 25B.

	Unrealised rent [Section 25AA]	Arrears of rent [Section 25B]
(a)	Taxable in the hands of the assessee whether he is the owner of that property or not.	Taxable in the hands of the assessee whether he is the owner of that property or not.
(b)	Taxable as income of the previous year in which he recovers the unrealized rent.	Taxable as income of the year in which he receives the arrears of rent.
(c)	No deduction shall be allowed.	30% of the amount of arrears shall be allowed as deduction.
(d)	Unrealised rent means the rent which has been deducted from actual rent in any previous year for determining annual value.	Arrears of rent is in respect of rent not charged to income-tax for any previous year.

2.10 TREATMENT OF INCOME FROM CO-OWNED PROPERTY [SECTION 26]

(i) Where property is owned by two or more persons, whose shares are definite and ascertainable, then the income from such property cannot be taxed as income of an AOP.

(ii) The share income of each such co-owner should be determined in accordance with sections 22 to 25 and included in his individual assessment.

(iii) Where the house property owned by co-owners is self occupied by each of the co-owners, the annual value of the property of each co-owner will be Nil and each co-owner shall be entitled to a deduction of Rs.30,000/Rs.1,50,000, as the case may be, under section 24(b) on account of interest on borrowed capital.

(iv) Where the house property owned by co-owners is let out, the income from such property shall be computed as if the property is owned by one owner and thereafter the income so computed shall be apportioned amongst each co-owner as per their specific share.

2.11 TREATMENT OF INCOME FROM PROPERTY OWNED BY A PARTNERSHIP FIRM

(i) Where an immovable property or properties is included in the assets of a firm, the income from such property should be assessed in the hands of the firm only.

(ii) Hence, the property income cannot be assessed as income of the individual partner in respect of his share in the firm.

2.12 DEEMED OWNERSHIP [SECTION 27]

As per section 27, the following persons, though not legal owners of a property, are deemed to be the owners for the purposes of section 22 to 26.

(i) Transfer to a spouse [Section 27(i)] – In case of transfer of house property by an individual to his or her spouse otherwise than for adequate consideration, the transferor is deemed to be the owner of the transferred property.

Exception *– In case of transfer to spouse in connection with an agreement to live apart, the transferor will not be deemed to be the owner. The transferee will be the owner of the house property.*

(ii) Transfer to a minor child [Section 27(i)] – In case of transfer of house property by an individual to his or her minor child otherwise than for adequate consideration, the transferor would be deemed to be owner of the house property transferred.

Exception *– In case of transfer to a minor married daughter, the transferor is not deemed to be the owner.*

Note - Where cash is transferred to spouse/minor child and the transferee acquires property out of such cash, then the transferor shall not be treated as deemed owner of the house property. However, clubbing provisions will be attracted.

(iii) Holder of an impartible estate [Section 27(ii)] – The impartible estate is a property which is not legally divisible. The holder of an impartible estate shall be deemed to be the individual owner of all properties comprised in the estate.

After enactment of the Hindu Succession Act, 1956, all the properties comprised in an impartible estate by custom is to be assessed in the status of a HUF. However, section 27(ii) will continue to be applicable in relation to impartible estates by grant or covenant,.

(iv) Member of a co-operative society etc. [Section 27(iii)] – A member of a co-operative society, company or other association of persons to whom a building or part thereof is allotted or leased under a House Building Scheme of a society/company/association, shall be deemed to be owner of that building or part thereof allotted to him although the co-operative society/company/ association is the legal owner of that building.

(v) Person in possession of a property [Section 27(iiia)] – A person who is allowed to take or retain the possession of any building or part thereof in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act shall be the deemed owner of that house property. This would include cases where the –

(1) possession of property has been handed over to the buyer

(2) sale consideration has been paid or promised to be paid to the seller by the buyer

(3) sale deed has not been executed in favour of the buyer, although certain other documents like power of attorney/agreement to sell/will etc. have been executed.

In all the above cases, the buyer would be deemed to be the owner of the property although it is not registered in his name.

(vi) Person having right in a property for a period not less than 12 years [Section 27(iiib)] – A person who acquires any rights in or with respect to any building or part thereof, by virtue of any transaction as is referred to in section 269UA(f) i.e. transfer by way of lease for not less than 12 years, shall be deemed to be the owner of that building or part thereof.

Exception *– Any rights by way of lease from month to month or for a period not exceeding one year.*

2.13 CASES WHERE INCOME FROM HOUSE PROPERTY IS EXEMPT FROM TAX

Sl. No.	Section	Particulars
1	10(1)	Income from any farm house forming part of agricultural income.
2	10(19A)	Annual value of any one palace in the occupation of an ex-ruler.
3	10(20)	Income from house property of a local authority.
4	10(21)	Income from house property of an approved scientific research association.
5	10(23C)	Property income of universities, educational institutions, etc.
6	10(24)	Property income of any registered trade union.
7	11	Income from house property held for charitable or religious purpose.
8	13A	Property income of any political party.
9	22	Property used for own business or profession
10	23(2)	One self-occupied property of an individual/HUF

Self-examination questions

1. Ganesh is a member of a house building co-operative society. The society is the owner of the flats constructed by it. One of the flats is allotted to Ganesh. The income from that flat will be assessed in the hands of
   a) Co-operative Society
   b) Ganesh
   c) Neither of the above.
2. Vacant site lease rent is taxable as
   a) Income from house property
   b) Business income
   c) Income from other sources
3. Treatment of unrealized rent for determining income from house property
   a) To be deducted from annual letting value
   b) To be deducted from actual rent
   c) To be deducted under section 24 from annual value

4. Municipal taxes to be deducted from GAV should be
   a) Paid by the tenant during the previous year
   b) Paid by the owner during the previous year
   c) Accrued during the previous year
5. Deduction under section 24(a) is
   a) 1/3rd of NAV
   b) repairs actually incurred by the owner
   c) 30% of NAV
6. Interest on borrowed capital accrued up to the end of the previous year prior to the year of completion of construction is allowed
   a) as a deduction in the year of completion of construction
   b) in 5 equal annual installments from the year of completion of construction
   c) In the respective year in which the interest accrues
7. The ceiling limit of deduction under section 24(b) in respect of interest on loan taken on 1.4.08 for repairs of a self-occupied house is
   a) Rs.30,000 p.a.
   b) Rs.1,50,000 p.a.
   c) No limit
8. Where an assessee has two house properties for self-occupation, the benefit of nil annual value will be available in respect of -
   a) Both the properties
   b) The property which has been acquired/constructed first
   c) Any one of the properties, at the option of the assessee
9. Leena received Rs.30,000 as arrears of rent during the P.Y. 2009-10. The amount taxable under section 25B would be -
   a) 30,000
   b) 21,000
   c) 20,000
10. Vidya received Rs.90,000 in May, 2009 towards recovery of unrealised rent, which was deducted from actual rent during the P.Y. 2008-09 for determining annual value. The amount taxable under section 25AA for A.Y.2010-11 would be -

a) 90,000

b) 63,000

c) 60,000

11. Ganesh and Rajesh are co-owners of a self-occupied property. They own 50% share each. The interest paid by each co-owner during the previous year on loan (taken for acquisition of property during the year 2003) is Rs.1,62,000. The amount of allowable deduction in respect of each co-owner is –

a) 1,62,000

b) 75,000

c) 1,50,000

12. Discuss the following issues relating to Income from house property -

(i) Income earned by residents from house properties situated in foreign countries.

(ii) Properties which are used for agricultural purposes.

13. In the following cases, state the head of income under which the receipt is to be assessed and comment.

(1) X let out his property to Y. Y sublets it. How is subletting receipt to be assessed in the hands of Y.

(2) X has built a house on a leasehold land. He has let-out the above property and claims income from house property under "Other sources" and deducted expenses on repairs, security charges, insurance and collection charges in all amounting to 40% of receipts.

14. An assessee, who was deriving income from house property, realised a sum of Rs.52,000 on account of display of advertisement hoardings of various concerns on the roof of the building. He claims that this amount should be considered under the head “Income from house property” and not “Income from other sources”. How do you deal with the following issue under the provisions of the Income-tax Act?

15. Ram owned a house property at Chennai which was occupied by him for the purpose of his residence. He was transferred to Mumbai in June, 2009 and therefore, he let out the property w.e.f. 1.7.2009 on a monthly rent of Rs.8,000. The corporation tax payable in respect of the property was Rs.2,000 of which 50% was paid by him before 31.3.2010. Interest on money borrowed for the construction of the property amounted to Rs.12,000. Compute the income from house property for the A.Y.2010-11.

Answers

1. b; **2.** c; **3.** b; **4.** b; **5.** c; **6.** b; **7.** a; **8.** c; **9.** b; **10.** a; **11.** c

15. Rs.37,700

UNIT – 3 : PROFITS AND GAINS OF BUSINESS OR PROFESSION

Learning Objectives

After studying this unit, you would be able to understand -

- the meaning of "business" and "profession"
- when income is chargeable under this head
- what is a speculative transaction
- what is the tax treatment of loss incurred in speculative business
- what are the admissible deductions while computing income under this head
- what are the inadmissible deductions while computing income under this head
- when certain receipts are deemed to be income chargeable to tax under this head
- which are the deductions allowable only on actual payment
- who are the assessees required to compulsorily maintain books of account
- when audit of accounts is compulsory
- who are the assessees to whom presumptive tax provisions apply
- how income is computed on presumptive basis in case of such assessees
- how business income is computed in cases where income is partly agricultural and partly business in nature

3.1 MEANING OF 'BUSINESS', 'PROFESSION' AND 'PROFITS'

(i) The tax payable by an assessee on his income under this head is in respect of the profits and gains of any business or profession, carried on by him or on his behalf during the previous year. The term "business" has been defined in section 2(13) to "include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture". But the term "profession" has not been defined in the Act. It means an occupation requiring some degree of learning. Thus, a painter, a sculptor, an author, an auditor, a lawyer, a doctor, an architect and, even an astrologer are persons who can be said to be carrying on a profession but not business. The term 'profession' includes vocation as well [Section 2(36)]. However, it is not material whether a person is carrying on a 'business' or 'profession' or 'vocation' since for purposes of assessment, profits from all these sources are treated and taxed alike.

(ii) Business necessarily means a continuous exercise of an activity; nevertheless, profit from a single venture in the nature of trade would also be assessable under this head if the

venture had come to an end or after the entire cost had been recouped. For example, where a person had purchased a piece of land, got it surveyed, laid down a scheme of development, divided it into a number of building plots and sold some of the plots from time to time, though he would not be charged tax on a notional profit made on the individual sale of plots, he would be liable to pay tax on the surplus after all the plots have been sold and the venture has come to an end or after he has recovered the cost of all the plots and expenditure incidental thereto and has a surplus left.

(iii) Profits may be realised in money or in money's worth, i.e., in cash or in kind. Where profit is realised in any form other than cash, the cash equivalent of the receipt on the date of receipt must be taken as the value of the income received in kind. Capital receipts are not generally to be taken into account while computing profits under this head. Payment voluntarily made by persons who were under no obligation to pay anything at all would be income in the hands of the recipient, if they were received in the course of a business or by the exercise of a profession or vocation. Thus, any amount paid to a lawyer by a person who was not a client, but who has been benefited by the lawyer's professional service to another would be assessable as the lawyer's income.

(iv) Application of the gains of trade is immaterial. Gains made even for the benefit of the community by a public body would be liable to tax. To attract the provisions of section 28, it is necessary that the business, profession or vocation should be carried on at least for some time during the accounting year but not necessarily throughout that year and not necessarily by the assessee-owner personally, but it should be under his direction and control.

(v) The charge is not on the gross receipts but on the profits and gains in their natural and proper sense. Profits are ascertained on ordinary principles of commercial trading and commercial accounting. According to section 145, income has to be computed in accordance with the method of accounting regularly and consistently employed by the assessee. The assessee may account for his receipts on the cash basis or mercantile basis.

(vi) The Act, however, contains certain provisions for determining how the income is to be assessed. These must be followed in every case of business or profession. The illegality of a business, profession or vocation does not exempt its profits from tax: the revenue is not concerned with the taint of illegality in the income or its source. Income is taxable even if the assessee is carrying on the business, profession or vocation without any profit motive. The liability to tax arises once income arises to the assessee; the motive or purpose of earning the income is immaterial. Thus, profit motive is not essential for describing the income from that activity as income from business or profession.

(vii) The profits of each distinct business must be computed separately but the tax chargeable under this section is not on the separate income of every distinct business but on the aggregate profits of all the business carried on by the assessee. Profits should be computed after deducting the losses and expenses incurred for earning the income in the regular course

of the business, profession, or vocation unless the loss or expenses is expressly or by necessary implication, disallowed by the Act.

(viii) Income arising from business assets which are temporarily let out e.g., an oil mill, cinema theatre, hotel, ginning or textile factory, rice mill or jute press would be assessable as business income. But if the commercial asset is permanently let the income is taxable as income from house property or income from other sources, depending on the facts and circumstances of the case.

3.2 INCOME CHARGEABLE UNDER THIS HEAD [SECTION 28]

The various items of income chargeable to tax as income under the head 'profits and gains of business or profession' are as under:

(i) Income arising to any person by way of profits and gains from the business, profession or vocation carried on by him at any time during the previous year.

(ii) Any compensation or other payment due to or received by:

(a) Any person, by whatever name called, managing the whole or substantially the whole of (i) the affairs of an Indian company or (ii) the affairs in India of any other company at or in connection with the termination of his management or office or the modification of any of the terms and conditions relating thereto;

(b) any person, by whatever name called, holding an agency in India for any part of the activities relating to the business of any other person at or in connection with the termination of the agency or the modification of any of the terms and conditions relating thereto ;

(c) any person, for or in connection with the vesting in the Government or any corporation owned or controlled by the Government under any law for the time being in force, of the management of any property or business ;

By taxing compensation received on termination of agency or on the takeover of management (which is a capital receipt) as income from business, section 28(ii) provides exception to the general rule that capital receipts are not income taxable in the hands of the recipient.

(iii) Income derived by any trade, professional or similar associations from specific services rendered by them to their members. It may be noted that this forms an exception to the general principle governing the assessment of income of mutual associations such as chambers of commerce, stock brokers' associations etc. As a result a trade, professional or similar association performing specific services for its members is to be deemed as carrying on business in respect of these services and on that assumption the income arising therefrom is to be subjected to tax. For this purpose, it is not necessary that the

income received by the association should be definitely or directly related to these services.

(iv) Profits on sale of a licence granted under the Imports (Control) Order, 1955 made under the Imports and Exports (Control) Act, 1947.

(v) Cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India.

(vi) Any Customs duty or Excise duty drawback repaid or repayable to any person against export under the Customs and Central Excise Duties Drawback Rules, 1971.

(vii) 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.

(viii) 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.

(ix) The value of any benefit or perquisite whether convertible into money or not, arising from business or the exercise of any profession.

(x) Any interest, salary, bonus, commission or remuneration, by whatever name called, due to or received by a partner of a firm from such firm will be deemed to be income from business. However, where any interest, salary, bonus, commission or remuneration by whatever name called, or any part thereof has not been allowed to be deducted under section 40(b), in the computation of the income of the firm the income to be taxed shall be adjusted to the extent of the amount disallowed. In other words, suppose a firm pays interest to a partner at 20% simple interest p.a. The allowable rate of interest is 12% p.a. Hence the excess 8% paid will be disallowed in the hands of the firm. Since the excess interest has suffered tax in the hands of the firm, the same will not be taxed in the hands of the partner.

(xi) Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy will be taxable as income from business. "Keyman insurance policy" means a life insurance policy taken by a person on the life of another person who is or was the employee of the first mentioned person or is or was connected in any manner whatsoever with the business of the first mentioned person.

(xii) Any sum received or receivable, in cash or kind, on account of any capital asset (in respect of which deduction has been allowed under section 35AD) being demolished, destroyed, discarded or transferred.

(xiii) any sum whether received or receivable, in cash or kind, under an agreement

(a) for not carrying out any activity in relation to any business; or

(b) not to share any know-how, patent, copyright, trade mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services.

However, the above sub-clause (a) shall not apply to

(i) any sum, whether received or receivable, in cash or kind, on account of transfer of the right to manufacture, produce or process any article or thing or right to carry on any business, which is chargeable under the head "Capital gains";

(ii) any sum received as compensation, from the multilateral fund of the Montreal Protocol on Substances that Deplete the Ozone layer under the United Nations Environment Programme, in accordance with the terms of agreement entered into with the Government of India.

The Explanation for the purposes of this clause provides that

(i) "agreement" includes any arrangement or understanding or action in concert,-

(A) whether or not such arrangement, understanding or action is formal or in writing; or

(B) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings;

(ii) "service" means service of any description which is made available to potential users and includes the provision of services in connection with business of any industrial or commercial nature such as accounting, banking, communication, conveying of news or information, advertising, entertainment, amusement, education, financing, insurance, chit funds, real estate, construction, transport, storage, processing, supply of electrical or other energy, boarding and lodging.

3.3 SPECULATION BUSINESS

Explanation 2 to section 28 specifically provides that where an assessee carries on speculative business, that business of the assessee must be deemed as distinct and separate from any other business. This becomes necessary because section 73 provides that losses in speculation business unlike other business, cannot be set-off against the profits of any business other than a speculation business. Likewise, a loss in speculation business carried forward to a subsequent year can be set-off only against the profit and gains of any speculative business in the subsequent year. Profits and losses resulting from speculative

transaction must, therefore, be treated as separate and distinct from other profits and gains of business and profession.

According to section 43(5) the expression "speculative transaction" means a transaction in which a contract for the purchase or sales of any commodity including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips. Further, in view of Explanation to section 73, the transaction of purchase and sale of shares by non-banking and non-investment companies must also be deemed to be speculative transactions for tax purposes. However, the following forms of transactions shall not be deemed to be speculative transaction:

(i) a contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchandising business to guard against loss through future price fluctuations in respect of his contracts for the actual delivery of goods manufactured by him or merchandise sold by him ; or

(ii) a contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuation; or

(iii) a contract entered into by a member of a forward market or stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against any loss which may arise in the ordinary course of his business as a member; or

(iv) an eligible transaction carried out in respect of trading in derivatives in a recognized stock exchange.

(a) "eligible transaction" means any transaction,–

(A) carried out electronically on screen-based systems through a stock broker or sub-broker or such other intermediary registered under section 12 of the Securities and Exchange Board of India Act, 1992 in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956 or the Securities and Exchange Board of India Act, 1992 or the Depositories Act, 1996 and the rules, regulations or bye-laws made or directions issued under those Acts or by banks or mutual funds on a recognised stock exchange; and

(B) which is supported by a time stamped contract note issued by such stock broker or sub-broker or such other intermediary to every client indicating in the contract note the unique client identity number allotted under any Act referred to in sub-clause (A) and permanent account number allotted under this Act;

(b) "recognised stock exchange" means a recognised stock exchange as referred to in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956 and which fulfils such conditions as may be prescribed and notified by the Central Government for this purpose.'

Thus, in all the cases where actual delivery or transfer of the commodity or scrips takes place, the transaction would not amount to speculative transaction, however highly speculative it may be in its nature. The actual delivery may be symbolic and includes delivery effected by the mere transfer of delivery orders according to trade practice.

The instances stated above constitute the exceptions specifically provided by the Act, whereby certain transactions (e.g., hedging contracts) entered into by manufacturers and merchants in the course of their business to guard against the loss through price fluctuations are excluded from the definition of speculative transactions. This provision should be liberally construed to cover not only hedging forward contracts for purchase of goods but also such contracts for sale.

The Supreme Court held in *CIT v. Shantilal (P) Ltd. [1983] 144 ITR 57 (SC)* that an award of damages for breach of contract is not the same thing as a party to the contract accepting satisfaction of the contract otherwise than in accordance with the original terms thereof. In this view of the matter, the court held that in a case where a company contracted to sell a certain commodity to a party but was unable to effect delivery due to a sharp rise in the price of the commodity and the dispute which arose out of such breach of contract was settled by payment of damages as decided by an arbitrator, the transaction could not be described as a 'speculative transaction' within the meaning of section 43(5). This principle has been followed by various High Courts also.

3.4 COMPUTATION OF INCOME FROM BUSINESS [SECTION 29]

(i) According to section 29, the profits and gains of any business or profession are to be computed in accordance with the provisions contained in sections 30 to 43D. It must, however, be remembered that in addition to the specific allowances and deductions stated in sections 30 to 36, the Act further permits allowance of items of expenses under the residuary section 37(1), which extends the allowance to items of business expenditure not covered by sections 30 to 36, where these are allowable according to accepted commercial practices.

(ii) An item of loss or expenditure not falling within any of the express deductions may be allowed if it is deductible on the basis of common principles of commercial expediency. Thus, in determining whether a particular item (other than those covered by sections 30 to 36) is deductible from profits, it is necessary first to enquire whether the deduction is expressly or by necessary implication prohibited by the Act and then, if it is not so prohibited, to consider whether it is of such nature that it should be charged against income in the computation of the "profits and gains of business or profession". Accordingly, a loss due to embezzlement or theft of cash by an employee during the course of business is allowable as a deduction in computing the business profit, even though they are not covered by any specific provision of the Act. Losses of non-capital nature which are incidental to the trade and arise unexpectedly in the regular course of the business would be allowed as losses incidental to the trade though

there is no specified provision in the Act for allowing such deductions. Examples of such losses are embezzlement, theft, robbery or destruction of assets, overdrawing by employees, loss of stock in trade by damage or by fire or by ravages of white ants or by enemy action during war or by negligence or fraud of employees, etc. However, if a businessman, having business connection with a non-resident, is unable to recover from the non-resident the amount of tax, he cannot claim it as a bad debt or business loss incidental to the trade on principles of commercial accounting as was held in *CIT v. Abdullabhai Abdul Kadar [1961] 41 ITR 546 (SC).*

(iii) Where a trader stands surety for the debt of another and such guarantee is not in the course of or for the purposes of trade, any payment made as a result of such guarantee cannot be deducted as a business loss except in a case where the contract of guarantee is entered into in the course of business pursuant to a trade or custom of which mutual accommodation is the essence e.g., trader standing surety for one another. Loss of cash in a bank on account of robbery by dacoits or loss through burglary of cash which the assessee is under legal obligation or business necessity required to keep in till it would be allowable as loss incidental to the trade. Losses arising from payments made as advances to employees and money lent by the managed company to the managing agents which had become irrecoverable would be incidental to the business provided that the amounts paid in advance or as loan were so made with reasonable business prudence and hence would be deductible.

(iv) Loss caused by embezzlement is allowable as a deduction not necessarily in the year in which the embezzlement takes place, but when there is no reasonable chance of obtaining restitution and the amount is found to be irrecoverable. Normally when a businessman writes off the amount, it is a prima facie evidence of the fact that the amount has become irrecoverable. If embezzled or stolen moneys which are allowed as deduction in any year are subsequently recovered, they should be brought to tax as a revenue receipt from the business in the year of recovery.

(v) In respect of wasting assets or exhaustion of capital, no deduction is allowable from the income derived from such capital or wasting asset. Accordingly, where an annuity is purchased, the entire amount of annuity received is taxable regardless of the capital paid away and exhausted for the purchase of annuity. Likewise, in the case of a lease, the capital cost of the lease is not allowed to be deducted over the life of the lease.

3.5 ADMISSIBLE DEDUCTIONS

(i) Rent, rates, repairs and insurance for buildings [Section 30]

Section 30 allows deduction in respect of the rent, rates, taxes, repairs and insurance of buildings used by the assessee for the purpose of his business or profession. However, where the premises are used partly for business and partly for other purposes, only a proportionate

part of the expenses attributable to that part of the premises used for purposes of business will be allowed as a deduction. Where the assessee has sublet a part of the premises, the allowance under the section would be confined to the difference between the rent paid by the assessee and the rent recovered from the sub-tenant. The rent payable would be an allowable deduction under this section even though the income from the property in respect of which it is paid may be exempt from taxation in the hands of the owner. Where the assessee himself is owner of the premises and occupies them for his business purposes, no notional rent would be allowed under this section. But where a firm runs its business in the premises owned by one of its partners, the rent payable to the partner will be an allowable deduction to the extent it is reasonable and is not excessive.

Apart from rent, this section allows deductions in respect of expenses incurred on account of repairs to building in case where (i) the assessee is the owner of the building or (ii) the assessee is a tenant who has undertaken to bear the cost of repairs to the premises. Even if the assessee occupies the premises otherwise than as a tenant or owner, i.e., as a lessee, licensee or mortgagee with possession, he is entitled to a deduction under the section in respect of current repairs to the premises.

In addition, deductions are allowed in respect of expenses by way of land revenue, local rates, municipal taxes and insurance in respect of the premises used for the purposes of the business or profession. Cesses, rates and taxes levied by a foreign Government are also allowed. Where the premises in respect of which these expenses are incurred are not utilized wholly for the purposes of the business, then, the deduction allowable should be of an amount proportionate to the use of the premises for the purposes of the business.

(ii) Repairs and insurance of machinery, plant and furniture [Section 31]

Section 31 allows deduction in respect of the expenses on current repairs and insurance of machinery, plant and furniture in computing the income from business or profession. In order to claim this deduction the assets must have been used for purposes of the assessee's own business the profits of which are being taxed. The word 'used' has to be read in a wide sense so as to include a passive as well as an active user. Thus, insurance and repair charges of assets which have been discarded (though owned by the assessee) or have not been used for the business during the previous year would not be allowed as a deduction. Even if an asset is used for a part of the previous year, the assessee is entitled to the deduction of the full amount of expenses on repair and insurance charges and not merely an amount proportionate to the period of use.

The term 'repairs' will include renewal or renovation of an asset but not its replacement or reconstruction. Also, the deduction allowable under this section is only of current repairs but not arrears of repairs for earlier years even though they may still rank for a deduction under section 37(1).

The deduction allowable in respect of premia paid for insuring the machinery, plant or furniture is subject to the following conditions: (i) The insurance must be against the risk of damage or destruction of the machinery, plant or furniture. (ii) The assets must be used by the assessee for the purposes of his business or profession during the accounting year. (iii) The premium should have been actually paid (or payable under the mercantile system of accounting). The premium may even take the form of contribution to a trade association which undertakes to indemnify and insure its members against loss; such premium or contribution would be deductible as an allowance under this section even if a part of it is returnable to the insured in certain circumstances. It does not matter if the payment of the claim will enure to the benefit of someone other than the owner.

Cost of repairs and current repairs of capital nature not to be allowed

As per section 30(a), deduction for cost of repairs to the premises occupied by the assessee as a tenant and the amount paid on account of current repairs to the premises occupied by the assessee, otherwise than as a tenant, is allowed.

As per section 31, the amount paid on account of current repairs of machinery, plant or furniture is allowed as deduction in the computation of income under the head "profits and gains of business or profession"

A view has been taken in *Hanuman Motor Service v. CIT (1967) 66 ITR 88*, 91 (Mys.) that in considering a claim for deduction under section 10(2)(v) of the 1922 Act (corresponding to section 30(a)(ii) of the 1961 Act), the question whether the expenditure is a capital expenditure or revenue expenditure is irrelevant. Once an expenditure has been established to be cost of repairs or current repairs, the same is allowable whether it is of a revenue or capital nature.

Under the Income-tax Act, 1962 the concept of capital and revenue is of fundamental importance. Income-tax Act is an Act to bring to charge only revenue and not capital. Wherever the legislature has felt that capital receipts have to be charged to income-tax they have specifically included such capital receipts in the definition of income e.g. Capital gains. In the same way, wherever the legislature desired that capital expenditure should be allowed as a deduction, specific provisions have been made for such allowance e.g. capital expenditure on scientific research. While computing income under the Income-tax Act, only revenue receipts are to be considered against which only revenue expenditure is allowable unless the Act specifically allows the deduction of capital expenditure. Hence it is clear that in respect of cost of repairs and current repairs, as per correct accounting principles, only expenditure of revenue nature can be allowed.

To clarify this, the Explanation to section 30 and section 31 provides that the amount paid on account of the cost of repairs and the amount paid on account of current repairs shall not include any expenditure in the nature of capital expenditure.

(iii) Depreciation [Section 32]

(1) Section 32 allows a deduction in respect of depreciation resulting from the diminution or exhaustion in the value of certain capital assets.

The Explanation to this section provides that deduction on account of depreciation shall be made compulsorily, whether or not the assessee has claimed the deduction in computing his total income.

(2) The allowance of depreciation which is regulated by Rule 5 of the IT Rules, is subject to the following conditions which are cumulative in their application.

(a) The assets in respect of which depreciation is claimed must belong to either of the following categories, namely:

(i) buildings, machinery, plant or furniture, being tangible assets;

(ii) know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets acquired on or after 1st April, 1998.

The depreciation in the value of any other capital assets cannot be claimed as a deduction from the business income. No depreciation is allowable on the cost of the land on which the building is erected because the term 'building' refers only to superstructure but not the land on which it has been erected. The term 'plant' as defined in section 43(3) includes books, vehicles, scientific apparatus and surgical equipments. The expression 'plant' includes part of a plant (e.g., the engine of a vehicle); machinery includes part of a machinery and building includes a part of the building. However, the word 'plant' does not include an animal, human body or stock-in-trade. Thus plant includes all goods and chattels, fixed or movable, which a businessman keeps for employment in his business with some degree of durability. Similarly the term 'buildings' includes within its scope roads, bridges, culverts, wells and tubewells.

(b) The assets should be actually used by the assessee for purposes of his business during the previous year - The asset must be put to use at any time during the previous year. The amount of depreciation allowance is not proportionate to the period of use during the previous year.

Asset used for less than 180 days - However, it has been provided that where any asset is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period of less than 180 days, depreciation shall be allowed at 50 per cent of the allowable depreciation according to the percentage prescribed in respect of the block of assets comprising such asset. It is significant to note that this restriction applies only to the year of acquisition and not for subsequent years.

If the assets are not used exclusively for the business of the assessee but for other purposes

as well, the depreciation allowable would be a proportionate part of the depreciation allowance to which the assessee would be otherwise entitled. This is provided in section 38.

Depreciation would be allowable to the owner even in respect of assets which are actually worked or utilized by another person e.g., a lessee or licensee. The deduction on account of depreciation would be allowed under this section to the owner who has let on hire his building, machinery, plant or furniture provided that letting out of such assets is the business of the assessee. In other cases where the letting out of such assets does not constitute the business of the assessee, the deduction on account of depreciation would still be allowable under section 57(ii).

(c) The assessee must own the assets, wholly or partly - In the case of buildings, the assessee must own the superstructure and not necessarily the land on which the building is constructed. In such cases, the assessee should be a lessee of the land on which the building stands and the lease deed must provide that the building will belong to the lessor of the land upon the expiry of the period of lease. Thus, no depreciation will be allowed to an assessee in respect of an asset which he does not own but only uses or hires for purposes of his business.

However, in this connection, students may note that the Explanation 1 to section 32 provides that where the business or profession of the assessee is carried on in a building not owned by him but in respect of which the assessee holds a lease or other right of occupancy, and any capital expenditure is incurred by the assessee for the purposes of the business or profession or the construction of any structure or doing of any work by way of renovation, extension or improvement to the building, then depreciation will be allowed as if the said structure or work is a building owned by the assessee.

Depreciation is allowable not only in respect of assets "wholly" owned by the assessee but also in respect of assets "partly" owned by him and used for the purposes of his business or profession.

(3) In case of succession of firm/sole proprietary concern by a company or amalgamation or demerger of companies - In order to restrict the double allowance under the proviso to section 32, in the cases of succession or amalgamation or demerger, the aggregate deduction in respect of depreciation allowable in the hands of the predecessor and the successor or in the case of amalgamating company and the amalgamated company or in the case of the demerged company and the resulting company, as the case may be, shall not exceed the amount of depreciation calculated at the prescribed rates as if the succession/amalgamation, demerger had not taken place. It is also provided that such deduction shall be apportioned between the two entities in the ratio of the number of days for which the assets were used by them.

(4) Hire purchase - In the case of assets under the hire purchase system the allowance for depreciation would under Circular No. 9 of 1943 R. Dis. No. 27(4) I.T. 43 dated 23-3-1943, be granted as follows :

1. In every case of payment purporting to be for hire purchase, production of the agreement under which the payment is made would be insisted upon by the department.
2. Where the effect of an agreement is that the ownership of the asset is at once transferred on the lessee the transaction should be regarded as one of purchase by instalments and consequently no deduction in respect of the hire amount should be made. This principle will be applicable in a case where the lessor obtains a right to sue for arrears of instalments but has no right to recover the asset back from the lessee. Depreciation in such cases should be allowed to the lessee on the hire purchase price determined in accordance with the terms of hire purchase agreement.
3. Where the terms of an agreement provide that the asset shall eventually become the property of the hirer or confer on the hirer an option to purchase an asset, the transaction should be regarded as one of hire purchase. In such case, periodical payments made by the hirer should for all tax purposes be regarded as made up of (i) the consideration for hirer which will be allowed as a deduction in assessment, and (ii) payment on account of the purchase price, to be treated as capital outlay and depreciation being allowed to the lessee on the initial value namely, the amount for which the hired assets would have been sold for cash at the date of the agreement. The allowance to be made in respect of the hire should be the amount of the difference between the aggregate amount of the periodical payments under the agreement and the initial value as stated above. The amount of this allowance should be spread over the duration of the agreement evenly. If, however, agreement is terminated either by outright purchase of the asset or by its return to the seller, the deduction should cease as from the date of termination of agreement.

For the purpose of allowing depreciation an assessee claiming deduction in respect of the assets acquired on hire purchase would be required to furnish a certificate from the seller or any other suitable documentary evidence in respect of the initial value or the cash price of the asset. In cases where no such certificate or other evidence is furnished the initial value of the assets should be arrived at by computing the present value of the amount payable under the agreement at an appropriate per centum. For the purpose of allowing depreciation the question whether in a particular case the assessee is the owner of the hired asset or not is to be decided on a consideration of all the facts and circumstances of each case and the terms of the hire purchase agreement. Where the hired asset is originally purchased by the assessee and is registered in his name, the mere fact that the payment of the price is spread over the specified period and is made in instalments to suit the needs of the purchaser does not disentitle the assessee from claiming depreciation in respect of the asset, since the assessee would be the real owner although the payment of purchase price is made subsequent to the date of acquisition of the asset itself.

(5) Computation of Depreciation Allowance - Depreciation allowance will be calculated on the following basis:

(i) In the case of assets of an undertaking engaged in generation or generation and distribution of power, such percentage on the actual cost to the assessee as prescribed by Rule 5(1A).

Rule 5(1A) - As per this rule, the depreciation on the abovementioned assets shall be calculated at the percentage of the actual cost at rates specified in Appendix IA of these rules. However, the aggregate depreciation allowed in respect of any asset for different assessment years shall not exceed the actual cost of the asset. It is further provided that such an undertaking as mentioned above has the option of being allowed depreciation on the written down value of such block of assets as are used for its business at rates specified in Appendix I to these rules.

However, such option must be exercised before the due date for furnishing return under section 139(1) for the assessment year relevant to the previous year in which it begins to generate power. It is further provided that any such option once exercised shall be final and shall apply to all subsequent assessment years.

(ii) In the case of any block of assets, at such percentage of the written down value of the block, as may be prescribed by Rule 5(1).

Block of Assets - 1. A "block of assets" is defined in clause (11) of section 2 of the Act as a group of assets falling within a class of assets comprising—

(a) tangible assets, being buildings, machinery, plant or furniture;

(b) intangible assets, being know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature,

in respect of which the same percentage of depreciation is prescribed.

Know-how - In this context, 'know-how' means any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil-well or other sources of mineral deposits (including searching for discovery or testing of deposits for the winning of access thereto).

(iii) **Additional depreciation on Plant & Machinery acquired by an Industrial Undertaking**:

Additional depreciation is allowed on any new machinery or plant (other than ships and aircraft) acquired and installed after 31.3.2005 by an assessee engaged in the business of manufacture or production of any article or thing at the rate of 20% of the actual cost of such machinery or plant.

Such additional depreciation will not be available in respect of:

(i) any machinery or plant which, before its installation by the assessee, was used within or outside India by any other person; or

(ii) any machinery or plant installed in office premises, residential accommodation, or in any guest house; or

(iii) office appliances or road transport vehicles; or

(iv) any machinery or plant, the whole or part of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and Gains of Business or Profession" of any one previous year.

(iv) **Terminal depreciation**

In case of a power concern as covered under clause (i) above, if any asset is sold, discarded, demolished or otherwise destroyed in the previous year, the depreciation amount will be the amount by which the monies payable in respect of such building, machinery, plant or furniture, together with the amount of scrap value, if any, falls short of the written down value thereof. The depreciation will be available only if the deficiency is actually written off in the books of the assessee.

"Moneys payable" in respect of any building, machinery, plant or furniture includes—

(a) any insurance, salvage or compensation moneys payable in respect thereof;

(b) where the building, machinery, plant or furniture is sold, the price for which it is sold, so, however, that where the actual cost of a motor-car is, in accordance with the proviso to clause (1) of section 43, taken to be Rs.25,000, the moneys payable in respect of such motor-car shall be taken to be a sum which bears to the amount for which the motor-car is sold or, as the case may be, the amount of any insurance, salvage or compensation moneys payable in respect thereof (including the amount of scrap value, if any) the same proportion as the amount of Rs.25,000 bears to the actual cost of the motor-car to the assessee as it would have been computed before applying the said proviso;

"Sold" includes a transfer by way of exchange or a compulsory acquisition under any law for the time being in force but does not include a transfer, in a scheme of amalgamation, of any asset by the amalgamating company to the amalgamated company where the amalgamated company is an Indian company or a transfer of any asset by a banking company to a banking institution in a scheme of amalgamation of such banking company with the banking institution, sanctioned and brought into force by the Central Government.

(6) Actual Cost [Section 43(1)] - The expression "actual cost" means the actual cost of the asset to the assessee as reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority.

Actual cost in certain special situations [Explanations to section 43(1)]

(i) Where an asset is used for the purposes of business after it ceases to be used for

scientific research related to that business, the actual cost to the assessee for depreciation purposes shall be the actual cost to the assessee as reduced by any deduction allowed under section 35(1)(iv) [Explanation 1].

(ii) Where an asset is acquired by way of gift or inheritance, its actual cost shall be the written down value to the previous owner [Explanation 2].

(iii) Where, before the date of its acquisition by the assessee, the asset was at any time used by any other person for the purposes of his business or profession, and the Assessing Officer is satisfied that the main purpose of the transfer of the asset directly or indirectly to the assessee was the reduction of liability of income-tax directly or indirectly to the assessee (by claiming depreciation with reference to an enhanced cost) the actual cost to the assessee shall be taken to be such an amount which the Assessing Officer may, with the previous approval of the Joint Commissioner, determine, having regard to all the circumstances of the case [Explanation 3].

(iv) Where any asset which had once belonged to the assessee and had been used by him for the purposes of his business or profession and thereafter ceased to be his property by reason of transfer or otherwise, is re-acquired by him, the actual cost to the assessee shall be —

(i) the written down value at the time of original transfer; or

(ii) the actual price for which the asset is re-acquired by him

whichever is less [Explanation 4].

(v) Where before the date of acquisition by the assessee say, Mr.A, the assets were at any time used by any other person, say Mr.B, for the purposes of his business or profession and depreciation allowance has been claimed in respect of such assets in the case of Mr.B and such person acquires on lease, hire or otherwise, assets from Mr.A, then, the actual cost of the transferred assets, in the case of Mr.A, shall be the same as the written down value of the said assets at the time of transfer thereof by Mr.B [Explanation 4A].

We can explain the above as follows—

A person (say "A") owns an asset and uses it for the purposes of his business or profession. A has claimed depreciation in respect of such asset. The said asset is transferred by A to another person (say "B"). A then acquires the same asset back from B on lease, hire or otherwise. B being the new owner will be entitled to depreciation. In the above situation, the cost of acquisition of the transferred assets in the hands of B shall be the same as the written down value of the said assets at the time of transfer.

Explanation 4A overrides Explanation 3 - Explanation 3 to section 43(1) deals with a situation where a transfer of any asset is made with the main purpose of reduction of tax liability (by claiming depreciation on enhanced cost), and the Assessing Officer, having

satisfied himself about such purpose of transfer, may determine the actual cost having regard to all the circumstances of the case.

In the Explanation 4A, a *non-obstante* clause has been included to the effect that Explanation 4A will have an overriding effect over Explanation 3. The result of this is that there is no necessity of finding out whether the main purpose of the transaction is reduction of tax liability. Explanation 4(A) is activated in every situation described above without inquiring about the main purpose.

(vi) Where a building which was previously the property of the assessee is brought into use for the purposes of the business or profession, its actual cost to the assessee shall be the actual cost of the building to the assessee, as reduced by an amount equal to the depreciation calculated at the rates in force on that date that would have been allowable had the building been used for the purposes of the business or profession since the date of its acquisition by the assessee [Explanation 5].

(vii) When any capital asset is transferred by a holding company to its subsidiary company or by a subsidiary company to its holding company then, if the conditions specified in section 47(iv) or (v) are satisfied, the transaction not being regarded as a transfer of a capital asset, the actual cost of the transferred capital asset to the transferee company shall be taken to be the same as it would have been if the transferor company had continued to hold the capital asset for the purposes of its own business [Explanation 6].

(viii) In a scheme of amalgamation, if any capital asset is transferred by the amalgamating company to the amalgamated company, the actual cost of the transferred capital assets to the amalgamated company will be taken at the same amount as it would have been taken in the case of the amalgamating company had it continued to hold it for the purposes of its own business [Explanation 7].

In the case of a demerger, where any capital asset is transferred by the demerged company to the resulting company, the actual cost of the transferred asset to the resulting company shall be taken to be the same as it would have been if the demerged company had continued to hold the asset. However, the actual cost shall not exceed the WDV of the asset in the hands of the demerged company [Explanation 7A].

(ix) Certain taxpayers have, with a view to obtain more tax benefits and reduce the tax outflow, resorted to the method of capitalising interest paid or payable in connection with acquisition of an asset relatable to the period after such asset is first put to use. Certain judicial rulings also favoured this approach. This capitalisation implies inclusion of such interest in the 'Actual Cost' of the asset for the purposes of claiming depreciation, investment allowance etc. under the Income-tax Act. This was never the legislative intent nor was it in accordance with recognised accounting practices. Therefore, with a view to counter-acting tax avoidance through this method and placing the matter beyond doubt,

Explanation 8 to section 43(1) provides that any amount paid or payable as interest in connection with the acquisition of an asset and relatable to period after asset is first put to use shall not be included and shall be deemed to have never been included in the actual cost of the asset [Explanation 8].

(x) Where an asset is or has been acquired by an assessee, the actual cost of asset shall be reduced by the amount of duty of excise or the additional duty leviable under section 3 of the Customs Tariff Act, 1975 in respect of which a claim of credit has been made and allowed under the Central Excise Rules, 1944 [Explanation 9].

(xi) Where a portion of the cost of an asset acquired by the assessee has been met directly or indirectly by the Central Government or a State Government or any authority established under any law or by any other person, in the form of a subsidy or grant or reimbursement (by whatever name called), then, so much of the cost as is relatable to such subsidy or grant or reimbursement shall not be included in the actual cost of the asset to the assessee.

However, where such subsidy or grant or reimbursement is of such nature that it cannot be directly relatable to the asset acquired, so much of the amount which bears to the total subsidy or reimbursement or grant the same proportion as such asset bears to all the assets in respect of or with reference to which the subsidy or grant or reimbursement is so received, shall not be included in the actual cost of the asset to the assessee [Explanation 10].

(xii) Where an asset is acquired outside India by an assessee, being a non-resident and such asset is brought by him to India and used for the purposes of his business or profession, the actual cost of asset to the assessee shall be the actual cost the asset to the assessee, as reduced by an amount equal to the amount of depreciation calculated at the rate in force that would have been allowable had the asset been used in India for the said purposes since the date of its acquisition by the assessee [Explanation 11].

(xiii) Where any capital asset is acquired under a scheme for corporatisation of a recognised stock exchange in India approved by the SEBI, the actual cost shall be deemed to be the amount which would have been regarded as actual cost had there been no such corporatisation.

(xiv) Explanation 13 has been inserted in section 43(1) to provide that the actual cost of any capital asset, on which deduction has been allowed or is allowable to the assessee under section 35AD, shall be nil. This would be applicable in the case of transfer of asset by the assessee where -

(1) *the assessee himself has claimed deduction under section 35AD; or*

(2) *the previous owner has claimed deduction under section 35AD. This would be applicable where the capital asset is acquired by the assessee by way of -*

(a) *gift, will or an irrevocable trust;*

(b) *any distribution on liquidation of the company;*

(c) *any distribution of capital assets on total or partial partition of a HUF;*

(d) *any transfer of a capital asset by a holding company to its 100% subsidiary company, being an Indian company;*

(e) *any transfer of a capital asset by a subsidiary company to its 100% holding company, being an Indian company;*

(f) *any transfer of a capital asset by the amalgamating company to an amalgamated company in a scheme of amalgamation, if the amalgamated company is an Indian company;*

(g) *any transfer of a capital asset by the demerged company to the resulting company in a scheme of demerger, if the resulting company is an Indian company;*

(h) *any transfer of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm, or any transfer of a capital asset to a company in the course of demutualization or corporatisation of a recognized stock exchange in India as a result of which an association of persons or body of individuals is succeeded by such company (fulfilling the conditions specified);*

(i) *any transfer of a capital asset or intangible asset by a sole proprietory concern to a company, where the sole proprietory concern is succeeded by a company (fulfilling the conditions specified).which would have been regarded as actual cost had there been no such corporatisation.*

Definition of plant [Section 43(3)] – "Plant" includes ships, vehicles, books, scientific apparatus and surgical equipment used for the purposes of business or profession but does not include tea bushes or livestock or buildings or furniture and fittings.

(7) Written down value [Section 43(6)] - (i) In the case of assets acquired by the assessee during the previous year, the written down value means the actual cost to the assessee.

(ii) In the case of assets acquired before the previous year, the written down value would be the actual cost to the assessee less the aggregate of all deductions actually allowed in respect of depreciation. For this purpose, any depreciation carried forward is deemed to be depreciation actually allowed [Section 43(6)(c)(i) read with Explanation (3)].

The written down value of any asset shall be worked out as under in accordance with section 43(6)(c) -

(1) The aggregate of the written down value of the block of assets at the beginning of the previous year.

(2) The sum arrived at as above shall be increased by the actual cost of any asset falling within that block which is acquired by the assessee during the previous year.

(3) The sum so arrived at shall be reduced by the sale proceeds and other amounts receivable by the assessee with regard to any asset falling within that block which is sold, discarded, demolished or destroyed during that previous year.

(iii) When in the case of a succession to business or profession, an assessment is made on the successor under section 170(2), the written down value of an asset or block of assets shall be the amount which would have been taken as the written down value if the assessment had been made directly on the person succeeded to [Explanation 1 to section 43(6)].

(iv) Where in any previous year any block of assets is transferred by a holding company to a subsidiary company or vice versa and the conditions of clause 47(iv) or (v) are satisfied or by an amalgamating company to an amalgamated company the latter being an Indian company then the actual cost of the block of assets in the case of transferee-company or amalgamated company as the case may be, shall be the written down value of the block of assets as in the case of the transferor company or amalgamating company, as the case may be, for the immediately preceding year as reduced by depreciation actually allowed in relation to the said previous year [Explanation 2 to section 43(6)].

(v) Where in any previous year any asset forming part of a block of assets is transferred by demerged company to the resulting company, the written down value of the block of assets of the demerged company for the immediately preceding year shall be reduced by the written down value of the assets transferred to the resulting company [Explanation 2A to section 43(6)].

(vi) Where any asset forming part of a block of assets is transferred by a demerged company to the resulting company, the written down value of the block of assets in the case of resulting company shall be the written down value of the transferred assets of the demerged company immediately before the demerger [Explanation 2B to section 43(6)].

(vii) Where any asset forming part of a block of assets is transferred in any previous year by a recognised stock exchange in India to a company under a scheme for corporatisation

approved by SEBI, the written down value of the block shall be the written down value of the transferred assets immediately before the transfer[Explanation 5 to section 43(6)].

(viii) Depreciation provided in the books of account deemed to be depreciation actually allowed [Explanation 6 to section 43(6)]

Section 32(1)(ii) provides that depreciation shall be allowed at the prescribed percentage on the written down value (WDV) of any block of assets. Section 43(6)(b) provides that written down value in the case of assets acquired before the previous year means the actual cost to the assessee less all depreciation actually allowed to him under the Income-tax Act.

Persons who were exempt from tax were not required to compute their income under the head "Profits and gains of business or profession". However, when the exemption is withdrawn subsequently, such persons became liable to income-tax and hence, were required to compute their income for income-tax purposes. In this regard, a question arises as to the basis on which depreciation is to be allowed under the Income-tax Act in respect of assets acquired during the years when the person was exempt from tax.

Explanation 6 has been inserted in section 43(6) to provide that,-

(a) the actual cost of an asset has to be adjusted by the amount attributable to the revaluation of such asset, if any, in the books of account;

(b) the total amount of depreciation on such asset provided in the books of account of the assessee in respect of such previous year or years preceding the previous year relevant to the assessment year under consideration shall be deemed to be the depreciation actually allowed under the Income-tax Act for the purposes of section 43(6);

(c) the depreciation actually allowed as above has to be adjusted by the amount of depreciation attributable to such revaluation.

(ix) Explanation 7 provides that in cases of 'composite income', for the purpose of computing written down value of assets acquired before the previous year, the total amount of depreciation shall be computed as if the entire composite income of the assessee is chargeable under the head "Profits and Gains of business or profession". The depreciation so computed shall be deemed to have been "actually allowed" to the assessee.

For instance, Rule 8 prescribes the taxability of income from the manufacture of tea. Under the said rule, income derived from the sale of tea grown and manufactured by seller shall be computed as if it were income derived from business, and 40% of such income shall be deemed to be income liable to tax. If the turnover is, say, Rs.20 lakh, the depreciation Rs.1 lakh and other expenses Rs.4 lakh, then the income would be Rs.15 lakh. Business income would be Rs.6 lakh (being 40% of Rs.15 lakh). As per earlier Court decisions, only the depreciation "actually allowed" i.e., Rs.40,000, being 40% of Rs.1 lakh, has to be deducted to arrive at the written down value. The ambiguity in this case has arisen on account of the interpretation of the

meaning of the phrase "actually allowed" used in section 43(6)(b). However, the correct legislative intent is that the WDV is required to be computed by deducting the full depreciation attributable to composite income i.e. Rs.1 lakh in this case. Explanation 7 clarifies this legislative intent.

(x) The written down value of any block of assets, may be reduced to nil for any of the following reasons:

(a) The moneys receivable by the assessee in regard to the assets sold or otherwise transferred during the previous year together with the amount of scrap value may exceed the written down value at the beginning of the year as increased by the actual cost of any new asset acquired, or

(b) All the assets in the relevant block may be transferred during the year.

(8) Rates of depreciation

All assets have been divided into four main categories and rates of depreciation as prescribed by Rule 5(1) are given below :

PART A TANGIBLE ASSETS

I Buildings

Block 1.	Buildings (other than covered by sub-item 3 below) which are used mainly for residential purposes	5%
Block 2.	Buildings which are not used mainly for residential purposes and not covered by sub-items (1) above and (3) below	10%
Block 3.	Buildings acquired on or after the 1st day of September, 2002 for installing machinery and plant forming part of water supply project or water treatment system and which is put to use for the purpose of business of providing infrastructure facilities under clause (i) of sub-section (4) of section 80-IA	100%
Block 4.	Purely temporary erections such as wooden structures	100%

II Furniture and Fittings

Block 1.	Furniture and fittings including electrical fittings	10%

III Plant & Machinery

Block 1.	Motors buses, motor lorries, motor taxis used in a business of running them on hire	30%

Block 2	Aeroplanes, aeroengines	40%
Block 3.	Air, Water Pollution control equipments, Solid waste control equipment	100%
Block 4.	Energy Saving Devices	80%
Block 5.	Motor cars other than those used in a business of running them on hire, acquired or put to use on or after 1-4-1990.	15%
Block 6	Computers including computer software	60%
Block 7.	Annual Publications owned by assessees carrying on a profession	100%
Block 8.	Books owned by assessees carrying on business in running lending libraries	100%
Block 9.	Books, other than annual publications, owned by assesses carrying on a profession	60%
Block 10.	Plant & machinery (General rate)	15%
IV Ships		
Block 1.	Ocean-going ships	20%
Block 2.	Vessels ordinarily operating on inland waters not covered by sub-item 3 below	20%
Block 3.	Speed boats operating on inland water	20%
PART B	**INTANGIBLE ASSETS**	
	Know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature	25%

Students should refer to Income-tax Rules for the detailed classification of assets under Rule 5(1) and the rates applicable thereto.

Notification No. 37/2009 dated 21.4.2009

"New commercial vehicles acquired on or after 1.1.2009 but before 1.10.2009 and put to use before 1.10.2009 for the purposes of business or profession" would be classified under the head MACHINERY AND PLANT and would be eligible for depreciation at the rate of 50%.

(9) Increased rate of depreciation for certain assets - Rule 5(2) - Any new machinery or plant installed to manufacture or produce any article or thing by using any technology or other

know-how developed in a laboratory owned or financed by the Government or a laboratory owned by a public sector company or a University or an institution recognized by the Secretary, Department of Scientific and Industrial Research, Government of India shall be treated as a part of the block of assets qualifying for depreciation@ 40%.

Conditions to be fulfilled

1. The right to use such technology to manufacture such article has been acquired from the owner of such laboratory or any person deriving title from such owner.

2. The return filed by the assessee for any previous year in which the said machinery is acquired, should be accompanied by a certificate from the Secretary, Department of Scientific and Industrial Research, Government of India to the effect that such article is manufactured by using such technology developed in such laboratory or such article has been invented in that laboratory.

3. The machinery or plant is not used for the purpose of business of manufacture or production of any article or thing specified in the Eleventh schedule.

The depreciation ordinarily allowable to an assessee in respect of any block of assets shall be calculated at the above specified rates on the WDV of such block of assets as are used for the purposes of the business or profession of the assessee at any time during the previous year.

(10) Carry forward and set off of depreciation [Section 32(2)]

Section 32(2) provides for carry forward of unabsorbed depreciation. Where, in any previous year the profits or gains chargeable are not sufficient to give full effect to the depreciation allowance, the unabsorbed depreciation shall be added to the depreciation allowance for the following previous year and shall be deemed to be part of that allowance. If no depreciation allowance is available for that previous year, the unabsorbed depreciation of the earlier previous year shall become the depreciation allowance of that year. The effect of this provision is that the unabsorbed depreciation shall be carried forward indefinitely till it is fully set off.

However, in the order of set-off of losses under different heads of income, effect shall first be given to business losses and then to unabsorbed depreciation.

The provisions in effect are as follows:

- Since the unabsorbed depreciation now falls part of the current year's depreciation, it can be set off against any other head of income.
- The unabsorbed depreciation can be carried forward for indefinite number of previous years.
- Set off will be allowed even if the same business to which it relates is no longer in existence in the year in which the set off takes place.

Current depreciation to be deducted first - The Supreme Court in *CIT v. Mother India Refrigeration (P.) Ltd*. [1985] 23 Taxman 8 has categorically held that current depreciation must be deducted first before deducting the unabsorbed carried forward business losses of the earlier years in giving set off while computing the total income of any particular year.

Illustration 1

A newly qualified Chartered Accountant Mr. Dhaval, commenced practice and has acquired the following assets in his office during F.Y. 2009-10 at the cost shown against each item. Calculate the amount of depreciation that can be claimed from his professional income for A.Y. 2010-11:

Sl. No.	Description	Date of acquisition	Date when put to use	Amount Rs.
1.	Computer	27 Sept., 09	1 Oct., 09	35,000
2.	Computer software	2 Oct., 09	4 Oct., 09	8,500
3.	Computer printer	2 Oct., 09	1 Oct., 09	12,500
4.	Books (of which books being annual publications are of Rs.12,000)	1 Apr., 09	1 Apr., 09	13,000
5.	Office furniture (Acquired from a practising C.A.)	1 Apr., 09	1 Apr., 09	3,00,000
6.	Laptop	26 Sep., 09	4 Oct., 09	43,000

Solution

Computation of depreciation allowable for A.Y.2010-11

	Asset	Rate	Depreciation
Block 1	Furniture	10%	30,000
Block 2	Plant (Computer, computer software, laptop & books)	60%	37,050
Block 3	Plant (Books)	100%	12,000
Block 4	Plant (Printer)	15%	1,875
	Total depreciation allowable		**80,925**

Notes -

1. Computation of depreciation

Block of Assets	**Rs.**
Block 1: Furniture – rate 10%	
Put to use for more than 180 days [Rs.3,00,000@10%]	**30,000**
Block 2: Plant – rate 60%	
(a) Computer (put to use for more than 180 days) [35,000 @ 60%]	21,000
(b) Laptop (put to use for less than 180 days) [43,000 @ 30%]	12,900
(c) Computer Software (put to use for less than 180 days) [8,500@ 30%]	2,550
(d) Books (other than annual publications) (Put to use for more than 180 days) [1,000 @ 60%]	600
	37,050
Block 3: Plant – Rate 100%	
Books (being annual publications) put to use for more than 180 days [12,000@100%]	**12,000**
Block 4: Plant – Rate 15%	
Computer printer (Put to use for more than180 days) [12,500 @15%]	1,875

2. Where an asset is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period of less than 180 days, the deduction on account of depreciation would be restricted to 50% of the prescribed rate. In this case, since Mr.Dhaval commenced his practice in the P.Y.2009-10 and acquired the assets during the same year, the restriction of depreciation to 50% of the prescribed rate would apply to those assets which have been put to use for less than 180 days in that year, namely, laptop and computer software.

Illustration 2

Gamma Ltd. was incorporated on 1.1.2009 for manufacture of tyres and tubes for motor vehicles. The manufacturing unit was set up on 1.5.2009. The company commenced its manufacturing operations on 1.6.2009. The total cost of the plant and machinery installed in the unit is Rs.120 crore. The said plant and machinery included second hand plant and machinery bought for Rs.20 crore and new plant and machinery for scientific research relating to the business of the assessee acquired at a cost of Rs.15 crore.

Compute the amount of depreciation allowable under section 32 of the Income-tax Act, 1961 in respect of the assessment year 2010-11.

Solution

Computation of depreciation allowable for the A.Y. 2010-11 in the hands of Gamma Ltd.

Particulars			Rs. in crore
Total cost of plant and machinery		120.00	
Less: Used for Scientific Research (Note 1)		15.00	
		105.00	
Normal Depreciation at 15% on Rs.105 crore			15.75
Additional Depreciation:			
Cost of plant and machinery		120.00	
Less: Second hand plant and machinery (Note 2)	20.00		
Plant and machinery used for scientific research, the whole of the actual cost of which is allowable as deduction under section 35(2)(ia) (Note 2)	15.00	35.00	
		85.00	
Additional Depreciation at 20%			17.00
Depreciation allowable for A.Y.2010-11			**32.75**

Notes:

1. As per section 35(2)(iv), no depreciation shall be allowed in respect of plant and machinery purchased for scientific research relating to assessee's business, since deduction is allowable under section 35 in respect of such capital expenditure.

2. As per section 32(1)(iia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005 by an assessee engaged in the business of manufacture or production of any article or thing, at the rate of 20% of the actual cost of such machinery or plant.

However, additional depreciation shall not be allowed in respect of, inter alia, –

(i) any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person;

(ii) any machinery or plant, the whole of the actual cost of which is allowed as a deduction

(whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profit and gains of business or profession" of any one previous year.

In view of the above provisions, additional depreciation cannot be claimed in respect of -

(i) Second hand plant and machinery;

(ii) New plant and machinery purchased for scientific research relating to assessee's business in respect of which the whole of the capital expenditure can be claimed as deduction under section 35(1)(iv) read with section 35(2)(ia).

(11) Balancing Charge - Section 41(2) provides for the manner of calculation of the amount which shall be chargeable to income-tax as income of the business of the previous year in which the monies payable for the building, machinery, plant or furniture on which depreciation has been claimed under section 32(1)(i), i.e. in the case of power undertakings, is sold, discarded, demolished or destroyed. The balancing charge will be the amount by which the moneys payable in respect of such building, machinery, plant or furniture, together with the amount of scrap value, if any, exceeds the written down value. However, the amount of balancing charge should not exceed the difference between the actual cost and the WDV. The tax shall be levied in the year in which the moneys payable become due.

The *Explanation* below section 41(2) makes it clear that where the moneys payable in respect of the building, machinery, plant or furniture referred to in section 41(2) become due in a previous year in which the business, for the purpose of which the building, machinery, plant or furniture was being used, is no longer in existence, these provisions will apply as if the business is in existence in that previous year.

(iv) Tea Development Account/Coffee Development Account/Rubber Development Account [Section 33AB]

(1) Where an assessee carrying on the business of growing and manufacturing tea or coffee or rubber in India has, before the expiry of six months from the end of the previous year or before the due date of furnishing the return of income, whichever is earlier, (i) deposited with a National Bank any amount in a special account maintained by the assessee with that Bank in accordance with a scheme approved by Tea Board or Coffee Board or Rubber Board, or (ii) opened an account to be known as Deposit Account in accordance with the scheme framed by the Tea Board or Coffee Board or Rubber Board, as the case may be, with the previous approval of the Central Government, the assessee shall be allowed a deduction of :

(a) A sum equal to the aggregate of the deposits made or

(b) 40% of the profits of such business computed under the head 'Profits and Gains of Business of Profession' before making any deduction under this section,

whichever is less.

(2) The above deduction will be allowed before the setting off of brought-forward loss under section 72.

(3) Where the assessee is a firm or any association of persons or any body of individuals the deduction under this section shall not be allowed in the computation of the income of any partner or member of such firm, AOP or BOI.

(4) This deduction shall not be allowed unless the accounts of such business of the assessee for the previous year have been audited by a chartered accountant and the assessee furnishes along with his return of income the report of such audit in the prescribed form duly signed and verified by such accountant [Form No. 3AC].

(5) However, where the assessee is required by any other law to get his accounts audited it shall be sufficient compliance with the provision of this section if such assessee gets the accounts of such business audited under any such law and furnishes the report of the audit and a further report in the prescribed form under this section.

(6) Any amount standing to the credit of the assessee in the special account cannot be withdrawn except for the purposes specified in the scheme, or, as the case may be, in the deposit scheme.

The above amount can also be withdrawn in the following circumstances:

(a) Closure of business

(b) Death of an assessee

(c) Partition of HUF

(d) Dissolution of a firm

(e) Liquidation of a company.

(7) Where the sum standing to the credit of the assessee in the Special account or in the Deposit account is released by the National Bank or is withdrawn by the assessee from the Deposit account and is utilised for the purchase of:

(a) Any machinery or plant installed in any office premises or residential accommodation including a guest house.

(b) Any office appliances (other than computers)

(c) Any machinery or plant the whole of whose actual cost is allowed as deduction by way of depreciation or otherwise in computing the business income.

(d) Any new machinery or plant installed for production of any XI Schedule item,

the whole of such amount so utilised will be treated as taxable profits of that year and taxed accordingly.

(8) Where any amount is withdrawn by the assessee from the special account during any previous year on the closure of his business or dissolution of a firm, the whole of such withdrawal shall be deemed to be the profits and gains of business of that previous year and shall be chargeable to tax as the income of that previous year, as if the business had not closed or the firm had not been dissolved.

(9) Where any amount standing to the credit of the assessee in the special account is utilised by the assessee for the purpose of any expenditure in connection with such business in accordance with the scheme, such expenditure shall not be allowed in computing the business income.

(10) Where any amount in the special account which is released during any previous year by the National Bank for being utilised by the assessee for the purposes of such business in accordance with the scheme is not so utilised within that previous year, the unutilised amount shall be deemed to be profits and gains and chargeable to income-tax as the income of that previous year.

However, where such amount is released during the previous year at the closing of the account on the death of the assessee, partition of a HUF or liquidation of a company, the above restriction will not apply.

(11) Where an asset acquired in accordance with the scheme is sold or otherwise transferred in any previous year by the assessee to any person at any time before the expiry of 8 years from the end of the previous year in which it was acquired, such portion of the cost equal to the deduction allowed under this section shall be deemed to be profits of the previous year in which the asset is sold or transferred and shall be chargeable to income-tax as the income of that previous year.

However, the above restriction will not apply in the following cases :

(i) Where the asset is sold or otherwise transferred to Government, local authority, statutory corporation or a Government company.

(ii) Where the sale or transfer is made in connection with the succession of a firm by a company in the business or profession carried on by the firm as result of which the firm sells or otherwise transfers any asset to the company and the scheme continues to apply to the company in the same manner as applicable to the firm. Further, all the properties of the firm relating to the business or profession immediately before the succession should become the liabilities of the company and all the shareholders of the company should have been partners of the firm immediately before the succession.

(12) The Central Government has the power to direct that the deduction allowable under this section shall not be allowed after a specified date.

(13) "National Bank" means the National Bank for Agricultural and Rural Development (NABARD).

(v) Site Restoration Fund [Section 33ABA] – (1) This section provides for a deduction in the computation of the taxable profits in the case of an assessee carrying on business of prospecting for, or extraction or production, of petroleum or natural gas or both in India and in relation to which the Central Government has entered into an agreement with such assessee for such business.

(2) It provides that where the assessee has during the previous year -

(i) deposited any sum with the State Bank of India in a special account maintained by the assessee with that bank in accordance with the scheme approved in this behalf by the Government of India in the Ministry of Petroleum and Natural Gas (hereinafter referred to as the Site Restoration Account), or

(ii) deposited any amount in an account opened by the assessee for the purposes specified in a scheme framed by the said Ministry,

the assessee shall be entitled to a deduction of —

- a sum equal to the sum deposited; or
- a sum equal to twenty per cent of its profits (as computed under the head "Profits and gains of business or profession" before making any deduction under the new section),

whichever is less.

(3) For this purpose, it is provided that any amount credited in the special account or Site Restoration Account by way of interest shall also be deemed to be a deposit.

(4) Non-eligibility - (i) Where such assessee is a firm or AOP or BOI, the deduction under this section will not be available in the computation of the income of any partner of the firm or the member of the AOP or BOI.

(ii) Where any deduction in respect of any amount deposited in the special account or Site Restoration Account has been allowed in any previous year, no deduction shall be allowed in respect of such amount in any other previous year.

(5) Audit - (i) Section 33ABA(2) provides that deduction under sub-section (1) shall not be admissible unless the accounts of the said business of the assessee for the previous year relevant to the assessment year have been audited by a chartered accountant and the assessee furnishes the report of such audit in the prescribed form along with the return.

(ii) Where the assessee is required by or under any other law to get his accounts audited, it will be sufficient compliance with the provisions of this sub-section if the assessee gets the accounts of the aforesaid business audited under any such law and furnishes the report of the audit and a further report in the prescribed form.

(6) Withdrawal of deduction - Any amount standing to the credit in the special account or the Site Restoration Account will not be allowed to be withdrawn except for the purposes specified in the scheme or in the deposit scheme.

No deduction shall be allowed in respect of any amount utilised for the purchase of the following items :

(a) any machinery or plant to be installed in any office premises or residential accommodation, including any accommodation in the nature of a guest house;

(b) any office appliances (not being computers);

(c) any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head 'Profits and gains of business or profession' of any one previous year;

(d) any new machinery or plant to be installed in an industrial undertaking for the purpose of the business of construction, manufacture or production of any article or thing specified in the list in the Eleventh Schedule.

(7) Withdrawal on closure of account - (i) Where any amount standing to the credit of the assessee in the special account or in the Site Restoration Account is withdrawn on closure of the account during any previous year by the assessee, the amount so withdrawn from the account as reduced by the amount, if any, payable to the Central Government by way of profit or production share as provided in the agreement referred to in section 42, shall be deemed to be the profits and gains of business or profession of that previous year and shall accordingly be chargeable to income-tax as the income of that previous year.

(ii) Where any amount is withdrawn on closure of the account in a previous year in which the business carried on by the assessee in no longer in existence, these provisions will apply as if the business is in existence in that previous year.

(8) Utilisation from scheme not available as a deduction - When any amount standing to the credit of the assessee in the special account or in the Site Restoration Account business is utilised by the assessee for the purpose of any expenditure in connection with such business in accordance with the scheme or the deposit scheme such expenditure will not be allowed in computing the income chargeable under the head 'Profits and gains of business or profession'.

(9) Consequences of non-utilisation - Where any amount is released in the previous year by the State Bank of India or is withdrawn from the Site Restoration Account and is not utilised in accordance with the scheme or the deposit scheme, the whole of such amount or the part thereof shall be deemed to be the profits and gains of business and accordingly chargeable to income-tax as income of that previous year. This sub-section will not apply in a case where such amount is released in the event of death of an assessee, partition of a Hindu undivided

family or liquidation of a company. These circumstances are provided in clauses (b), (c) and (e) of section 33AB(3).

(10) Consequences of sale or transfer - Where any asset acquired in accordance with the scheme or the deposit scheme is sold or otherwise transferred in any previous year by the assessee before the expiry of eight years from the end of the previous year in which such assets were acquired, such part of the cost of such asset as is relatable to the deduction allowed under section 33ABA(1) shall be deemed to be the profits and gains of business or profession of the previous year in which the asset is sold or otherwise transferred and shall accordingly be chargeable to income-tax as the income of that previous year.

This sub-section will not apply in the following cases:

(a) where the asset is sold or otherwise transferred by the assessee to the Government, a local authority, a corporation established by or under a Central, State or Provincial Act or a Government company as defined in section 617 of the Companies Act, 1956; or

(b) where the sale or transfer of the asset is made in connection with the succession of a firm by a company in the business or profession carried on by the firm as a result of which the firm sells or otherwise transfers to the company any asset and the scheme or the deposit scheme continues to apply to the company in the manner applicable to the firm, if the following conditions are satisfied;

  (i) all the properties of the firm relating to the business or profession immediately before the succession become the properties of the company;

  (ii) all the liabilities of the firm relating to the business or profession immediately before the succession become the liabilities of the company; and

  (iii) all the shareholders of the company were partners of the firm immediately before the succession.

Specified period - The Central Government may, by notification in the Official Gazette, direct that the deduction allowable under this section will not be allowed after such date as may be specified in such notification.

(vi) Reserves for Shipping Business [Section 33AC]

The tonnage tax scheme, introduced by insertion of Chapter XII-G in the Income-tax Act, provides for special provisions relating to taxation of income of shipping companies. Consequently, no deduction under section 33AC is allowable from. A.Y. 2005-06, where a shipping company has opted for the tonnage tax scheme.

(vii) Expenditure on Scientific Research [Section 35]

This section allows a deduction in respect of any expenditure on scientific research related to the business of assessee. The expression 'scientific research' as defined in section 43(4)(i)

means activities for the extension of knowledge in the fields of natural or applied science including agriculture, animal husbandry or fisheries. A reference to expenditure incurred on scientific research would include all expenditure incurred for the prosecution or the provision of facilities for the prosecution of scientific research but does not include any expenditure incurred in the acquisition of rights in or arising out of scientific research. In particular, a reference to scientific research related to a business or a class of business would include (i) any scientific research which may lead to or facilitate an extension of that business or all the business of that class, as the case may be; (ii) any scientific research of a medical nature which has a special relation to the welfare of the workers employed in that business or all the business of that class, as the case may be.

(1) The deduction allowable under this section consists of -

(i) Revenue Expenditure:

(a) Any revenue expenditure incurred by the assessee himself on scientific research related to his business. Expenditure incurred within three years immediately preceding the commencement of the business on payment of salary to research personnel engaged in scientific research related to his business carried on by the taxpayer or on material inputs for such scientific research will be allowed as deduction in the year in which the business is commenced. The deduction will be limited to the amount certified by the prescribed authority.

(b) An amount equal to 1¼ times of any sum paid to a university, college or other institution or scientific research association which has as its object, the undertaking of scientific research to be used for scientific research provided that the university, college institution or association is approved for this purpose by the Central Government by notification in the Official Gazette.

The scope of the above deduction has been extended to cover expenditure on sponsored research carried out in the in-house research and development facilities of public companies. For the purpose, the expression "public sector company" means Government company as defined in section 617 of the Companies Act, 1956.

The payments so made to such institutions would be allowable irrespective of whether (i) the field of scientific research is related to the assessee's business or not, and (ii) the payment is of a revenue nature or of a capital nature.

(c) A sum equal to 1¼ times of any amount paid to a company to be used by it for scientific research [Clause (iia) of section 35(1)]

However, such deduction would be available only if the company is registered in India and has as its main object the scientific research and development. Further, it should be approved by the prescribed authority and should fulfill the other prescribed conditions.

A company approved under section 35(1)(iia) will not be entitled to claim weighted deduction of 150% under section 35(2AB). However, it can continue to claim deduction under section

35(1)(i) in respect of the revenue expenditure incurred on scientific research.

(d) A sum equal to 1¼ times of any amount paid to any university, college or other institution approved by the Central Government by notification in the Official Gazette to be used for research in any social science or statistical research.

(e) The applicant scientific research association, university, college or other institution shall be approved in accordance with the guidelines, in the manner and subject to such conditions as may be prescribed. The guidelines, manner (including application Forms) and conditions have since been prescribed vide notification bearing S.O. 1856 (E) dated 30.10.2006.

(f) The deduction would be available only if such association, university, college or other institution is for the time being approved in accordance with the guidelines, in the manner and subject to such conditions as may be prescribed.

(g) Further, it has been clarified that the deduction to which an assessee (i.e. donor) is entitled on account of payment of any sum to a scientific research association or university or college or other institution, shall not be denied merely on the ground that subsequent to payment of such sum by the assessee, the approval granted to any of the aforesaid entities is withdrawn.

(ii) Capital Expenditure:

Any expenditure of a capital nature related to the business carried on by the assessee would be deductible in full in the previous year in which it is incurred.

Capital expenditure prior to commencement of business - The *Explanation* added to sub-section (2) specifically provides that where any capital expenditure has been incurred prior to the commencement of the business the aggregate of the expenditure so incurred within the three years immediately preceding the commencement of the business shall be deemed to have been incurred in the previous year in which the business is commenced. Consequently, any capital expenditure incurred within three years before the commencement of business will rank for deduction as expenditure for scientific research incurred during the previous year.

Expenditure on land disallowed - No deduction will be allowed in respect of capital expenditure incurred on the acquisition of any land after 29-2-1984 whether the land is acquired as such or as part of any property.

For the above purpose the expression 'land' would include any interest in land and it shall be deemed to be acquired on the date on which the document purporting to transfer the land is registered under the Registration Act, 1908 and where the possession of any land has been obtained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882, on the date on which such possession was obtained.

(2) If any question arises under this section as to whether, and if so, to what extent, any activity constitutes, or any asset is being used, for scientific research, the Board shall refer the question to—

(a) the Central Government, when such question relates to any activity under clauses (ii) and (iii) of sub-section (1) i.e. any scientific research, or any research in social science or statistical research carried on by a university, college or institution approved for this purpose, and its decision shall be final;

(b) the prescribed authority, when such question relates to any activity other than the activity specified in clause (a) above whose decision shall be final.

(3) Carry forward of deficiency - Capital expenditure incurred on scientific research which cannot be absorbed by the business profits of the relevant previous year can be carried forward to the immediately succeeding previous year and shall be treated as the allowance for that year. In effect, this means that there is no time bar on the period of carry forward. It shall be accordingly allowable for that previous year.

(4) No depreciation - Section 35(2)(iv) clarifies that no depreciation will be admissible on any capital asset represented by expenditure which has been allowed as a deduction under section 35 whether in the year in which deduction under section 35 was allowed or in any other previous year.

(5) Approval by Central Government - The Central Government by notification in the Official Gazette will approve such scientific research association, university, college or institution for the purpose of sections 35(1)(ii) and 35(1)(iii).

The scientific research association, university or college or other institution referred to in section 35(1)(ii) or (iii) shall make an application in the prescribed form and manner to the Central Government for the purpose of grant of approval or continuance thereof under these clauses.

The Central Government may call for such documents (including audited annual accounts) or information from the scientific research association etc. in order to satisfy itself about the genuineness of the activities of the research association.

Notification issued by the Central Government under these clauses shall at any time have effect for not more than three assessment years (including an assessment year or years commencing before the date on which such notification is issued), as may be specified in the Notification. This time limit is applicable in respect of a notification issued by the Central Government under clause (ii) or clause (iii) before 13.7.2006. Consequently, any notification issued on or after 13.7.2006 shall remain in force until approval granted to such entity is withdrawn.

In respect of an application received on or after 13.7.2006, every notification under clause (ii) or clause (iii) shall be issued or an order rejecting the application shall be passed before

expiry of 12 months from the end of the month in which the application for approval was received by the Central Government.

(6) Application of section 41 - Section 41, *inter alia*, seeks to tax the profits arising on the sale of an asset representing expenditure of a capital nature on scientific research. Such an asset might be sold, discarded, demolished or destroyed, either after having been used for the purposes of business on the cessation of its use for the purpose of scientific research related to the business or without having been used for other purposes. In either case, tax liability could arise. In the first case, where the asset is sold, etc., after having been used for the purposes of the business, the moneys payable in respect of such asset together with the amount of scrap value, if any, could be brought to charge under section 41(1) the provisions of which are wide enough to cover such situations and to bring to tax that amount of deductions allowed in earlier years. It may be noted that in such cases, the actual cost of the concerned asset under section 43(1) read with explanation would be nil and no depreciation would be allowed by virtue of section 35(2)(iv).

Where the asset representing expenditure of a capital nature on Scientific Research is sold without having been used for other purposes, then the case would come under section 41(3) and if the proceeds of sale together with the total amount of the deductions made under section 35 exceed the amount of capital expenditure, the excess or the amount of deduction so made, whichever is less, will be charged to tax as income of the business of the previous year in which the sale took place.

(7) Sum paid to National Laboratory, etc. [Section 35(2AA)]- Sub-section (2AA) of section 35 provides that any sum paid by an assessee to a National Laboratory or University or Indian Institute of Technology or a specified person for carrying out programmes of scientific research approved by the prescribed authority will be eligible for weighted deduction of one and one-fourth times of the amount so paid.

No contribution which qualifies for weighted deduction under this clause will be entitled to deduction under any other provision of the Act.

The authority which will approve the National Laboratory will also approve the programmes and procedure. Such programmes and procedure will be specified in rules.

The prescribed authority can call for each document or information as it considers necessary to satisfy itself about the genuineness of scientific research activities of the National Laboratory applying for approval. The prescribed authority under Rules 6(3) to (7) is Secretary, Department of Scientific & Industrial Research/Director General (Income-tax *Exemptions).*

It has been clarified that the deduction to which an assessee is entitled on account of payment of any sum by him to a National Laboratory, University, Indian Institute of Technology or a specified person for the approved programme [referred to in sub-section (2AA) of section 35]

shall not be denied to the donor-assessee merely on the ground that after payment of such sum by him, the approval granted to any of the aforesaid donee-entities has been withdrawn.

'National Laboratory' means a scientific laboratory functioning at the national level under the aegis of the Indian Council of Agricultural Research, Indian Council of Medical Research or the Council of Scientific and Industrial Research, the Defence Research and Development Organisation, the Department of Electronics, the Department of Bio-Technology, or the Department of Atomic Energy and which is approved as a National Laboratory by the prescribed authority in the prescribed manner. 'Specified person' means a person who is approved by the prescribed authority.

(8) Company engaged in Business of Drugs, Electronic Equipments, etc. [Section 35(2AB)]

Where a company engaged in the business of bio-technology or *in any business of manufacture or production of any article or thing, not being an article or thing specified in the list of the Eleventh Schedule* incurs any expenditure on scientific research on inhouse research and development facility as approved by the prescribed authority, a deduction of a sum equal to one and one-half times of the expenditure will be allowed. Such expenditure should not be in the nature of cost ofany land or building.

For this clause, "expenditure on scientific research" in relation to drugs and pharmaceuticals shall include expenditure incurred on clinical drug trial, obtaining approval from any state regulatory authority, and filing an application for a patent under the Patents Act, 1970.

No deduction will be allowed in respect of the above expenditure under any other provision of this Act.

No company will be entitled to this deduction unless it enters into an agreement with the prescribed authority for co-operation in such research and development facility and for audit of accounts maintained for that facility.

The prescribed authority shall submit its report in relation to the approval of the said facility to the Director General in such form and within such time as may be prescribed.

No deduction shall be allowed in respect of such expenditure incurred after 31-3-2012.

(9) Prescribed Authority - Rule 6 of the Income-tax Rules specifies the 'prescribed authority' for the purpose of section 35, in relation to research in the field of agriculture, animal husbandry and fisheries, medical sciences, social sciences or statistical research and other natural or applied science. The expression "prescribed authority", for this purpose refers to the Indian Council of Agricultural Research, the Indian Council of Medical Research or the Indian Council of Social Science Research or the Secretary, Department of Science and Technology, Government of India or any other officer of the Department nominated by him in this behalf as may be appropriate to the nature of the scientific research in question of Rule 6.

(viii) Expenditure for obtaining licence to operate telecommunication services [Section 35ABB]: (1) Where any capital expenditure has been incurred for acquiring any right to operate telecommunication services and for which payment has actually been made to obtain a licence, a deduction will be allowed in equal annual instalments over the relevant previous years.

"Relevant previous years" means—

(a) in a case where the licence fee is actually paid before the commencement of the business to operate telecommunication services, the previous years beginning with the previous year in which such business commenced;

(b) in any other case, the previous years beginning with the previous year in which the licence fee is actually paid, and the subsequent previous year or years during which the licence, for which the fee is paid, shall be in force.

"Payment has actually been made" means the actual payment of expenditure irrespective of the previous year in which the liability for the expenditure was incurred according to the method of accounting regularly employed by the assessee.

(2) Moreover, any capital expenditure so incurred before the actual commencement of the business shall also be eligible for deduction under sub-section (1).

(3) Where the licence is transferred and the proceeds of the transfer (so far as they consist of capital sums) are less than the expenditure incurred remaining unallowed, a deduction equal to such expenditure remaining unallowed, as reduced by the proceeds of the transfer, shall be allowed in respect of the previous year in which the licence is transferred.

(4) Where the whole or any part of the licence is transferred and the proceeds of the transfer (so far as they consist of capital sums) exceed the amount of the expenditure incurred remaining unallowed, so much of the excess as does not exceed the difference between the expenditure incurred to obtain the licence and the amount of such expenditure remaining unallowed shall be chargeable to income-tax as profits and gains of the business in the previous year in which the licence has been transferred.

Where the licence is transferred in a previous year in which the business is no longer in existence, the above provisions will apply as if the business is in existence in that previous year.

(5) Where the whole or any part of the licence is transferred and the proceeds of the transfer (so far as they consist of captial sums) are not less than the amount of expenditure incurred remaining unallowed, no deduction for such expenditure shall be allowed in respect of the previous year in which the licence is transferred or in any subsequent previous year.

(6) Where a part of the licence is transferred in a previous year, the proceeds of transfer will be subtracted from the expenditure remaining unallowed. Such remainder will be divided by

the number of relevant previous years which have not expired at the beginning of the previous year during which the licence is transferred.

(7) Where in a scheme of amalgamation the amalgamating company sells or otherwise transfers the licence to the amalgamated company being an Indian company, the above provisions with regard to the chargeability of the surplus will not apply to the amalgamating company. Further, the provisions will apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not transferred the licence.

(8) The said provisions relating to transfer of licence given in (iii), (iv) and (v) above shall not be applicable in the case of demerged company where the demerged company sells or transfers the licence to the resulting company (being an Indian company) and the provisions of the section allowing deduction of expenditure incurred for obtaining the licence shall be applicable to the resulting company as it would have applied to demerged company.

(9) Where a deduction is claimed and allowed for any previous year under sub-section (1) of the section 35ABB, then, no deduction on the capital expenditure so incurred shall be allowed by way of depreciation under sub-section (1) of section 32 in respect of acquiring any right to operate telecommunication services.

(ix) Promotion of social and economic welfare [Section 35AC] – (1) Under this section, deduction will be allowed in computing profits of business or profession chargeable to tax, in respect of the expenditure incurred for an eligible project or scheme for promoting social and economic welfare or uplift of the public as may be specified by the Central Government on the recommendations of the "National Committee". For this purpose, 'National Committee' will be the committee constituted by the Central Government from amongst persons of eminence in public life. Rules 11-F to 11-O deal with the National Committee for Promotion of Social and Economic Welfare and the guidelines for granting approval of associations and institutions and for recommending projects or schemes, for the purposes of this provision.

(2) The deduction will be allowed in case where the qualifying expenditure is either incurred by way of payment to a public sector company, a local authority or to an approved association or institution for carrying out any eligible project or scheme.

(3) However, companies will be allowed the deduction also in cases where expenditure is incurred by them directly on an eligible project or scheme.

(4) The claim for deduction under this section should be supported by a certificate obtained from the public sector company, local authority or approved association or institution as the case may be. Where the claim is in respect of expenditure directly incurred by a company on an eligible project or scheme, a certificate should be obtained from a Chartered Accountant.

(5) The deduction to which an assessee (i.e. the donor) is entitled on account of payment of any sum by him to a public sector company or a local authority or to an association or institution shall not be denied to the assessee merely on the ground that after payment of such sum by him, the approval granted to such association or institution has been withdrawn or the notification notifying the eligible project or scheme referred to in section 35AC has been withdrawn.

(6) The Committee can withdraw the approval to an association or institution if it is satisfied that the project or the scheme is not being carried on in accordance with all or any of the conditions subject to which approval was granted or if the association/institution has failed to furnish to the National Committee, after the end of each financial year, a progress report within the prescribed time in the prescribed form. The National Committee, should however, give a reasonable opportunity to the concerned association or institution of showing cause against the proposed withdrawal. Further, a copy of the order withdrawing the approval or notification should be forwarded to the Assessing Officer having jurisdiction over the concerned association or institution.

(7) Similarly, the Committee can withdraw a notification regarding an eligible project or scheme if it is satisfied that the project or the scheme is not being carried out in accordance with all or any of the conditions subject to which such project or scheme was notified or a report in respect of such eligible project or scheme has not been furnished after the end of each financial year, in the prescribed form within the prescribed time. The National Committee should however, give a reasonable opportunity of showing cause against the proposed withdrawal.

(8) Further, a copy of the notification by which the eligible project or scheme is withdrawn should be forwarded to the Assessing Officer having jurisdiction over the concerned association, institution, public sector company or local authority, as the case may be, carrying on such eligible project or scheme.

(i) Where the approval of the National Committee or the notification in respect of eligible project or scheme is withdrawn in case of a public sector company or local authority, etc; or

(ii) Where a company has claimed deduction in respect of any expenditure incurred directly on the eligible project or scheme and the approval for such project or scheme is withdrawn by the National Committee,

the total amount of payment received by the public sector company or the local authority, etc., as case may be, in respect of which it has furnished to certificate, or the deduction claimed by the company shall be deemed to be the income of such company/authority, etc. for previous year in which the approval or notification is withdrawn. Further, tax will be charged on such income at the maximum marginal rate in force.

(x) Introduction of "investment-linked tax incentives" for specified businesses [New Section 35AD]

(i) Although there are a plethora of tax incentives available under the Income-tax Act, they do not fulfill the intended purpose of creating infrastructure since these incentives are linked to profits and consequently have the effect of diverting profits from the taxable sector to the tax-free sector. Therefore, with the specific objective of creating rural infrastructure and environment friendly alternate means for transportation of bulk goods, investment-linked tax incentives have been introduced for specified businesses, namely, –

- *setting-up and operating 'cold chain' facilities for specified products;*
- *setting-up and operating warehousing facilities for storing agricultural produce;*
- *laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network.*

(ii) 100% of the capital expenditure incurred during the previous year, wholly and exclusively for the above businesses would be allowed as deduction from the business income. However, expenditure incurred on acquisition of any land, goodwill or financial instrument would not be eligible for deduction.

(iii) Further, the expenditure incurred, wholly and exclusively, for the purpose of specified business prior to commencement of operation would be allowed as deduction during the previous year in which the assessee commences operation of his specified business. A condition has been inserted that such amount incurred prior to commencement should be capitalized in the books of account of the assessee on the date of commencement of its operations.

(iv) The specified business should fulfill the following conditions -

(1) it should not be set up by splitting up, or the reconstruction, of a business already in existence;

(2) it should not be set up by the transfer to the specified business of machinery or plant previously used for any purpose;

In order to satisfy this condition, the total value of the plant or machinery so transferred should not exceed 20% of the value of the total plant or machinery used in the new business.

For the purpose of this condition, machinery or plant would not be regarded as previously used if it had been used outside India by any person other than the assessee provided the following conditions are satisfied:

(a) such plant or machinery was not used in India at any time prior to the date of its installation by the assessee;

(b) the plant or machinery was imported into India from a foreign country;

(c) no deduction in respect of depreciation of such plant or machinery has been allowed to any person at any time prior to the date of installation by the assessee.

(3) In respect of the business of laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network, such business,—

(a) should be owned by a company formed and registered in India under the Companies Act, 1956 or by a consortium of such companies or by an authority or a board or a corporation established or constituted under any Central or State Act;

(b) should have been approved by the Petroleum and Natural Gas Regulatory Board and notified by the Central Government in the Official Gazette.

(c) should have made not less than one-third of its total pipeline capacity available for use on common carrier basis by any person other than the assessee or an associated person; and

(d) should fulfill any other prescribed condition.

(v) The assessee shall not be allowed any deduction in respect of the specified business under the provisions of Chapter VI-A under the heading "C– Deductions in respect of certain incomes".

(vi) The assessee cannot claim deduction in respect of such expenditure incurred for specified business under any other provision of the Income-tax Act in the current year or under this section for any other year.

(vii) The benefit will be available–

(a) in a case where the business relates to laying and operating a cross country natural gas pipeline network for distribution, if such business commences its operations on or after the 1st April, 2007; and

(b) *in any other case, if such business commences its operation on or after the 1st April, 2009.*

Consequently, profit-linked deduction provided under section 80-IA to the business of laying and operating a cross country natural gas distribution network has been discontinued. As a result, any person availing of this incentive can now avail of the benefit under section 35AD.

(viii) *For the previous year 2009-10, an assessee carrying on the business of laying and operating a cross country natural gas pipeline network for distribution, including storage facilities being an integral part of such network, would be allowed a deduction of 100% of the capital expenditure (other than on land, goodwill and financial instrument) incurred during any earlier previous year, if the business has commenced operation between 1.4.2007 and 31.3.2009. This will be available in addition to any other capital expenditure (excluding land, goodwill and financial instrument) incurred during the previous year 2009-10. However, no deduction for such amount should have been allowed or allowable to the assessee in any earlier previous year.*

(ix) *"Cold chain facility" means a chain of facilities for storage or transportation of agricultural and forest produce, meat and meat products, poultry, marine and dairy products, products of horticulture, floriculture and apiculture and processed food items under scientifically controlled conditions including refrigeration and other facilities necessary for the preservation of such produce.*

An "associated person" in relation to the assessee means a person—

(1) *who participates directly or indirectly or through one or more intermediaries in the management or control or capital of the assessee;*

(2) *who holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the capital of the assessee;*

(3) *who appoints more than half of the Board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of the assessee; or*

(4) *who guarantees not less than 10% of the total borrowings of the assessee.*

(x) ***Example***

A Ltd. commenced operations of the business of laying and operating a cross-country

natural gas pipeline network for distribution on 1st April, 2009. The company incurred capital expenditure of Rs.40 lakh during the period January to March, 2009 exclusively for the above business, and capitalized the same in its books of account as on 1st April, 2009. Further, during the financial year 2009-10, it incurred capital expenditure of Rs.150 lakh (out of which Rs.50 lakh was for acquisition of land) exclusively for the above business. Compute the deduction under section 35AD for the A.Y.2010-11, assuming that A Ltd. has fulfilled all the conditions specified in section 35AD.

The amount of deduction allowable under section 35AD for A.Y.2010-11 would be –

Particulars	***Rs.***
Capital expenditure incurred during the P.Y.2009-10 (excluding the expenditure incurred on acquisition of land) = Rs.150 lakh – Rs.50 lakh	*100 lakh*
Capital expenditure incurred prior to 1.4.2009 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2009	*40 lakh*
Total deduction under section 35AD for A.Y.2010-11	***140 lakh***

(xi) Where any goods or services held for the purposes of the specified business are transferred to any other business carried on by the assessee, or vice versa, and if the consideration for such transfer does not correspond with the market value of the goods or services then the profits and gains of the specified business shall be computed as if the transfer was made at market value.

For the above purpose, "market value" means the price such goods or services would ordinarily fetch in the open market, subject to statutory or regulatory restrictions, if any.

(xii) The deduction shall be allowed to the assessee only if the accounts of the assessee for the relevant previous year have been audited by a chartered accountant and the assessee furnishes the audit report in the prescribed form, duly signed and verified by such accountant along with his return of income.

(xiii) Where it appears to the Assessing Officer that the assessee derives more than ordinary profits from the specified business due to close connection between the assessee and any other person, or due to any other reason, the Assessing Officer may consider such profits as may be reasonably deemed to have been derived from the specified business for the purpose of computing deduction under this section.

(xi) Contributions for Rural Development [Section 35CCA]

This section allows a deduction of the following expenditure incurred by the assessee during the previous year:

(1) Payment to an association or institution, having the objective of undertaking programmes of rural development. Such payment must be used for carrying out any programme of rural development approved by the prescribed authority.

Conditions for Allowance

(a) The assessee must furnish a certificate from such association (which should be authorised by the prescribed authority to issue such a certificate) that the programme of rural development had been approved by the prescribed authority before 1-3-1983 and

(b) Where such payment is made after 28-2-1983, the programme should involve work by way of (i) construction of any building, or other structure (to be used for dispensary, school, training or welfare centre, workshop, etc.) or (ii) the laying of any road or (iii) the construction or boring of a well or tube well or (iv) the installation of any plant or machinery and such work must have commenced before 1-3-1983.

(2) Payment to an association or institution having as its object the training of persons for implementing rural development programme.

Conditions:

(a) Assessee must furnish a certificate from such association (which should be authorised by the prescribed authority to issue such a certificate) that it has been approved by the prescribed authority before 1-3-1983.

(b) Such training of persons must have started before 1-3-1983.

The deduction to which an assessee is entitled on account of payment of any sum by him to an association or institution for carrying out the programme of rural development shall not be denied to the assessee merely on the ground that after payment of such sum by him, the approval granted to such programme or, as the case may be, to the association or institution has been withdrawn.

(3) Payment to a rural development fund set up and notified by the Central Government.

The expression 'programme of rural development' for this purpose have the same meaning as has been assigned to it under Explanation to section 35CC(i).

(4) Payments made to "National Urban Poverty Eradication Fund" (NUPEF) set up and notified by the Central Government.

It has been specifically provided that in every case where any deduction in respect of

contribution for rural development is claimed by the assessee and allowed to him for any assessment year in respect of any expenditure incurred by way of payment of contribution to the approved association or institution, no deduction in respect of the same expenditure can again be claimed by the assessee under any other relevant provision.

(xii) Amortisation of Preliminary Expenses [Section 35D]– (1) Section 35D provides for the amortisation of preliminary expenses incurred by Indian companies and other resident non-corporate taxpayers for the establishment of business concerns or the expansion of the business of existing concerns.

(2) This section applies (a) only to Indian companies and resident non-corporate assessees; (b) in the case of new companies to expenses incurred before the commencement of the business; (c) in the case of extension of an existing undertaking to expenses incurred till the extension is completed, i.e., in the case of the setting up of a new unit - to expenses incurred till the new unit commences production or operation.

(3) Such preliminary expenditure incurred shall be amortised over a period of 5 years. In other words, 1/5th of such expenditure is allowable as a deduction for each of the five successive previous years beginning with the previous year in which the business commences or, the previous year in which the extension of the undertaking is completed or the new unit commences production or operation, as the case may be.

(4) Eligible expenses - The following expenditure are eligible for amortisation:

(i) Expenditure in connection with - (a) the preparation of feasibility report (b) the preparation of project report; (c) conducting market survey or any other survey necessary for the business of the assessee; (d) engineering services relating to the assessee's business; (e) legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting up to conduct the business of assessee.

(ii) Where the assessee is a company, in addition to the above, expenditure incurred - (f) by way of legal charges for drafting the Memorandum and Articles of Association of the company; (g) on printing the Memorandum and Articles of Association; (h) by way of fees for registering the company under the Companies Act; (i) in connection with the issue, for public subscription, of the shares in or debentures of the company, being underwriting commission, brokerage and charges for drafting, printing and advertisement of the prospectus; and

(iii) Such other items of expenditure (not being expenditure qualifying for any allowance or deduction under any other provision of the Act) as may be prescribed by the Board for the purpose of amortisation. However, the Board, so far, has not prescribed any specific item of expense as qualifying for amortisation under this clause.

In the case of expenditure specified in items (a) to (e) above, the work in connection with the preparation of the feasibility report or the project report or the conducting of market survey or any other survey or the engineering services referred to must be carried out by the assessee himself or by a concern which is for the time being approved in this behalf by the Board.

(5) Overall Limits - The maximum aggregate amount of the qualifying expenses that can be amortised has been fixed at 5% of the cost of the project or in the case of an Indian company, or, at the option of the company, 5% of the capital employed in the business of the company, whichever is higher. The excess, if any, of the qualifying expenses shall be ignored.

The assessee is entitled to a deduction of an amount equal to one-fifth of the qualifying amount of the expenditure for each of the five successive accounting years beginning with the year in which the business commences, or as the case may be, the previous year in which the business commences or as the case may be, the previous year in which extension of the undertaking is completed or the new unit commences production or operation.

(6) For purpose of amortisation, the expression, '**cost of the project**' means -

(i) In the case of expenses incurred before the commencement of business the actual cost of the fixed assets, being land, buildings, leaseholds, plant, machinery, furniture, fittings, railway sidings (including expenditure on the development of land, buildings) which are shown in the books of the assessee as on the last day of the previous year in which the business of the assessee commences;

(ii) in case of extension of the business or setting up of a new unit, the cost of the fixed assets being land, buildings, leaseholds, plant, machinery, furniture, fittings, and railway sidings (including expenditure on the development of land and buildings) which are shown in the books of the assessee as on the last day of the previous year in which the extension of the undertaking is completed or, as the case may be, the new unit commences production or operation, insofar as such assets have been acquired or developed in connection with the extension of the undertaking or the setting up of the new unit.

(7) The expression **"capital employed in the business of the company"** must be taken to mean -

(i) in the case of new company, the aggregate of the issued share capital, debentures and long-term borrowings as on the last day of the previous year in which the business of the company commences;

(ii) in the case of extension of the business or the setting up of a new unit, the aggregate of the issued share capital, debentures, and long-term borrowings as on the last day of the accounting year in which the extension of the undertaking is completed or, as the case may be, the unit commences production or operation insofar as such capital, debentures and long-term borrowings have been issued or obtained in connection with the extension

of the undertaking or the setting up of the new undertaking or the setting up of the new unit of the company.

(8) The expression "long-term borrowing," mentioned above, means any moneys borrowed in India by the company from the Government or the Industrial Finance Corporation of India or the Industrial Credit and Investment Corporation of India or any other financial institution eligible for deduction under section 36(1)(iii) or any banking institution, or any moneys borrowed or debt incurred by it in a foreign country in respect of the purchase outside India of plant and machinery where the terms under which such moneys are borrowed or the debt is incurred provide for the repayment thereof during a period of not less than seven years.

(9) In cases where the assessee is a person other than a company or a co-operative society, the deduction would be allowable only if the accounts of the assessee for the year or years in which the expenditure is incurred have been audited by a Chartered Accountant and the assessee furnishes, along with his return of income for the first year in respect of which the deduction is claimed, the report of such audit in the prescribed form duly signed and verified by the auditor and setting forth such other particulars as may be prescribed.

(10) Special provisions for amalgamation and demerger

Where the undertaking of an Indian company is transferred, before the expiry of the period of ten years, to another Indian company under a scheme of amalgamation as defined in section 2(IA) the aforesaid provisions will apply to the amalgamated company as if the amalgamation had not taken place. But no deduction will be admissible in the case of the amalgamating company for the previous year in which the amalgamation takes place.

Sub-section (5A) provides similar provisions for the scheme of demerger where the resulting company will be able to claim amortisation of preliminary expenses as if demerger had not taken place, and no deduction shall be allowed to the demerged company in the year of demerger.

It has been clarified that in case where a deduction under this section is claimed and allowed for any assessment year in respect of any item of expenditure, the expenditure in respect of which deduction is so allowed shall not qualify for deduction under any other provision of the Act for the same or any other assessment year.

(xiii) Amortisation of Expenses for Amalgamation/Demerger [Section 35DD]

(1) Where an assessee, being an Indian company, incurs expenditure on or after 1st April, 1999, wholly and exclusively for the purpose of amalgamation or demerger, the assessee shall be allowed a deduction equal to one-fifth of such expenditure for five successive previous years beginning with the previous year in which amalgamation or demerger takes place.

(2) No deduction shall be allowed in respect of the above expenditure under any other provisions of the Act.

(xiv) Amortisation of expenditure incurred under voluntary retirement scheme [Section 35DDA]- (1) This section applies to an assessee who has incurred expenditure in any previous year in the form of payment to any employee in connection with his voluntary retirement, in accordance with any scheme or schemes of voluntary retirement.

(2) The amount of deduction allowable is one-fifth of the amount paid for that previous year, and the balance in four equal installments in the four immediately succeeding previous years.

(3) In case of amalgamation, demerger, reorganisation or succession of business during the intervening period of the said 5 years, the benefit of deduction will be available to the "new company" for the balance period including the year in which such amalgamation/demerger/reorganisation or succession takes place.

(4) This will be applicable in the following situations:

(i) where an Indian company is transferred to another Indian company in a scheme of amalgamation;

(ii) where the undertaking of an Indian company is transferred to another company in a scheme of demerger;

(iii) where due to a re-organisation of business, a firm is succeeded by a company fulfilling the conditions in section 47(xiii) or a proprietary concern is succeeded by a company fulfilling the conditions in section 47(xiv).

(5) In the above cases, the deduction shall be available to the successor company as such deduction would have applied to the original entity if such transfer had not taken place at all.

(6) It is further provided that no deduction shall be available to the original entity being the amalgamating company, or the demerged company or the firm or proprietary concern (as the case may be) for the previous year in which the amalgamation, demerger or succession takes place.

(7) No deduction shall be allowed in respect of the above expenditure under any other provision of the Act.

(xv) Amortisation of expenses for prospecting and development of certain minerals [Section 35E] – (1) This provision applies only to expenditure incurred by an Indian company or any other person who is resident in India. Thus, foreign companies or foreign concerns and non-resident assessees are not entitled for the benefits of deduction under section 35E. In order to qualify for amortisation, the assessee should be engaged in any operations relating to prospecting for or the extraction or production of any mineral.

(2) Eligible expenses - The nature and kind of expenditure qualifying for amortisation are - (i) It must have been incurred during the year of commercial production or any one or more of

the four years immediately preceding that year, (ii) It must be an expenditure incurred wholly and exclusively on any operations relating to the prospecting for or extraction of certain minerals listed in the Seventh Schedule of the Income-tax Act.

(3) Expenditure not allowed for deduction - However, any portion of the expenditure which is met directly or indirectly by any other persons or authority and the sale, salvage, compensation or insurance moneys realised by the assessee in respect of any property or rights brought into existence as a result of the expenditure should be excluded from the amount of expenditure qualifying for amortisation. Further, specific provision has been made to the effect that the following items of expenses do not qualify for amortisation at all viz.:

(i) Expenditure incurred on the acquisition of the site of the source of any minerals or group of associated minerals stated above or of any right in or over such site;

(ii) Expenditure on the acquisition of the deposits of minerals or group of associated minerals referred to above or to any rights in or over such deposits; or

(iii) Expenditure of a capital nature in respect of any building, machinery, plant or furniture for which depreciation allowance is permissible under section 32.

(4) Amount of deduction - The assessee will be allowed for each of ten relevant previous years, a deduction of an amount equal to one-tenth of the aggregate amount of the qualifying expenditure. Thus, the deduction to be allowed for any relevant previous year is (i) one-tenth of the expenditure or (ii) such amount as will reduce to nil the income of the previous year arising from the commercial exploration of any minerals or other natural deposit of the mineral or minerals in a group of associated minerals in respect of which the expenditure was incurred, whichever figure is less. The amount of the deduction admissible in respect of any relevant previous year to the extent to which it remains unallowed, shall be carried forward and added to the installment relating to the previous year next following and shall be deemed to be a part of the installment and so on, for ten previous years beginning from the year of commercial production.

(5) For purposes of this amortisation, the expression "operation relating to prospecting" means any operation undertaken for the purpose of exploiting, locating or proving deposits of any minerals and includes any such operation which proves to be infructuous or abortive. The expression 'year of commercial production' means the previous year in which as a result of any operation relating to prospecting or commercial production of any material or one or more of the minerals in a group of associated minerals specified in Part A or Part B, respectively, of the Seventh Schedule to Act actually commences. The relevant previous year in which the deduction would be allowed to the assessee are those ten previous years beginning with the year of commercial production.

(6) In the case of amalgamation, such deduction would continue to be admissible to the amalgamated company as if the amalgamation had not taken place.

Sub-section (7A) provides for similar provisions in cases of demerger where such deduction can be availed of by the resulting company as if the demerger had not taken place.

Further, no deduction will be admissible to the amalgamating/demerged company in the year of amalgamation/demergers.

(7) Where a deduction is claimed and allowed on account of amortisation of the expenses under section 35E in any year in respect of any expenditure, the expenditure in respect of which deduction is so allowed shall not again qualify for deduction from the profits and gains under any other provisions of the Act for the same or any other assessment year. The provisions with regard to audit of accounts relating to the qualifying expenditure are similar to those applicable for amortisation of preliminary expenses discussed earlier.

(xvi) Other Deductions [Section 36] - This section authorises deduction of certain specific expenses. The items of expenditure and the conditions under which such expenditures are deductible are:

(1) Insurance premia paid [Section 36(1)(i)] - If insurance policy has been taken out against risk, damage or destruction of the stock or stock of the business or profession, the premia paid is deductible. But the premium in respect of any insurance undertaken for any other purpose is not allowable under the clause.

(2) Insurance premia paid by a Federal Milk Co-operative Society [Section 36(1)(ia)] - Deduction is allowed in respect of the amount of premium paid by a Federal Milk Co-operative Society to effect or to keep in force an insurance on the life of the cattle owned by a member of a co-operative society being a primary society engaged in supply of milk raised by its members to such Federal Milk Co-operative Society. The deduction is admissible without any monetary or other limits.

(3) Premia paid by employer for health insurance of employees [Section 36(1)(ib)] - This clause seeks to allow a deduction to an employer in respect of premia paid by him by any mode of payment other than cash to effect or to keep in force an insurance on the health of his employees in accordance with a scheme framed by (i) the General Insurance Corporation of India and approved by the Central Government; or (ii) any other insurer and approved by the IRDA.

(4) Bonus and Commission [Section 36(1)(ii)] - These are deductible in full provided the sum paid to the employees as bonus or commission shall not be payable to them as profits or dividends if it had not been paid as bonus or commission. It is a provision intended to safeguard against a private company or an association escaping tax by distributing a part of its profits by way of bonus amongst the members, or employees of their own concern instead of distributing the money as dividends or profits.

(5) Interest on borrowed capital [Section 36(1)(iii)] - In the case of genuine business borrowings, the department cannot disallow any part of the interest on the ground that the rate of interest is unreasonably high except in cases falling under section 40A.

Under section 36(1), deduction of interest is allowed in respect of capital borrowed for the purposes of business or profession in the computation of income under the head "Profits and gains of business or profession".

Capital may be borrowed for several purposes like for acquiring a capital asset, or to pay off a trading debt or loss etc. The scope of the expression 'for the purposes of business' is very wide. Capital may be borrowed in the course of the existing business as well as for acquiring assets for extension of existing business. Explanation 8 to section 43(1) clarifies that interest relatable to a period after the asset is first put to use cannot be capitalised. Interest in respect of capital borrowed for any period from the date of borrowing to the date on which the asset was first put to use should normally be capitalised. However, there was scope for the asssessees to claim it as a revenue expenditure.

It has now been provided that no such deduction shall be allowed in respect of any amount of interest paid, in respect of capital borrowed for acquisition of new asset for extension of existing business or profession (whether capitalised in the books of account or not) for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use. It is significant to note here that even after the amendment the scope for claiming such interest as revenue expenditure in respect of existing business still exists.

(6) Discount on Zero Coupon Bonds(ZCBs) [Section 36(1)(iiia)] - Section 36(1)(iiia) provides 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. The Explanation seeks to provide the meaning of the expression 'discount' as a difference of the amount received or receivable by an infrastructure capital company/infrastructure capital fund/public sector company/ *scheduled bank* on issue of the bond and the amount payable by such company or fund *or bank* on maturity or redemption of the bond. The expression 'period of life of the bond' has been defined to mean the period commencing from the date of issue of the bond and ending on the date of the maturity or redemption.

For definitions of "infrastructure capital company" and "infrastructure capital fund", refer sections 2(26A) and 2(26B) in Chapter 1 of this study material– Basic Concepts.

(7) Contributions to provident and other funds [Section 36(1)(iv) and (v)] - Contribution to the employees' provident and other funds are allowable subject to the following conditions:

(a) The fund should be settled upon a trust.

(b) In case of Provident or a superannuation or a Gratuity Fund, it should be one recognised or approved under the Fourth Schedule to the Income-tax Act.

(c) The amount contributed should be periodic payment and not an adhoc payment to start the fund.

(d) The fund should be for exclusive benefit of the employees.

The nature of the benefit available to the employees from the fund is not material ; it may be pension, gratuity or provident fund.

(8) Amount received by assessee as contribution from his employees towards their welfare fund to be allowed only if such amount is credited on or before due date - Clause (va) of section 36(1) and clause (ia) of section 57 provide that deduction in respect of any sum received by the taxpayer as contribution from his employees towards any welfare fund of such employees will be allowed only if such sum is credited by the taxpayer to the employee's account in the relevant fund on or before the due date. For the purposes of this section, "due date" will mean the date by which the assessee is required as an employer to credit such contribution to the employee's account in the relevant fund under the provisions of any law on term of contract of service or otherwise.

As per paragraph 38 of the Employees Provident Funds Scheme, 1952, the amounts under consideration in respect of wages of the employees for any particular mouth shall be paid within 15 days of the close of every month. A further grace period of 5 days is allowed [CPFC's Circular No. E 128(1) 60-III dt. 19.3.1964].

(9) Allowance for animals [Section 36(1)(vi)] - This clause grants an allowance in respect of animals which have died or become permanently useless. The amount of the allowance is the difference between the actual cost of the animals and the price realised on the sale of the animals themselves or their carcasses. The allowance under the clause would thus recoup to the assessee the entire capital expenditure in respect of animal.

(10) Bad debts [Section 36(1)(vii) and sub-section (2)] - These can be deducted subject to the following conditions:

(a) The debts or loans should be in respect of a business which was carried on by the assessee during the relevant previous year.

(b) The debt should have been taken into account in computing the income of the assessee of the previous year in which such debt is written off or of an earlier previous year or should represent money lent by the assessee in the ordinary course of his business of banking or money lending.

The proviso to the above sub-clause provides that in the case of banks to which clause (viia) applies, the amount of the deduction relating to any such debt or part thereof shall be limited to the amount by which such debt or part thereof exceeds credit balance in the provision for

bad and doubtful debts account made under that clause. The scope of the above proviso has been expanded to cover any assessee and not only banks.

For the purpose of clause (vii) it has been clarified in the Act that any bad debt or part thereof written off as irrecoverable in the accounts shall not include any provision for bad and doubtful debts.

Further in the case of a claim for bad debts by an assessee covered by section 36(1)(viia), the bank or financial institution etc. should have debited the bad debt to the provision for bad and doubtful debts account.

Further, if on the final settlement the amount recovered in respect of any debt, where deduction had already been allowed, falls short of the difference between the debt due and the amount of debt allowed, the deficiency can be claimed as a deduction from the income of the previous year in which the ultimate recovery out of the debt is made. It is permissible for the Assessing Officer to allow deduction in respect of a bad debt or any part thereof in the assessment of a particular year and subsequently to allow the balance of the amount, if any, in the year in which the ultimate recovery is made, that is to say, when the final result of the process of recovery comes to be known.

Furthermore, where any bad debt has been written off as irrecoverable in the accounts of the previous year and the Assessing Officer is satisfied that such a debt or part thereof, in fact had become a bad debt in any earlier previous year not falling beyond a period of four previous years in which the debts should have been allowed provided the assessee accepts such a finding [Section 155(6)].

Recovery of a bad debt subsequently [Section 41(4)] - If a deduction has been allowed in respect of a bad debt under section 36, and subsequently the amount recovered in respect of such debt is more than the amount due after the allowance had been made, the excess shall be deemed to be the profits and gains of business or profession and will be chargeable as income of the previous year in which it is recovered, whether or not the business or profession in respect of which the deduction has been allowed is in existence at the time.

For example, let us assume that a debt of Rs.10,000 was claimed as a bad debt in the previous year 2008-09. However, the Assessing Officer allowed only a sum of Rs.5,000 as bad debt. If in the previous year 2009-10, a sum of Rs.4,000 is recovered ultimately in respect of the debt, then the Assessing Officer should allow a deduction in respect of the deficiency namely, Rs.1,000 i.e., the difference between the amount ultimately recovered and the amount disallowed earlier under Section 36(1)(vii). If on the other hand, the sum ultimately recovered is Rs.6,000 then there will be a liability, under section 41(4) in respect of sum of Rs.1,000, which would be deemed to be the profits and gains of business or profession. Such a liability under section 41(4) would arise even if the business or profession in respect of which deduction has been allowed is not in existence at that time.

(11) Special provision for bad and doubtful debts in cases of Rural Branches of Scheduled Banks [Section 36(1) (viia)]

(a) In the case of a scheduled bank which is not a bank incorporated by or under the laws of a country outside India or a non-scheduled bank, the following deductions will be allowed:

(i) an amount not exceeding 7.5% of the total income (computed before making any deduction under this clause and Chapter VI-A), and

(ii) an amount not exceeding 10% of the aggregate average advances made by the rural branches of such bank computed in the manner prescribed by the CBDT.

(b) A scheduled bank or a non-scheduled bank referred to in (a) above or a co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank shall, at its option, be allowed a further deduction in excess of the limits specified in the foregoing provisions, for an amount not exceeding the income derived from redemption of securities in accordance with a scheme framed by the Central Government. It is also provided that this deduction shall not be allowed unless such income has been disclosed in the return of income under the head "Profits and gains of business or profession".

Scheduled Bank : It refers to the State Bank of India or any of its subsidiaries or any of the nationalised banks and would also include any other bank which is listed in the Second Schedule to the Reserve Bank of India Act, 1935.

Non-Scheduled Bank : This refers to a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 which is not a scheduled bank.

Rural branch : This means a branch of a scheduled bank or a non-scheduled bank situated in a place which has a population of not more than 10,000 according to the last preceding census of which the relevant figures have been published before the first day of the previous year.

(c) **Foreign Banks** : In the case of foreign banks the deduction will be an amount not exceeding 5% of the total income (computed before making any deduction under this clause and Chapter VI-A).

(d) A public financial institution, a State Financial Corporation and a State Industrial Investment Corporation will be entitled to a deduction in respect of provision for bad and doubtful debts made out of profits. The maximum amount to be allowed as a deduction will be limited to 5% of its total income before making any deduction in respect of the provision for bad and doubtful debt or in respect of any deduction in Chapter VI-A.

"Public Financial Institution" shall have the meaning assigned to it in section 4A of the Companies Act.

"State Financial Corporation" means a financial corporation established under section 3 or section 3A or an institution notified under section 46 of the State Financial Corporations Act, 1951.

"State Industrial Investment Corporation" means a Government company within the meaning of Section 617 of the Companies Act engaged in the business of providing long-term finance for industrial projects and eligible for deduction under clause (viii) of this sub-section.

Co-operative bank, primary agricultural credit society and primary co-operative agricultural and rural development bank have the same meanings assigned in Explanation to section 80P(4).

(12) Special deduction to Specified Entities engaged in eligible business [Section 36(1)(viii)]

(a) This section provides deduction in respect of any special reserve created and maintained by a specified entity.

(b) The quantum of deduction, however, should not exceed 20% of the profits derived from eligible business computed under the head "Profits and gains of business or profession" carried to such reserve account.

(c) The eligible business for different entities specified are given in the table below–

	Specified entity	Eligible business
1.	Financial Corporation specified in section 4A of the Companies Act, 1956 Financial corporation which is a public sector company Banking company Co-operative bank (other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank)	Business of providing long-term finance for - (i) industrial or agricultural development or (ii) development of infrastructure facility in India; or *(iii) development of housing in India*.
2.	A housing finance company	Business of providing long-term finance for the construction or purchase of houses in India for residential purposes.
3.	Any other financial corporation including a public company	Business of providing long-term finance for development of infrastructure facility in India.

(d) However, where the aggregate amount carried to such reserve account exceeds twice the amount of paid up share capital and general reserve, no deduction shall be allowed in respect of such excess.

(e) Infrastructure facility has been defined to mean -

(a) (1) an infrastructure facility as defined in the Explanation to clause (i) of sub-section (4) of section 80-IA i.e.

(i) a road including toll road, a bridge or a rail system;

(ii) a highway project including housing or other activities being an integral part of the highway project;

(iii) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system; and

(iv) a port, airport, inland waterway or inland port or a navigational channel in the sea

(2) any other public facility of a similar nature as may be notified by the CBDT in this behalf in the Official Gazette and which fulfils the prescribed conditions;

(b) an undertaking referred to in clause (ii) or clause (iii) or clause (iv) of sub-section (4) of section 80-IA (i.e. an undertaking providing telecommunication services, an undertaking developing, developing and operating, maintaining and operating an industrial park or SEZ notified by the Central Government, an undertaking generating, distributing or transmitting power); and

(c) an undertaking referred to in sub-section (10) of section 80-IB i.e. an undertaking developing and building housing projects approved by a local authority.

Conditions to be fulfilled by a public facility to be eligible to be notified as an infrastructure facility [Notification No.187/2006 dated 20.7.2006]

Rule 6ABAA has been inserted in the Income-tax Rules, 1962 which specifies the conditions to be fulfilled by a public facility to be eligible to be notified as an infrastructure facility in accordance with the provisions of clause (d) of the Explanation to clause (viii) of sub-section (1) of section 36. The conditions specified therein are -

(a) it is owned by a company registered in India or by a consortium of such companies or by an authority or a board or a corporation or any other body established or constituted under any Central or State Act;

(b) it has entered into an agreement with the Central Government or a State Government or a local authority or any other statutory body for (i) developing or (ii) operating and

maintaining or (iii) developing, operating and maintaining a new infrastructure facility similar in nature to an infrastructure facility referred to in the Explanation to section 80-IA(4)(i);

(c) it has started or starts operating and maintaining such infrastructure facility on or after 1st April, 1995.

Notification of public facilities as infrastructure facility for the purpose of section 36(1)(viii) [Notification No. 188/2006, dated 20.7.2006]

The following public facilities have been notified by the CBDT as infrastructure facility for purposes of section 36(1)(viii)-

(1) Inland Container Depot and Container Freight Station notified under the Customs Act, 1962

(2) Mass Rapid Transit system

(3) Light Rail Transit system

(4) Expressways

(5) Intra-urban or semi-urban roads like ring roads or urban by-passes or flyovers

(6) Bus and truck terminals

(7) Subways

(8) Road dividers

(9) Bulk Handling Terminals which are developed or maintained or operated for development of rail system

(10) Multilevel Computerised Car Parking.

Deduction in respect of income from long-term finance for development of infrastructure facilities - The deduction will now be available also to approved financial corporations providing long-term finance for development of infrastructure facilities in India. For this purpose, the expression "infrastructure facility" shall have the meaning assigned to it in section 80-IA.

(13) Expenses on family planning [Section 36(1)(ix)] - Any expenditure of revenue nature bona fide incurred by a company for the purpose of promoting family planning amongst its employees will be allowed as a deduction in computing the company's business income; where, the expenditure is of a capital nature, one-fifth of such expenditure will be deducted in the previous year in which it was incurred and in each of the four immediately succeeding previous years. This deduction is allowable only to companies and not to other assessees. The assessee would be entitled to carry forward

and set off the unabsorbed part of the allowance in the same way as unabsorbed depreciation. The capital expenditure on promoting family planning will be treated in the same way as capital expenditure for scientific research for purposes of dealing with the profit or loss on the sale or transfer of the asset including a transfer on amalgamation.

(14) Deduction for expenditure incurred by entities established under any Central, State or Provincial Act [Section 36(1)(xii)]

Any expenditure (not being in the nature of capital expenditure) incurred by a corporation or a body corporate, by whatever name called, if –

(a) it is constituted or established by a Central, State or Provincial Act;

(b) such corporation or body corporate is notified by the Central Government in the Official Gazette for this purpose having regard to the objects and purposes of the Act;

(c) the expenditure is incurred for the objects and purposes authorised by the Act under which it is constituted and established.

Accordingly, the Central Government has notified the Oil Industry Development Board for the purpose of deduction under section 36(1)(xii).

(15) Deduction in respect of banking cash transaction tax [Section 36(1)(xiii)]

(a) The Finance Act, 2005 has, through Chapter VII, introduced a tax called banking cash transaction tax, as an anti tax-evasion measure, in respect of every taxable banking transaction entered into on or after 1.6.2005, at the rate of 0.1% of the value of every such taxable banking transaction.

(b) Taxable banking transaction means -

(1) a transaction, being withdrawal of cash (by whatever mode) on any single day from an account (other than a savings bank account) maintained with any scheduled bank, exceeding, -

(i) Rs.50,000, in case such withdrawal is from the account maintained by any individual or HUF;

(ii) Rs.1,00,000, in case such withdrawal is from the account maintained by a person other than any individual or HUF; or

(2) A transaction, being receipt of cash from any scheduled bank on any single day on encashment of one or more term deposits, whether on maturity or otherwise, from that bank, exceeding -

(i) Rs.50,000, in case such term deposit or deposits are in the name of any individual or HUF;

(ii) Rs.1,00,000, in case such term deposit or deposits are by any person other than any individual or HUF.

(c) However, banking cash transaction tax is not leviable if the amount of term deposit or deposits is credited to any account with the bank.

(d) Section 36(1)(xiii) provides for deduction of any amount of banking cash transaction tax paid by the assessee during the previous year on the taxable banking transactions entered into by him.

Note – Banking Cash Transaction Tax is not chargeable in respect of any taxable banking transaction entered into on or after 1.4.2009.

(16) Deduction of contribution by a public financial institution to Credit guarantee fund trust for small industries [Section 36(1)(xiv)]

(i) Section 36(1)(xiv) provides for deduction of any sum paid by a public financial institution by way of contribution to such credit guarantee fund trust for small industries notified by the Central Government in the Official Gazette.

(ii) Public financial institution has the meaning assigned to it in section 4A of the Companies Act, 1956.

(17) Deduction of securities transaction tax paid [Section 36(1)(xv)]

The amount of securities transaction tax paid by the assessee during the year in respect of taxable securities transactions entered into in the course of business shall be allowed as deduction under section 36 subject to the condition that such income from taxable securities transactions is included under the head 'Profits and gains of business or profession'. Thus, securities transaction tax paid would be allowed as a deduction like any other business expenditure.

(xvii) Residuary Expenses [Section 37]

(1) Revenue expenditure incurred for purposes of carrying on the business, profession or vocation - This is a residuary section under which only business expenditure is allowable but not the business losses, e.g., those arising out of embezzlement, theft, destruction of assets, misappropriation by employees etc. (These are allowable under section 29 as losses incidental to the business). The deduction is limited only to the amount actually expended and does not extend to a reserve created against a contingent liability.

(2) Conditions for allowance : The following conditions should be fulfilled in order that a particular item of expenditure may be deductible under this section :

(a) The expenditure should not be of the nature described in sections 30 to 36.

(b) It should have been incurred by the assessee in the accounting year.

(c) It should be in respect of a business carried on by the assessee the profits of which are being computed and assessed.

(d) It must have been incurred after the business was set up.

(e) It should not be in the nature of any personal expenses of the assessee.

(f) It should have been laid out or expended wholly and exclusively for the purposes of such business.

(g) It should not be in the nature of capital expenditure. (The principles to be followed for distinguishing capital expenditure from revenue are discussed below.)

(h) The expenditure should not have been incurred by the assessee for any purpose which is an offence or is prohibited by law.

This section is thus limited in scope. It does not permit an assessee to make all deductions which a prudent trader would make in ascertaining his own profit. It might be observed that the section requires that the expenditure should be wholly and exclusively laid out for purpose of the business but not that it should have been necessarily laid out for such purpose. There fore, expenses wholly and exclusively laid out for the purpose of trade are, subject to the fulfilment of other conditions, allowed under this section even though the outlay is unnecessary.

(3) For determining whether an expenditure is of the nature contemplated by the foregoing provisions of law the following tests should be applied:

(i) **'Character as a trader':** The expenditure should be incurred by the assessee in his character as a trader.

(ii) **'Voluntarily expended on grounds of commercial expediency' :** A sum of money expended, not out of necessity but with a view to getting a direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency and in order indirectly to facilitate the carrying on of the business may yet be expended wholly and exclusively for purposes of the trade [*Atherton v British Insulated and Helsby Ltd.* 10 LTC. 115 (H.L.)].

(iii) **'Direct concern and direct purpose' :** In order to ascertain whether the expenditure has been incurred wholly and exclusively for the purpose of the business one must look to the direct concern and direct purpose for which the money is laid out and not the remote or indirect result which may possibly motivate or flow from the expenditure.

(iv) **'Purpose of the assessee's own business' :** The expenditure should be primarily incurred for the assessee's own business. Notwithstanding this proposition so long as the expenditure is for the whole and exclusive purpose of the assessee's trade the mere fact

that the expenditure incidentally obtains some advantage to the assessee in some character other than that of a trader, would not detract the effect of the finding that the expenditure was wholly and exclusively incurred for purpose of the assessee's business.

(v) **'Unremunerative expenditure' :** The expenditure need not be incurred solely for the purpose of earning profit in the year of account. For example, the cost of repairs or advertisement or expenses on a foreign tour by the managing directors would be deductible even though the income therefrom would be earned in future years.

(vi) **'Treatment in assessee's accounts' :** The way in which an item of expenditure is treated in the assessee's accounts is not a conclusive evidence against or in favour of the assessee.

Payment out of profits and payments ascertained by reference to profits : When a trader makes a payment which is computed in relation to profits the question that arises is : Does the payment represent a mere division of profit with another person or is it an item of expenditure the amount of which is ascertained by reference to the profits? The payment would be allowable in the second case but not in the first.

(4) Distinction between capital and revenue expenditure : The line of demarcation between capital and revenue expenditure is very thin and the ultimate conclusion on the nature of the expenditure is always a mixed question of law and fact. In deciding whether an expenditure is of a revenue or a capital nature, one must take into consideration the nature and ordinary course of the business of the assessee and the object for which the expenditure had been incurred.

Whether a particular item of expenditure is incurred for the purpose of the business or not must be viewed in the larger context of business necessity and expediency. For this purpose, one must look not to the documents but also the surrounding circumstances so as to arrive at a decision as to what exactly is the real nature of the transaction from the commercial point of view.

It is often very difficult to lay down a test of a comprehensive nature which would be of universal application. Different tests have to be applied from the business point of view and then conclusions must be arrived at on the question whether, on a fair consideration of the whole situation as evident from the facts, the expenditure in question incurred in a particular case is of revenue nature or of a capital nature. The following broad principles have been evolved by the decisions of the various courts from time to time. These principles are neither exhaustive nor are they intended to be. They would serve only as guidelines to decide any problem arising in regard to the determination of the capital or revenue of a particular item [*Hylam Ltd. v CIT* [1913] 87 ITR 310 (A.P.)].

(i) If the expenditure is for the initial outlay or for acquiring or bringing into existence any asset or advantage of an enduring benefit to the business of the assessee or for extension of the

business which is already in existence or for substantial replacement of any existing business asset it must be treated as capital expenditure. The Supreme Court has reiterated the above principle in *CIT v. Jalan Trading Co. (P) Ltd. [1985] 23 Taxman (SC).*

(ii) If, however, the expenditure, although incurred for the purpose of the business that too for acquiring an asset or advantage, is for running the business or for working out that asset with a view to producing profits, it would be a revenue expenditure. The expenditure incurred for the purpose of carrying on the business undertaking would be of a revenue nature. The expenditure which has to be incurred by an assessee in the ordinary course of his business, to enable him to carry on his trading operations is normally to be considered to be of a revenue nature. The expenditure by the assessee cannot be considered to be capital in nature merely because of the fact that the amount involved is large. The quantum of the expenditure cannot go to affect or alter the real nature and character of expenditure.

(iii) In cases where the outgoing of money spent by the assessee is so related to the carrying on or the conduct of the business that it may be regarded as an integral part of the profit-earning process of operations and not for the acquisition of any asset of a permanent character the possession of which is a condition precedent to the running of the business, then such an item of payment would constitute an expenditure of a revenue nature.

(iv) Any special knowledge, technical know-how or patent or trade mark constitutes an asset and if such an asset is acquired on payment for its use and exploitation for a limited period in the business and the acquisition is not of an asset or advantage of an enduring nature and at the end of the stipulated period the asset or advantage reverts back intact to the giver of the special knowledge or the owner of the patent, trade mark or copyright, it would constitute an expenditure of a revenue nature. In this context, it may be noted that a payment made to ward off competition in business to a rival would constitute a capital expenditure if the object of making that payment is to derive an advantage by eliminating competition over some length of time. The same result would not follow if there is no certainty of the duration of the advantage and the same can be put to an end at any point of time. How long the period of contemplated advantage or the benefit should be in order to constitute benefit of an enduring nature would depend upon the facts and circumstances of each individual case. Although enduring benefit need not be of an everlasting character, it should not be so transitory and ephemeral that it may be terminated at any time at the volition of any of the parties to the contract.

(v) In cases of acquisition of a capital asset, it is immaterial whether the price for it is paid by the assessee once and for all in lumpsum or periodically and also whether it is paid out of capital or income or is linked with the total sales or the turnover of the business. In such a case, the expenditure or outgoing would constitute payment of a capital nature although it may indirectly be linked to or is paid out of revenue profit or sales.

(vi) In cases where the amount paid for acquisition of an asset of an enduring nature is settled, by the mere fact that the amount so settled is chalked out into various small amounts or periodical instalments the capital nature of the transaction or expenditure would not in any way be affected nor the fact that the payment is made in instalments or in small amounts would in any way alter the nature of the expenditure from capital to revenue. In other words, the magnitude of the payment and its periodicity would not be deciding factors for determining the capital or revenue nature of any particular payment.

(vii) A lumpsum amount paid for liquidating recurring claims would generally be of a revenue nature; it would not cease to be a revenue expenditure or get converted into capital expenditure merely because its payment is spread over a number of years. In such a case it is the intention and the object for which the assets are acquired that determine the nature of the expenditure incurred over it, and not the mode and the manner in which the payment is made nor is it in any way related to or determined by the source of such payment.

(viii) If the expenditure in question is recurring and is incurred by the assessee during the ordinary course of the business or manufacture, it would normally constitute a revenue expenditure.

(ix) An asset or advantage of an enduring nature resulting in capital expenditure does not mean that such an asset should last forever; if the capital asset is, by its very nature, a short lived one, the expenditure incurred over it does not on that account cease to be a capital expenditure.

(x) It is nowhere stipulated in the law that if a benefit of enduring nature is obtained, the expenditure for securing it must be treated as a capital expenditure. If the advantage or the benefit acquired by the assessee is to get stock-in-trade of a business it would constitute a revenue; but if what is acquired by the assessee is not the advantage of getting his current or trading assets directly but of something which requires to be processed before it is converted into stock-in-trade, the expenditure incurred over it would constitute a capital expenditure.

(xi) Further, an item of disbursement may be regarded as capital expenditure when it is referable to fixed capital or a capital asset; it is a revenue expenditure when it is referable to circulating capital or stock in trade. Expenditure which relates to the framework of the taxpayer's business is a capital expenditure. Expenditure incurred for the termination of trading relationship in order to avoid losses occurring in future though that relationship, whether pecuniary loss or commercial inconvenience, is a revenue expenditure. Expenditure incurred for the initial starting of the business before its setting up for substantial expansion and also expenditure incurred after the discontinuance of the business would be of a capital nature.

The capital or revenue character of a particular item must be decided from the facts and circumstances of each case and must be based upon the principles of law applicable to those facts. The fact that a particular transaction is treated by the parties as capital or revenue in nature or is called a sale, instead of being an agreement to use or let out the particular asset would not convert the capital or revenue character of the transaction. Similarly, the entries made by the parties concerned in their books of account or other documents would not always be indicative or conclusive, as to what the real nature of the transaction is based upon the above principles, the capital or revenue character of a particular expenditure will have to be decided in every case.

Instances of revenue expenditure: Payment made for the use of goodwill, use of quota rights or in the case of a hotel or restaurant business the cost of table linen, crockery, pots is of a revenue expenditure. The cost of dredging carried on by a harbour authority for the purpose of keeping the channels clear for shipping is also of revenue expenditure. Expenditure incurred by a surgeon or businessman on a study tour abroad to acquire knowledge of the latest techniques would be on revenue account.

Circular No.6/2007 dated 11.10.2007 clarifies the issue of allowability of the claim of harvesting and transportation expenses incurred by the Co-operative sugar mills for procuring sugarcane from farmers, who are members of such Co-operative Sugar Mills and who are bound under an agreement to supply the sugarcane exclusively to the concerned sugar Mill.

The issue of allowability of such expenses in the case of Co-operative Sugar Mills has been examined by the CBDT. These expenses are incurred by the Sugar Mills for ensuring an adequate and sustained supply of freshly cut sugarcane that is an essential input for the continuous running of such Mills. These expenses are, therefore, incurred for commercial expediency and are prima facie wholly and exclusively for the purpose of business. Such expenses are, therefore, allowable in the computation of the income of the Co-operative Sugar Mills.

Instances of capital expenditure: Expenditure on improvement to property as distinguished from mere repairs or that which is incurred by a company in raising loans or issuing debentures for capital outlay would be capital expenditure if they are incurred before the business is set up. Legal expenses incurred in connection with the mortgages of the premises belonging to the assessee in which the assessee carries on his business are also capital expenditure.

(5) Advertisements in souvenirs of political parties: Section 37(2B) disallows any deduction on account of advertisement expenses representing contributions made by any person carrying on business or profession in computing the profits and gains of the business or profession. It has specifically been provided that this provision for disallowance would apply

notwithstanding anything to the contrary contained in section 37(1). In other words, the expenditure representing contribution for political purposes would become disallowable even in those cases where the expenditure is otherwise incurred by the assessee in his character as a trader and the amount is wholly and exclusively incurred for the purpose of the business. Accordingly, a taxpayer would not be entitled to any deduction in respect of expenses incurred by him on advertisement in any souvenir, brochure, tract or the like published by any political party, whether it is registered with the Election Commission of India or not.

(6) Explanation to section 37(1) - This Explanation provides that any expenditure incurred by the assessee for any purpose which is an offence or is prohibited by law shall not be allowed as a deduction or allowance.

3.6 INADMISSIBLE DEDUCTIONS [SECTION 40]

By dividing the assessees into distinct groups, this section places absolute restraint on the deductibility of certain expenses as follows :

(i) Section 40(a) - In the case of any assessee, the following expenses are not deductible:

(1) Any interest (not being interest on loan issued for public subscription before the 1st day of April, 1938), royalty, fees for technical services or other sum chargeable under this Act, which is payable, -

(a) outside India;

(b) in India to a non-resident, not being a company or to a foreign company,

on which tax is deductible at source under Chapter XVIIB and such tax has not been deducted or, after deduction, has not been paid during the previous year, or in the subsequent year before the expiry of the time prescribed under section 200(1). It is also provided that where in respect of any such sum, where tax has been deducted in any subsequent year, or has been deducted in the previous year but paid in any subsequent year after the expiry of the time prescribed under section 200(1), such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

(2) Section 40(a)(ia) provides that interest, commission, brokerage, rent, royalty, fees for technical/professional services payable to a resident or amounts payable (for carrying out any work contract) to a resident contractor/sub-contractor, on which tax is deductible at source, shall be disallowed if –

(i) such tax has not been deducted; or

(ii) such tax, after deduction, has not been paid –

(a) on or before the due date specified in section 139(1), in a case where the tax was deductible and was so deducted during the last month (i.e., March) of the previous year;

(b) on or before the last day of the previous year, in any other case.

In case the tax is deducted in any subsequent year or has been deducted

(a) during the last month (i.e., March) of the previous year but paid after the due date specified in section 139(1); or

(b) during any other month (i.e., April to February) of the previous year but paid after the end of the previous year,

such sum shall be allowed as deduction in computing the income of the previous year in which such tax has been paid.

If, for instance, tax on royalty paid to Mr. A, a resident, has been deducted during the period between April, 2009 to February, 2010, the same has to be paid by 31st March, 2010. If the deduction has been made in March 2010, the same has to be paid by 31st July/30th September 2010, as the case may be. Otherwise, the expenditure would be disallowed in computing the income for A.Y.2010-11.

If such tax deducted between April 2009 and February 2010 is paid after 31st March 2010, the same would be allowed as deduction in the year of payment. If the tax deducted in March 2010 has been paid after 31st July/30th September, 2010, the same would be allowed as deduction in the year of payment.

(3) any sum paid on account of tax or cess levied on profits on the basis of or in proportion to the profits and gains of any business or profession;

(a) Any sum paid outside India (on account of any rate or tax levied) which is eligible for tax relief under section 90 or deduction from the income-tax payable under section 91 is not allowable and is deemed to have never been allowable as a deduction under section 40(a).

(b) However, the tax payers will continue to be eligible for tax credit in respect of income-tax paid in a foreign country in accordance with the provisions of section 90 or section 91, as the case may be.

(c) Any sum paid outside India (on account of any rate or tax levied) and eligible for relief under section 90A will not be allowed as a deduction.

(4) any sum paid on account of wealth tax.

For the purpose of this disallowance the expression 'wealth-tax' means the wealth-tax

chargeable under Wealth-tax Act, 1957, or any tax of similar nature or character chargeable under any law in any country outside India or any tax chargeable under such law with reference to the value of the assets of, or the capital employed in a business or profession carried on by the assessee, whether or not the debts of business or profession are allowed as a deduction in computing the amount with reference to which such tax is charged, but does not include any tax chargeable with reference to the value of any particular asset of the business or profession.

(5) any sum which is chargeable under the head 'Salaries' if it is payable outside India or to a non-resident and if the tax has not been paid thereon nor deducted therefrom under Chapter XVII-B.

(6) any contribution to a provident fund or the fund established for the benefit of employees of the assessee, unless the assessee has made effective arrangements to make sure that tax shall be deducted at source from any payments made from the fund which are chargeable to tax under the head 'Salaries'.

(7) Tax paid on perquisites on behalf of employees is not deductible- In case of an employee, deriving income in the nature of perquisites (other than monetary payments), the amount of tax on such income paid by his employer is exempt from tax in the hands of that employee. Correspondingly, such payment is not allowed as deduction from the income of the employer. Thus, the payment of tax on perquisites by an employer on behalf of employee will be exempt from tax in the hands of employee but will not be allowable as deduction in the hands of the employer.

(ii) Section 40(b) - In the case of any firm assessable as such *or a limited liability partnership(LLP)* the following amounts shall not be deducted in computing the income from business of any firm/*LLP* :

(1) Any salary, bonus, commission, remuneration by whatever name called, to any partner who is not a working partner. (In the following discussion, the term 'remuneration' is applied to denote payments in the nature of salary, bonus, commission);

(2) Any remuneration paid to the working partner or interest to any partner which is not authorised by or which is inconsistent with the terms of the partnership deed;

(3) It is possible that the current partnership deed may authorise payments of remuneration to any working partner or interest to any partner for a period which is prior to the date of the current partnership deed. The approval by the current partnership deed might have been necessitated due to the fact that such payment was not authorised by or was inconsistent with the earlier partnership deed. Such payments of remuneration or interest will also be disallowed. However, it should be noted that the current partnership deed cannot authorise any payment which relates to a period prior to the date of earlier partnership deed.

Next, by virtue of a further restriction contained in sub-clause (iii) of section 40(b), such remuneration paid to the working partners will be allowed as deduction to the firm from the date of such partnership deed and not for any period prior thereto. Consequently, if, for instance, a firm incorporates the clause relating to payment of remuneration to the working partners, by executing an appropriate deed, say, on July 1, but effective from April 1, the firm would get deduction for the remuneration paid to its working partners from July 1 and onwards, but not for the period from April 1 to June 30. In other words, it will not be possible to give retrospective effect to oral agreements entered into vis a vis such remuneration prior to putting the same in a written partnership deed.

(4) Any interest payment authorised by the partnership deed falling after the date of such deed to the extent such interest exceeds 12% simple interest p.a.

(5) Any remuneration paid to a partner, authorised by a partnership deed and falling after the date of the deed in excess of the following limits:

On the first Rs.3 lakh of book profit or in case of loss, the limit would be the higher of Rs.1,50,000 or 90% of book profit and on the balance of book profit, the limit would be 60%.

Example

If a firm has paid Rs.7,50,000 as remuneration to its partners for the P.Y.2009-10 in accordance with its partnership deed, and it has a book profit of Rs.10 lakh, then, the allowable remuneration calculated as per the limits specified in section 40(b)(v) would be -

Particulars	***Rs.***
On first Rs.3 lakh of book profit [3,00,000 × 90%]	*2,70,000*
On balance Rs.7 lakh of book profit [7,00,000 × 60%]	*4,20,000*
	6,90,000

The excess amount of Rs.60,000 (i.e., Rs.7,50,000 – Rs.6,90,000) would be disallowed as per section 40(b)(v).

There are four Explanations to section 40(b):

Explanation 1 provides that where an individual is a partner in a firm in a representative capacity:

(i) interest paid by the firm to such individual otherwise than as partner in a representative capacity shall not be taken into account for the purposes of this clause.

(ii) interest paid by the firm to such individual as partner in a representative capacity and interest paid by the firm to the person so represented shall be taken into account for the purposes of this clause.

Explanation 2 provides that where an individual is a partner in a firm otherwise than in a representative capacity, interest paid to him by the firm shall not be taken into account if he receives the same on behalf of or for the benefit of any other person.

Explanation 3 defines the term "book profit". It means the net profit as shown in the P & L A/c for the relevant previous year computed in accordance with the provisions for computing income from profits and gains.

The above amount should be increased by the remuneration paid or payable to all the partners of the firm if the same has been deducted while computing the net profit.

Explanation 4 defines a working partner: Accordingly, it means an individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner.

(iii) Section 40(ba) - Association of persons or body of individuals : Any payment of interest, salary, commission, bonus or remuneration made by an association of persons or body of individuals to its members will also not be allowed as a deduction in computing the income of the association or body.

There are three Explanations to section 40(ba):

Explanation 1 - Where interest is paid by an AOP or BOI to a member who has paid interest to the AOP/BOI, the amount of interest to be disallowed under clause (ba) shall be limited to the net amount of interest paid by AOP/BOI to the partner.

Explanation 2 - Where an individual is a member in an AOP/BOI on behalf of another person, interest paid by AOP/BOI shall not be taken into account for the purposes of clause (ba). But, interest paid to or received from each person in his representative capacity shall be taken into account.

Explanation 3 - Where an individual is a member in his individual capacity, interest paid to him in his representative capacity shall not be taken into account.

3.7 EXPENSES OR PAYMENTS NOT DEDUCTIBLE IN CERTAIN CIRCUMSTANCES [SECTION 40A]

(i) Payments to relatives and associates - Sub-section (2) of section 40A provides that where the assessee incurs any expenditure in respect of which a payment has been or is to be made to a relative or to an associate concern so much of the expenditure as is considered to be excessive or unreasonable shall be disallowed by the Assessing Officer. While doing so he shall have due regard to :

(i) the market value of the goods, service of facilities for which the payment is made; or

(ii) the legitimate needs of the business or profession carried on by the assessee; or

(iii) the benefit derived by or accruing to the assessee from such a payment.

The word "relative" as defined in the section 2(41) of the Act, means, in relation to individual, the spouse, brother or sister of any lineal ascendant or descendant of that individual. Whether the assessee is a firm, H.U.F. or an association of persons the relationship will have to be reckoned for the purpose, with reference to the partners of the firm and the members of the family or association. Similarly, where the assessee is a company the relationship will have to be reckoned with reference to the directors or persons having substantial interest in the company. A person shall be deemed to have a substantial interest in a business or profession if -

- in a case where the business or profession is carried on by a company, such person is, at any time during the previous year, the beneficial owner of equity shares carrying not less than 20% of the voting power and
- in any other case such person is, at any time during the previous year, beneficially entitled to not less than 20% the profits of such business or profession.

(ii) Cash payments in excess of Rs.20,000 - According to section 40A(3), where the assessee incurs any expenditure, in respect of which payment or aggregate of payments made to a person in a day otherwise than by an account payee cheque drawn on a bank or by an account payee bank draft exceeds Rs.20,000, such expenditure shall not be allowed as a deduction.

For example if, in respect of an expenditure of Rs.60,000 incurred by X Ltd., 4 cash payments of Rs.15,000 are made on a particular day to one Mr.Y – one in the morning at 10 a.m., one at 12 noon, one at 3 p.m. and one at 6 p.m., the entire expenditure of Rs.60,000 would be disallowed under section 40A(3), since the aggregate of cash payments made during a day to Mr.Y exceeds Rs.20,000.

In case of an assessee following mercantile system of accounting, if an expenditure has been allowed as deduction in any previous year on due basis, and payment has been made in a subsequent year otherwise than by account payee cheque or account payee bank draft, then the payment so made shall be deemed to be the income of the subsequent year if such payment or aggregate of payments made to a person in a day exceeds Rs.20,000 [Section 40A(3A)].

This limit of Rs.20,000 has been raised to Rs.35,000 with effect from 1st October, 2009 in case of payment made to transport operators for plying, hiring or leasing goods carriages. Therefore, payment or aggregate of payments up to Rs.35,000 in a day can be made to a transport operator otherwise than by way of account payee cheque or account payee bank

draft. In all other cases, the limit would continue to be Rs.20,000.

However, no disallowance would be made in such cases and under such circumstances as may be prescribed, having regard to the nature and extent of banking facilities available, considerations of business expediency and other relevant factors.

The provision applies to all categories of expenditure involving payments for goods or services which are deductible in computing the taxable income. It does not apply to loan transactions because advancing of loans or repayments of the principal amount of loan does not constitute an expenditure deductible in computing the taxable income. However, interest payments of amounts exceeding Rs.20,000 at a time are required to be made by account payee cheques or drafts as interest is a deductible expenditure. This requirement does not apply to payment made by commission agents for goods received by them for sale on commission or consignment basis because such a payment is not an expenditure deductible in computing the taxable income of the commission agent. For the same reason, this requirement does not apply to advance payment made by the commission agent to the party concerned against supply of goods. However, where commission agent purchases goods on his own account but not on commission basis, the requirement will apply. The provisions regarding payments by account payee cheque or draft apply equally to payments made for goods purchased on credit.

Rule 6DD provides for cases and circumstances in which a payment or aggregate of payments exceeding twenty thousand rupees may be made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft. As per this rule, no disallowance under sub-section (3) of section 40A shall be made and no payment shall be deemed to be the profits and gains of business or profession under sub-section (3A) of section 40A where a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds twenty thousand rupees in the cases and circumstances specified hereunder, namely:

(a) where the payment is made to

(i) the Reserve Bank of India or any banking company;

(ii) the State Bank of India or any subsidiary bank;

(iii) any co-operative bank or land mortgage bank;

(iv) any primary agricultural credit society or any primary credit society;

(v) the Life Insurance Corporation of India;

(b) *where the payment is made to the Government and, under the rules framed by it, such payment is required to be made in legal tender;*

(c) *where the payment is made by*

(i) *any letter of credit arrangements through a bank;*

(ii) *a mail or telegraphic transfer through a bank;*

(iii) *a book adjustment from any account in a bank to any other account in that or any other bank;*

(iv) *a bill of exchange made payable only to a bank;*

(v) *the use of electronic clearing system through a bank account;*

(vi) *a credit card;*

(vii) *a debit card.*

(d) *where the payment is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee;*

(e) *where the payment is made for the purchase of -*

(i) *agricultural or forest produce; or*

(ii) *the produce of animal husbandry (including livestock, meat, hides and skins) or dairy or poultry farming; or*

(iii) *fish or fish products; or*

(iv) *the products of horticulture or apiculture,*

to the cultivator, grower or producer of such articles, produce or products;

Note -

(i) *The expression 'fish or fish products' (iii) above would include 'other marine products such as shrimp, prawn, cuttlefish, squid, crab, lobster etc.'.*

(ii) *The 'producers' of fish or fish products for the purpose of rule 6DD(e) would include, besides the fishermen, any headman of fishermen, who sorts the catch of fish brought by fishermen from the sea, at the sea shore itself and then sells the fish or fish products to traders, exporters etc.*

However, the above exception will not be available on the payment for the purchase of fish or fish products from a person who is not proved to be a 'producer' of these goods and is only a trader, broker or any other middleman, by whatever name called.

(f) where the payment is made for the purchase of the products manufactured or processed without the aid of power in a cottage industry, to the producer of such products;

(g) where the payment is made in a village or town, which on the date of such payment is not served by any bank, to any person who ordinarily resides, or is carrying on any business, profession or vocation, in any such village or town;

(h) where any payment is made to an employee of the assessee or the heir of any such employee, on or in connection with the retirement, retrenchment, resignation, discharge or death of such employee, on account of gratuity, retrenchment compensation or similar terminal benefit and the aggregate of such sums payable to the employee or his heir does not exceed fifty thousand rupees;

(i) where the payment is made by an assessee by way of salary to his employee after deducting the income-tax from salary in accordance with the provisions of section 192 of the Act, and when such employee -

(i) is temporarily posted for a continuous period of fifteen days or more in a place other than his normal place of duty or on a ship; and

(ii) does not maintain any account in any bank at such place or ship;

(j) where the payment was required to be made on a day on which the banks were closed either on account of holiday or strike;

(k) where the payment is made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person;

(l) where the payment is made by an authorised dealer or a money changer against purchase of foreign currency or travellers cheques in the normal course of his business.

(iii) Disallowance of provision for gratuity - Section 40A(7) provides that no deduction would be allowable to any taxpayer carrying on any business or profession in respect of any provision (whether called as provision or by any other names) made by him towards the payment of gratuity to his employers on their retirement or on the termination of their employment for any reason. The reason for this disallowance is that, under section

36(1)(v), deduction is allowable in computing the profits and gains of the business or profession in respect of any sum paid by a taxpayer in his capacity as an employer in the form of contributions made by him to an approved gratuity fund created for the exclusive benefit of his employees under an irrevocable trust. Further, section 37(1) provides that any expenditure other than the expenditure of the nature described in sections 30 to 36 laid out or expended, wholly and exclusively for the purpose of the business or profession must be allowed as a deduction in computing the taxable income from business. A reading of these two provisions clearly indicates that the intention of the legislature has always been that the deduction in respect of gratuity be allowable to the employer either in the year in which the gratuity is actually paid or in the year in which contributions to an approved gratuity fund are actually made by employer. This provision, therefore, makes it clear that any amount claimed by the assessee towards provision for gratuity, by whatever name called would be disallowable in the assessment of employer even if the assessee follows the mercantile system of accounting.

However, no disallowance would be made under the provision of sub-section (7) of section 40A in the case where any provision is made by the employer for the purpose of payment of sum by way of contribution to an approved gratuity fund during the previous year or for the purpose of making payment of any gratuity that has become payable during the previous year by virtue of the employee's retirement, death, termination of service etc.

(iv) Contributions by employers to funds, trust etc. [Sections 40A(9) to (11)] - These sub-sections have been introduced to curb the growing practice amongst employers to claim deductions from taxable profits of the business of contributions made apparently to the welfare of employees from which, however, no genuine benefit flows to the employees.

Accordingly, no deduction will be allowed where the assessee pays in his capacity as an employer, any sum towards setting up or formation of or as contribution to any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act, 1860 or other institution for any purpose. However, where such sum is paid in respect of funds covered by sections 36(1)(iv) and 36(1)(v) or any other law, then the deduction will not be denied.

(v) Deduction in respect of Head Office expenses, in the case of non-residents - Section 44C restricts the scope of deduction available to non-resident taxpayers in the matter of allowance of head office expenses in computing their taxable income from the business carried on in India. These restrictions would have the effect of overriding anything to the contrary contained in the provisions for allowance of expenses and other deductions contained

in sections 28 to 43A of the Income-tax Act. This provision prescribes the limits upto which the deduction could be allowed in computing profits and gains from any business carried on by the non-resident in India and apply to the expenses in the matter of head office expenses.

For the purpose of those restrictions and the consequent disallowance, the expression 'head office expenditure' must be taken to mean executive and general administration expenses incurred by the assessee outside India including also the expenditure incurred in respect of the following items viz.,

(i) rent, rates, taxes, repairs or insurance in respect of any premises outside India used for the purpose of the business or profession;

(ii) salary, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profit in lieu of or in addition to salary, whether paid or allowed to any employee or other persons employed in, or managing the affairs of any office in India;

(iii) travelling expenses incurred in respect of any employee or other person who is employed in or who is looking after the management of the affairs of any office outside India; and

(iv) such other matter connected with executive and general administration of the business as may be prescribed by the Central Board of Direct Taxes from time to time.

The limits prescribed are the following :

(i) an amount equal to 5% of the adjusted total income of the assessee; or

(ii) an amount of so much of the expenditure in the nature of head office expenses (explained above), which are incurred by the assessee, as is attributable to the business or profession of the assessee in India.

The limit upto which the deduction is permissible to the assessee is the lesser of the aforesaid two amounts and consequently, the basis for allowance would be the lower of the above two items. If, however the actual amount on account of head office expenses claimed by the assessee is less than the limits specified above, the deduction admissible would be confined to the amount of actual expenditure incurred by the assessee.

For the purpose of determining the amount of deduction admissible to the assessee, the expression 'adjusted total income' used in item (i) above must be taken to mean the total income of the assessee computed in accordance with the provisions of the Income-tax Act before giving effect to the following items of allowance on deduction viz.,—

(a) depreciation allowance under section 32(2);

(b) capital expenditure on family planning incurred by companies admissible as a deduction under section 36(ix);

(c) any brought-forward business loss qualifying for set off against business income in accordance with the provisions of section 72(1);

(d) any brought-forward loss in regard to any speculation business qualifying for set off against income from speculation under section 73(3);

(e) any loss computed under the head 'capital gains' and brought forward from earlier assessment year qualifying for set-off under section 74(1), and

(f) any loss attributable to the casual item of income assessable under section 56 qualifying for set-off in accordance with the provisions of section 74A(3).

Thus the total income of the assessee computed for the relevant accounting year must be first ascertained before giving effect to the provisions for the aforesaid allowance and 5% thereof would be treated as the limit upto which head office expenses would be admissible as a deduction in computing the business income of the non-resident for income-tax purposes.

However, in cases where the adjusted total income of the assessee, 5% of which is to be taken as the basis for determining the first of the qualifying limits, happens to be a loss, the proviso to section 44C authorises the limit of 5% to be taken with reference to the average adjusted total income. For this purpose the expression 'average adjusted total income' would mean —

(i) in cases where the total income of the assessee is assessable for each of the three assessment years immediately preceding the relevant assessment year - one-third of the aggregate amount of the adjusted total income of the previous years relevant to the aforesaid three assessment years.

(ii) where the total income of the assessee is assessable for only two of the aforesaid three assessment years - one-half of the aggregate amount of the adjusted total income in respect of the two previous years relevant to the aforesaid two assessment years;

(iii) in cases where the total income of the assessee becomes assessable only for one of the three assessment years aforesaid - the amount of adjusted total incomes in respect of the previous year relevant to the assessment year.

The aforesaid provisions of restricting allowances on account of deduction in respect of head office expenditure would apply in the case of all non-resident taxpayers whose income from business or profession is chargeable to income-tax under section 28 of the Income-tax Act. The provisions for disallowance of the excess of the expenditure over the least of the limits mentioned above would apply even if the expenditure is such that it does not attract the provisions for disallowance contained in any other section of the Income-tax Act.

3.8 PROFITS CHARGEABLE TO TAX [SECTION 41]

This section enumerates certain receipts which are deemed to be income under the head "Business or profession." Such receipts would attract charge even if the business from which they arise had ceased to exist prior to the year in which the liability under this section arises.

The particulars of such receipts are given below:

(i) Section 41(1) - Suppose an allowance or deduction has been made in any assessment year in respect of loss, expenditure or trading liability incurred by A. Subsequently, if A has obtained, whether in cash or in any manner whatsoever, any amount in respect of such loss or expenditure of some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by A, or the value of benefit accruing to him shall be taxed as income of that previous year. It does not matter whether the business or profession in respect of which the allowance or deduction has been made is in existence in that year or not.

It is possible that after the above allowance in respect of loss, expenditure, or trading liability has been given to A, he could have been succeeded in his business by another person. In such a case, the successor will be liable to be taxed in respect of any such benefit received by him during a subsequent previous year.

Successor in business:

(i) Where there has been an amalgamation of a company with another company, the successor will be the amalgamated company.

(ii) Where a firm carrying on a business or profession is succeeded by another firm the successor will be the other firm.

(iii) In any other case, where one person is succeeded by any other person in that business or profession the other person will be the successor.

(iv) In case of a demerger, the successor will be the resulting company.

Remission or cessation of a trading liability includes remission or cessation of liability by a unilateral act of the assessee by way of writing off such liability in his accounts.

(ii) Balancing charge, etc. - The provisions of section 41(2) relating to balancing charge, of section 41(3) relating to assets acquired for scientific research and of section 41(4) dealing with recovery of bad debts have been dealt with earlier under the respective items.

(iii) Section 41(4A) - The withdrawal from special reserve created and maintained under section 36(1)(viii) will be deemed to be profits and gains of business and charged accordingly in the year of withdrawal. Even if the business is closed, it will be deemed to be in existence for this purpose. This also applies to section 41(5).

Brought forward losses of defunct business - In cases where a receipt is deemed under this section to be profit of a business under this section relating to a business that had ceased to exist and there is an unabsorbed loss, which arose in that business during the previous year in which it had ceased to exist, it would be set off against income that is chargeable under this section. This sub-section thus constitutes an exception to the rule that if a business has ceased to exist, any loss relating to it cannot be carried forward and set off against any income from any source.

3.9 SPECIAL PROVISIONS FOR DEDUCTION IN CASE OF BUSINESS FOR PROSPECTING ETC. FOR MINERAL OIL [SECTION 42]

This section has been enacted to permit an assessee to claim an allowance which may on general principles be inadmissible, e.g., allowance in respect of expenditure which would be regarded as an accretion to capital on the ground that it brings into existence an asset of enduring benefit or to constitute initial expenditure incurred on the setting up of a profit-earning machinery in motion. It must further be noted that this concession can be availed of only in relation to contract or arrangements entered into by the Central Government for prospecting for, or the extraction or production of mineral oils.

Allowable expenses : The allowance permissible under this section shall be in relation to (i) the expenditure by way of in fructuous or abortive exploration expenses in respect of an area surrendered prior to the beginning of commercial production by the assessee; (ii) after the beginning of commercial production, the expenditure incurred by the assessee, whether before or after such commercial production in respect of drilling or exploration activities in services in respect of physical assets used in that connection (except those assets which qualify for depreciation allowance under section 32); and (iii) to the depletion of mineral oil in the mining area in respect of the assessment year relevant to the previous year in which commercial production is begun and for such succeeding years as may be specified in the agreement.

Amount of deduction: The sum of those allowance should be computed and deduction should be made in the manner specified in the agreement entered into by the Central Government with any person for the association or participation in the business of the Central Government for the prospecting or exploration of mineral oil. It has been specifically provided that the other provisions of the Act are being deemed, for the purpose of this allowance, to have been modified to the extent necessary to give effect to the terms of the agreement. It may be noted that allowances in this regard are made in lieu of or in addition to the other allowances permissible under the Act, depending upon the terms of the agreement.

Subject to the provisions of the agreement entered into by the Central Government, where the business of assessee consisting of the prospecting for or extraction or production of petroleum and natural gas is transferred or any interest therein is transferred, wholly or partly, in accordance with the aforesaid agreement, various situations would arise. The tax treatment in respect of those situations are as follows:

(1) Where the proceeds of the transfer so far as they consist of capital sums are less than the expenditure incurred remaining unallowed, a deduction equal to such expenditure remaining unallowed, as reduced by the proceeds of transfer, shall be allowed in respect of the previous year in which such business or interest is transferred.

(2) Where such proceeds exceed the amount of the expenditure incurred remaining

unallowed, so much of the excess as does not exceed the difference between the expenditure incurred in connection with the business or to obtain interest therein and the amount of such expenditure remaining unallowed, shall be chargeable to income-tax as profits and gains of the business in the previous year in which the business or interest therein, whether wholly or partly, had been transferred.

However, in a case where the provisions of this clause do not apply, the deduction to be allowed for expenditure incurred remaining unallowed shall be arrived at by subtracting the proceeds of transfer (so far as they consist of capital sums) from the expenditure remaining unallowed.

Explanation - Where the business or interest in such business is transferred in a previous year in which such business carried on by the assessee is no longer in existence, the provisions of this clause shall apply as if the business is in existence in that previous year.

(3) Where such proceeds are not less than the amount of the expenditure incurred remaining unallowed, no deduction for such expenditure shall be allowed in respect of the previous year in which the business or interest in such business is transferred or in respect of any subsequent year or years.

Special provisions in case of amalgamation/demerger

Where in a scheme of amalgamation, the amalgamating company sells or otherwise transfers the business to the amalgamated company (being an Indian company), the provisions of this sub-section—

(i) shall not apply in the case of the amalgamating company and

(ii) shall, as far as may be, apply to the amalgamated company as they would have applied to the amalgamated company if the latter had not transferred the business or interest in the business.

The section provides for similar provisions in the case of demerger where the resulting company, being an Indian company, shall claim the production under the said section.

3.10 CHANGES IN THE RATE OF EXCHANGE OF CURRENCY [SECTION 43A]

The section provides that where an assessee has acquired any asset from a foreign country for the purpose of his business or profession, and due to a change thereafter in the exchange rate of the two currencies involved, there is an increase or decrease in the liability (expressed in Indian rupees) of the assessee at the time of making the payment, the following values may be changed accordingly with respect to the increase or decrease in such liability:

(i) the actual cost of the asset under section 43(1)

(ii) the amount of capital expenditure incurred on scientific research under section 35(1)(iv)

(iii) the amount of capital expenditure on acquisition of patents or copyrights under section 35A

(iv) the amount of capital expenditure incurred by a company for promoting family planning amongst its employees under section 36(1)(ix)

(v) the cost of acquisition of a non-depreciable capital asset falling under section 48.

The amount arrived at after making the above adjustment shall be taken as the amount of capital expenditure or the cost of acquisition of the capital asset, as the case may be.

The section further clarifies that where any adjustment has already been made under the erstwhile section 43A to the amount of capital expenditure or cost of acquisition of an asset on account of increase or decrease in liability due to exchange rate fluctuation, it should be verified that the amount of such adjustment is equal to the change in the liability at the time of making payment.

In this context

(a) "rate of exchange" means the rate of exchange determined or recognised by the Central Government for the conversion of Indian currency into foreign currency or foreign currency into Indian currency;

(b) "foreign currency" and "Indian currency" have the meanings respectively assigned to them in section 2 of the Foreign Exchange Management Act, 1999.

Where the whole or any part of the liability aforesaid is met, not by the assessee, but, directly or indirectly, by any other person or authority, the liability so met shall not be taken into account for the purposes of this section.

Where the assessee has entered into a contract with a authorised dealer as defined in section 2 of the Foreign Exchange Management Act, 1999 for providing him with a specified sum in a foreign currency on or after a stipulated future date at the rate of exchange specified in the contract to enable him to meet the whole or any part of the liability aforesaid, the amount, if any, for adjustment under this section shall be computed with reference to the rate of exchange specified therein.

3.11 CERTAIN DEDUCTIONS TO BE ONLY ON ACTUAL PAYMENT [SECTION 43B]

The following sums are allowed as deduction only on the basis of actual payment within the time limits specified in section 43B.

(a) Any sum payable by way of tax, duty, cess or fee, by whatever name called, under any law for the time being in force.

(b) Any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees.

(c) Bonus or Commission for services rendered payable to employees.

(d) Any sum payable by the assessee as interest on any loan or borrowing from any public financial institution or a State Financial Corporation or a State Industrial Investment Corporation.

(e) Interest on any loan or advance from a scheduled bank on actual payment basis.

(f) Any sum paid by the assessee as an employer in lieu of earned leave of his employee.

The above sums can be paid by the assessee on or before the due date for furnishing the return of income under section 139(1) in respect of the previous year in which the liability to pay such sum was incurred and the evidence of such payment is furnished by the assessee along with such return.

For the purposes of clause (a), "any sum payable" means a sum for which the assessee incurred liability in the previous year even though such sum might not have been payable within that year under the relevant law. For example, an assessee may collect sales tax from customers during the month of March, 2008. However, in respect of such collections he may have to discharge the liability only within say 10th of April, 2008 under Sales Tax law. The explanation covers this type of liability also. Consequently, if an assessee following accrual method of accounting has created a provision in respect of such a liability the same is not deductible unless remitted within the due date specified in this section.

For this purpose, scheduled bank has the meaning assigned to it in clause (iii) of the Explanation to section 11(5), that is, the State Bank of India (SBI), a subsidiary of SBI, a nationalised bank or any other bank included in the Second Schedule to the Reserve Bank of India Act, 1934.

"State Industrial Investment Corporation" means a Government company within the meaning of section 617 of the Companies Act, 1956, engaged in providing long-term finance for industrial projects and eligible for deduction under section 36(1)(iii).

Explanation 3B provides that where a deduction in respect of earned leave encashment paid to any employee is allowed in computing the business income of the employer for the previous year in which the liability to pay was incurred (applicable for previous year 2000-2001 or any earlier year), no deduction shall be allowed in respect of such sum in the previous year in which the sum is actually paid.

Explanation 3C & 3D clarifies that if any sum payable by the assessee as interest on any such loan or borrowing or advance referred to in (d) and (e) above, is converted into a loan or borrowing or advance, the interest so converted and not "actually paid" shall not be deemed as actual payment, and hence would not be allowed as deduction. The

clarificatory explanations only reiterate the rationale that conversion of interest into a loan or borrowing or advance does not amount to actual payment.

The manner in which the converted interest will be allowed as deduction has been clarified in Circular No.7/2006 dated 17.7.2006. The unpaid interest, whenever actually paid to the bank or financial institution, will be in the nature of revenue expenditure deserving deduction in the computation of income. Therefore, irrespective of the nomenclature, the deduction will be allowed in the previous year in which the converted interest is actually paid.

Illustration 3

Hari, an individual, carried on the business of purchase and sale of agricultural commodities like paddy, wheat, etc. He borrowed loans from Andhra Pradesh State Financial Corporation and Indian Bank and has not paid interest as detailed hereunder:

(i)	Andhra Pradesh State Financial Corporation (P.Y. 2008-09 & 2009-10)	15,00,000
(ii)	Indian Bank (P.Y. 2009-10)	30,00,000
		45,00,000

Both Andhra Pradesh State Financial Corporation and Indian Bank, while restructuring the loan facilities of Hari during the year 2009-10, converted the above interest payable by Hari to them as a loan repayable in 60 equal installments. During the year ended 31.3.2010, Hari paid 5 installments to Andhra Pradesh State Financial Corporation and 3 installments to Indian Bank.

Hari claimed the entire interest of Rs.45,00,000 as an expenditure while computing the income from business of purchase and sale of agricultural commodities. Discuss whether his claim is valid and if not what is the amount of interest, if any, allowable.

Solution

According to section 43B, any interest payable on the term loans to specified financial institutions and any interest payable on any loans and advances to scheduled banks shall be allowed only in the year of payment of such interest irrespective of the method of accounting followed by the assessee. Where there is default in the payment of interest by the assessee, such unpaid interest may be converted into loan. Such conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose of section 43B. The amount of unpaid interest so converted as loan shall be allowed as deduction only in the year in which the converted loan is actually paid.

In the given case of Hari, the unpaid interest of Rs.15,00,000 due to Andhra Pradesh State Financial Corporation (APSFC) and of Rs.30,00,000 due to Indian Bank was converted into loan. Such conversion would not amount to payment of interest and would not, therefore, be eligible for deduction in the year of such conversion. Hence, claim of Hari that the entire interest of Rs.45,00,000 is to be allowed as deduction in the year of conversion is not tenable. The deduction shall be allowed only to the extent of repayment made during the financial year. Accordingly, the amount of interest eligible for deduction for the A.Y. 2010-11 shall be calculated as follows:

	Interest outstanding	Number of Installments	Amount per installment	Installments paid	Interest allowable (Rs.)
APSFC	15 lakh	60	25,000	5	1,25,000
Indian Bank	30 lakh	60	50,000	3	1,50,000
Total amount eligible for deduction					**2,75,000**

3.12 SPECIAL PROVISION FOR COMPUTATION OF COST OF ACQUISITION OF CERTAIN ASSETS [SECTION 43C]

(i) Where an asset acquired under a scheme of amalgamation is sold by an amalgamated company as its stock-in-trade then in computing the profits and gains derived from sale of such stock-in-trade the cost of acquisition of stock-in-trade to the amalgamated company shall be the cost of acquisition of such stock-in-trade or the asset to the amalgamating company as increased by the cost if any of any improvement thereto and the expenditure incurred wholly and exclusively in connection with such a transfer.

(ii) The provisions of section 43C will thus apply to the following cases of revaluation:

(a) When the stock-in-trade of the amalgamating company is taken over at reduced price by the amalgamated company under the scheme of amalgamation.

(b) Where a capital asset of the amalgamating company is taken over as stock-in-trade by the amalgamated company after revaluation under the scheme of amalgamation.

(iii) The situation referred to at (b) above will in turn cover three situations :

(1) When the capital asset is converted to stock-in-trade by the amalgamating company with revaluation and the revalued asset is taken over by the amalgamated company under the scheme of amalgamation.

(2) Where the capital asset is taken over as stock-in-trade by the amalgamated company at renewed price at the time of amalgamation.

(3) Where the capital asset of the amalgamating company is taken over by the amalgamated company as a capital asset and has been converted into stock-in-trade and revalued.

(iv) In a case referred to above, where the revaluation and conversion of capital asset into stock-in-trade takes place in the hands of the amalgamated company the provisions of section 45(2) will apply. So in such a case the provision of section 43C will not apply. This has been done with a view to ensure that a tax payer does not face double taxation in respect of the same transaction. However when the stock-in-trade referred to in item (i) as well as at (a) and (b) above are sold, the provisions of section 43C will apply.

(v) A similar provision in section 43C has also been made to cover cases where the asset sold as stock-in-trade has been acquired by the assessee either by way of full or partial partition of HUF or under a gift or will or an irrevocable trust and such asset is sold as stock-in-trade.

3.13 SPECIAL PROVISION IN CASE OF INCOME OF PUBLIC FINANCIAL INSTITUTIONS [SECTION 43D]

(i) In the case of a public financial institution or a scheduled bank or a State financial corporation or a State industrial investment corporation, the income by way of interest on such categories of bad and doubtful debts, as may be prescribed having regard to the guidelines issued by the Reserve Bank of India in relation to such debts, shall be chargeable to tax in the previous year in which it is credited to the profit and loss account by the said institutions for that year or in the previous year in which it is actually received by them, whichever is earlier. This provision is now applicable to co-operative banks also [Sub-clause (a)].

(ii) In the case of a public company, the income by way of interest in relation to such categories of bad and doubtful debts as may be prescribed having regard to the guidelines issued by the National Housing Bank established under the National Housing Bank Act, 1987 in relation to such debts shall be chargeable to tax in the previous year in which it is credited to the profit and loss account by the said public company for that year or in the previous in which it is actually received by it, whichever is earlier. [Sub-clause (b)].

3.14 INSURANCE BUSINESS [SECTION 44]

This Section exempts an insurance business of any kind from the operation of the Section dealing with specified heads of income as well as those of section 199 which deals, with credits for tax deducted at source, to the extent to which the provisions of this section are inconsistent with the Rules contained in the First Schedule to the Act, and provides that the profits and gains of such a business, from all sources, are to be computed notionally in accordance with these rules. The principle is applicable even to mutual associations and co-operative societies carrying on insurance business. For further details please refer to the First Schedule to the Income-tax Act.

3.15 SPECIAL PROVISIONS IN THE CASE OF CERTAIN ASSOCIATIONS [SECTION 44A]

This is a provision calculated to encourage the development activities carried on by the trade, professional and other associations other than those whose incomes are already exempted under section 10(23A). This section provides that where the expenditure incurred by an association solely for purposes of protection or advancement of the common interest of its members exceeds the amount collected by the association from the members whether by way of subscription or otherwise, the resulting deficiency shall be allowed as a deduction in computing the income of the association assessable under the head "profits and gains of business or profession"; if there is no such income, then, it will be allowed as a deduction in computing the income under any other head. But only an amount upto 50% of total taxable income of the association can be set off against the deficiency aforementioned. In computing the taxable income of the association, effect must first be given to the allowances or losses brought forward under any other section of the Act. This section applies only to such associations which do not distribute their income amongst their members except in the form of grants to affiliated associations.

3.16 COMPULSORY MAINTENANCE OF ACCOUNTS [SECTION 44AA]

This section provides that every person carrying on the legal, medical, engineering or architectural profession or accountancy or technical consultancy or interior decoration or any other profession as has been notified by the Central Board of Direct Taxes in the Official Gazette must statutorily maintain such books of accounts and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of the Income-tax Act. The persons carrying on these professions are statutorily obliged to maintain the prescribed books of account and other documents regardless of the quantum of their income and also regardless of the question whether the profession was set up prior to or after the coming into force of this new provision.

The professions notified so far are as follows :

The profession of authorised representative; the profession of film artiste (actor, camera man, director, music director, art director, editor, singer, lyricist, story writer, screen play writer, dialogue writer and dress designer); the profession of Company Secretary; and information technology professionals.

Every taxpayer carrying on any business or profession (other than the professions specified above) must maintain the books of account prescribed by the Central Board of Direct Taxes in the following circumstances:

(a) in cases where the income from the business or profession exceeds Rs.1,20,000 or the total sales turnover or gross receipts, as the case may be, in the business or profession

exceed Rs.10,00,000 in any one of three years immediately preceding the accounting year; or

(b) in cases where the business or profession is newly set up in any previous year, if his income from business or profession is likely to exceed Rs.1,20,000 or his total sales turnover or gross receipts, as the case may be, in the business or profession are likely to exceed Rs.10,00,000 during the previous year ;

(c) in cases where profits and gains from the business are calculated on a presumptive basis under section 44AD or 44AE or 44AF or 44BB or 44BBB and the assessee has claimed that his income is lower than the profits or gains so deemed to be the profits and gains of his business.

(d) in cases where the profits and gains from the business are deemed to be the profits and gains of the assessee under section 44AD and he has claimed such income to be lower than the profits and gains so deemed to be the profits and gains of his business and his income exceeds the basic exemption limit during such previous year (This would be effective from A.Y.2011-12)

In such cases, compulsory tax audit would also become necessary.

The Central Board of Direct Taxes has been authorised, having due regard to the nature of the business or profession carried on by any class of persons, to prescribe by rules the books of account and other documents including inventories, wherever necessary, to be kept and maintained by the taxpayer, the particulars to be contained therein and the form and manner in which and the place at which they must be kept and maintained. Further, the Central Board of Direct Taxes has also been empowered to prescribe, by rules, the period for which the books of account and other documents are required to be kept and maintained by the taxpayer.

Rule 6F of the Income-tax Rules contains the details relating to the books of account and other documents to be maintained by certain professionals under section 44A.

As per Rule 6F, every person carrying on legal, medical, engineering, or architectural profession or the profession of accountancy or technical consultancy or interior decoration or authorised representative or film artist shall keep and maintain the books of account and other documents specified in sub-rule (2) in the following cases :

– if his gross receipts exceed Rs.1,50,000 in any one of the 3 years immediately preceding the previous year ; or

– if, where the profession has been newly set up in the previous year, his gross receipts are likely to exceed Rs.1,50,000 in that year.

Note : Students may note that professionals whose gross receipts are less than the specified limits given above are also required to maintain books of account but these have not been

specified in the Rule. In other words, they are required to maintain such books of account and other documents as may enable the Assessing Officer to compute the total income in accordance with the provisions of this Act.

Sub-rule (2) of Rule 6F

The following books of account and other documents are required to be maintained.

(i) a cash book;

(ii) a journal, if accounts are maintained on mercantile basis ;

(iii) a ledger;

(iv) Carbon copies of bills and receipts issued by the person whether machine numbered or otherwise serially numbered, in relation to sums exceeding Rs.25;

(v) Original bills and receipts issued to the person in respect of expenditure incurred by the person, or where such bills and receipts are not issued, payment vouchers prepared and signed by the person, provided the amount does not exceed Rs.50. Where the cash book contains adequate particulars, the preparation and signing of payment vouchers is not required.

In case of a person carrying on medical profession, he will be required to maintain the following in addition to the list given above :

(i) a daily case register in Form 3C.

(ii) an inventory under broad heads of the stock of drugs, medicines and other consumable accessories as on the first and last day of the previous year used for his profession.

The above books of account and documents shall be kept and maintained for a minimum of 8 years from the end of the relevant assessment year. However, in case of cash book and ledger, the period will be 16 years.

The books and documents shall be kept and maintained at the place where the person is carrying on the profession, or where there is more than one place, at the principal place of his profession. However, if he maintains separate set of books for each place of his profession, such books and documents may be kept and maintained at the respective places.

3.17 AUDIT OF ACCOUNTS OF CERTAIN PERSONS CARRYING ON BUSINESS OR PROFESSION [SECTION 44AB]

(i) It is obligatory in the following cases for a person carrying on business or profession to get his accounts audited before the "specified date" by a Chartered Accountant:

(1) if the total sales, turnover or gross receipts in business exceeds Rs.40 lakh in any previous year; or

(2) if the gross receipts in profession exceeds Rs.10 lakh in any previous year; or

(3) where the assessee is covered under section 44AD, 44AE, 44AF, 44BB or 44BBB and claims that the profits and gains from business are lower than the profits and gains computed on a presumptive basis. In such cases, the normal monetary limits for tax audit in respect of business would not apply.

(4) where the assessee is covered under section 44AD, and he claims that the profits and gains from business are lower than the profits and gains computed on a presumptive basis and his income exceeds the basic exemption limit. This provision would be effective from A.Y.2011-12.

(ii) The person mentioned above would have to furnish by the specified date a report of the audit in the prescribed forms. For this purpose, the Board has prescribed under Rule 6G, Forms 3CA/3CB/3CD containing forms of audit report and particulars to be furnished therewith.

(iii) In cases where the accounts of a person are required to be audited by or under any other law before the specified date, it will be sufficient if the person gets his accounts audited under such other law before the specified date and also furnish by the said date the report of audit in the prescribed form in addition to the report of audit required under such other law. Thus, for example, the provision regarding compulsory audit does not imply a second or separate audit of accounts of companies whose accounts are already required to be audited under the Companies Act. The provision only requires that companies should get their accounts audited under the Companies Act before the specified date and in addition to the report required to be given by the auditor under the Companies Act, furnish a report for tax purposes in the form to be prescribed in this behalf by the Central Board of Direct Taxes.

(iv) However, the requirement of audit under section 44AB does not apply to a person who derives income of the nature referred to in sections 44B and 44BBA.

(v) The expression "specified date" in relation to the accounts of the previous year or years relevant to any assessment year means the 30th September of the assessment year.

(vi) It may be noted that under section 271B, penal action can be taken for not getting the accounts audited and for not filing the audit report by the specified date. In cases where the audit report has been filed before furnishing of the return, non furnishing of a copy of the audit report or proof of its filing by the specified date along with the return of income will however be only a defect under section 139(9) which can be rectified.

Note - The Institute has brought out a Guidance Note dealing with the various aspects of tax audit under section 44AB. Students are advised to read the same carefully.

3.18 SPECIAL PROVISIONS FOR COMPUTING PROFITS AND GAINS OF CIVIL CONSTRUCTION ETC. [SECTION 44AD]

(i) This section provides for estimating income of an assessee who is engaged in the business of civil construction or supply or labour for civil construction ;

(ii) The income will be estimated at a sum equal to 8% of the gross receipts paid or payable to the assessee in the previous year on account of such business. However, if the assessee declares a higher amount in his return of income, that will be his income ;

(iii) This claim will apply only to such assessees engaged in the business of civil construction etc. whose gross receipts do not exceed Rs.40 lakh;

(iv) The assessee will be deemed to have been allowed deductions under sections 30 to 38. Accordingly, the written down value of any asset utilised for the purpose of the business of the assessee will be deemed to have been calculated as if the assessee had claimed and had actually been allowed the deduction in respect of depreciation for each of the relevant assessment years.

The assessee joining this scheme will not be required to maintain the books of account under section 44AA and section 44AB.

(v) An assessee may claim lower profits and gains than the deemed profits and gains specified in sub-sections (1) and (2) of the section subject to the condition that the books of account and other documents are kept and maintained as required under sub-section (2) of section 44AA and the assessee gets his accounts audited and furnishes a report of such audit as required under section 44AB.

Note –

Section 44AD has been substituted. However, since the new section is applicable from A.Y.2011-12, it is not applicable for May 2010 & November 2010 examinations. The provisions of new section 44AD are as follows -

(i) The presumptive taxation scheme, so far restricted to civil construction and retail trade, would now cover all small businesses with total turnover/gross receipts of up to Rs.40 lakh. Section 44AD has been substituted w.e.f. A.Y.2011-12, to include within its scope all such businesses (except the business of plying, hiring and leasing goods carriages covered under section 44AE). Consequently, section 44AF dealing with presumptive taxation for retail trade would not be applicable w.e.f. A.Y.2011-12 since retail trade would also fall within the scope of section 44AD.

(ii) Resident individuals, HUFs and partnership firms (but not LLPs) would be covered under this scheme.

(iii) The scheme would not apply to an assessee who is availing deductions under sections 10A, 10AA, 10B, 10BA or deduction under any provisions of Chapter VIA under the heading "C.—Deductions in respect of certain incomes" in the relevant assessment year.

(iv) The presumptive rate of tax would be 8% of total turnover or gross receipts. However, the assessee has the option to declare in his return of income, an amount higher than the presumptive income so calculated, claimed to have been actually earned by him.

(v) All deductions allowable under sections 30 to 38 shall be deemed to have been allowed in full and no further deduction shall be allowed. However, in the case of a firm, salary and interest would be allowed as deduction subject to the conditions and limits prescribed under section 40(b).

(vi) The written down value of any asset of such business shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed the deduction in respect of depreciation for each of the relevant assessment years.

(vii) The intention of widening the scope of this scheme is to reduce the compliance and administrative burden on small businessmen and relieve them from the requirement of maintaining books of account. Such assessees opting for the presumptive scheme are not required to maintain books of account under section 44AA or get them audited under section 44AB.

(viii) Further, they would also be relieved from the requirement of advance tax payments. It would be sufficient compliance if they pay their tax while filing their return of income before the due date.

(ix) An assessee with turnover of upto Rs.40 lakh, who shows an income below the presumptive rate prescribed under these provisions, will, in case his total income exceeds the taxable limit, be required to maintain books of accounts under section 44AA and also get them audited under section 44AB.

Thus, merely because an eligble assessee does not opt for presumptive taxation under section 44AD, it would not make him liable to maintain books of account under section 44AA or get the same audited under section 44AB. He will have to comply with these requirements only if his total income exceeds the taxable limit. If his total income does not exceed the taxable limit, the requirement of maintaining books of accounts under section 44AA and having the same audited under section 44AB would not arise.

(x) In order to determine whether an assessee, who is engaged in multiple businesses, is eligble to opt for section 44AD, the limit of Rs.40 lakh should be applied business-wise

and not by aggregating the turnover of all businesses of the assessee.

(xi) ***Example***

Let us take the case of an assessee, say Mr. X, who has 3 businesses, the details of which are given hereunder -

Business	***Turnover during the P.Y.2010-11***
1. Retail trade	*Rs. 35 lakh*
2. Civil construction	*Rs. 45 lakh*
3. Catering	*Rs. 30 lakh*

In this case, Mr.X can opt for presumptive taxation under section 44AD in respect of his retail trade business and catering business, but not in respect of civil construction business (since the turnover of this business exceeds Rs.40 lakh). If Mr.X opts for presumptive taxation scheme, then his income from retail trade business would be Rs.2.80 lakh (i.e., 8% of Rs.35 lakh) and his income from catering business would be Rs.2.40 lakh (i.e., 8% of Rs.30 lakh). He is not required to maintain books of account for retail trade and catering business. However, since he cannot avail presumptive taxation scheme in respect of civil construction business, he has to maintain books of account under section 44AA and get them audited under section 44AB.

3.19 SPECIAL PROVISIONS FOR COMPUTING PROFITS AND GAINS OF BUSINESS OF PLYING, HIRING OR LEASING GOODS CARRIAGES [SECTION 44AE]

(i) This section provides for estimating business income of an owner of trucks from the plying, hire or leasing of such trucks;

(ii) The scheme applies to persons owning not more than 10 trucks at any time during the previous year;

(iii) The estimated income from each truck in case of a heavy goods vehicle will be deemed to be Rs.3,500 for every month or part of a month during which the truck is owned by the assessee for the previous year. The assessee can also declare a higher amount in his return of income. In such case, the latter will be considered to be his income;

(iv) In case of a truck, other than a heavy goods vehicle, the estimated income will be deemed to be Rs.3,150 for every month or part of the month during which such truck is owned by the assessee in the previous year. However, he may also declare a higher income and in such a case, the higher amount will be considered to be his income;

(v) The assessee will be deemed to have been allowed the deductions under sections 30 to

38. Accordingly, the written down value of any asset used for the purpose of the business of the assessee will be deemed to have been calculated as if the assessee had claimed and had actually been allowed the deduction in respect of depreciation for each of the relevant assessment years.

(vi) The assessee joining the scheme will not be required to maintain books of account under section 44AA and get the accounts audited under section 44AB in respect of such income.

An assessee may claim lower profits and gains than the deemed profits and gains specified in sub-section (1) of that section subject to the condition that the books of account and other documents are kept and maintained as required under sub-section (2) of section 44AA and the assessee gets his accounts audited and furnishes a report of such audit as required under section 44AB.

Illustration 4

An assessee owns a light commercial vehicle for 9 months 15 days, a medium goods vehicle for 9 months and a medium goods vehicle for 12 months during the previous year. Compute his income applying the provisions of section 44AE

Solution

His profits and gains from the 3 trucks shall be deemed to be Rs.3,150 × 10 + Rs.3,150 × 9 + Rs.3,150 × 12 = Rs.97,650.

Illustration 5

An assessee owns a heavy goods vehicle for 9 months and 7 days, medium goods vehicle for 9 months and light commercial vehicle for 12 months during the previous year. Compute his income applying the provisions of section 44AE

Solution

His profits and gains from the 3 trucks shall be deemed to be Rs.3,500 × 10 + Rs.3,150 × 9 + Rs.3,150 × 12 = Rs.1,01,150.

Note – *The presumptive income per vehicle of transport operators under this scheme has been increased from Rs.3,150 per month to Rs.4,500 per month for vehicles other than heavy vehicles and from Rs.3,500 per month to Rs.5,000 per month for heavy vehicles with effect from A.Y.2011-12. (Month includes part of a month also). However, the assessee has the option to declare in his return of income, an amount higher than the presumptive income so calculated, claimed to have been actually earned by him from such vehicle.*

Example

Let us take the case of Mr.Y, who owns 5 heavy goods vehicles and 3 light goods vehicles. For the P.Y.2009-10, his presumptive income under section 44AE would be Rs.26,950 [(5 × 3,500) + (3 × 3,150)]. For the P.Y.2010-11, his presumptive income under section 44AE would be Rs.38,500

[(5 × 5,000) + (3 × 4,500)]. Therefore, consequent to this amendment, his presumptive income would go up by Rs.11,550 (i.e., Rs.38,500 – Rs.26,950) for the A.Y.2011-12.

Since this amendment is applicable from A.Y.2011-12, it is not applicable for May 2010 and November 2010 examinations.

3.20 SPECIAL PROVISIONS FOR COMPUTING PROFITS AND GAINS OF RETAIL TRADE BUSINESS [SECTION 44AF]

(i) This provision applies notwithstanding anything to the contrary contained in sections 28 to 43C. In the case of an assessee engaged in retail trade in any goods or merchandise 5% of the total turnover in the previous year on account of such business will be deemed to be the profits and gains of such business chargeable to tax under the head "profits and gains of business or profession". However, the assessee can declare a sum higher than the aforesaid sums.

(ii) This section will not apply in respect of an assessee whose turnover exceeds Rs. 40 lakh in a previous year.

(iii) Any deduction allowable under the provisions of sections 30 to 38 shall be deemed to have been already given full effect to and no further deduction under those sections shall be allowed.

(iv) Where the assessee is a firm, the salary and interest paid to its partners shall be deducted from the income computed above subject to the conditions and limits specified in section 40(b).

(v) The written down value of any asset used for the purposes of above business shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment years.

(vi) For these types of business sections 44AA and 44AB will not apply and in computing the monetary limits under those sections the total turnover or, as the case may be, the income from the said business shall be excluded.

An assessee may claim lower profits and gains than the deemed profits and gains specified in sub-section (1) of that section subject to the condition that the books of account and other documents are kept and maintained as required under sub-section (2) of section 44AA and the assessee gets his accounts audited and furnishes a report of such audit as required under section 44AB.

Note *– This section would not be relevant from A.Y.2011-12.*

3.21 SPECIAL PROVISION FOR COMPUTING THE PROFITS AND GAINS OF SHIPPING BUSINESS IN CASE OF NON-RESIDENTS [SECTION 44B]

(i) This section provides for computation of the profits and gains of the business of shipping carried on by non-residents to the extent they are chargeable to income-tax in India. According to this, a sum equal to 7½% of the aggregate of the following amounts must be deemed to be the profits and gains of the business of shipping chargeable to tax under the head 'profits and gains of business or profession'.

(ii) The amount paid or payable, whether within India or outside, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India.

(iii) The amount received or deemed to be received in India by the assessee himself or by any other person on behalf of or on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

The total of the above two amounts must be ascertained and 7½% thereof would be calculated and taken as the income from the business chargeable to tax in India. These provisions for computation of the income from the shipping business in case of non-residents would apply notwithstanding anything to the contrary contained in the provisions of sections 28 to 43A of the Income-tax Act. In other words, the income would be computed on this basis without applying the various provisions contained in sections 28 to 43A. Consequential provisions are also seen in section 172.

For the purposes of sub-section (2), receipts forming the basis of estimates on non resident shipping lines will include demurrage and handling charges.

3.22 PROVISIONS FOR COMPUTATION OF TAXABLE INCOME FROM ACTIVITIES CONNECTED WITH EXPLORATION OF MINERAL OILS [SECTION 44BB]

(i) The computation of taxable income of non-resident taxpayer engaged in the business of providing services and facilities in connection with or supplying plant and machinery on hire, used or to be used in the exploration for, and exploitation of mineral oils involves a number of complications.

(ii) As a measure of simplification, section 44BB provides for determination of income of such taxpayer at 10% of the aggregate of certain amounts. The amounts in respect of which the provisions will apply would be the amounts paid or payable to the taxpayer or to any person on his behalf whether in or out of India, on account of the provision of such services or facilities or supplying plant and machinery for the aforesaid purposes. This amount will also include facilities or supply of plant and machinery. This provision will not,

however apply to any income to which the provisions of section 42, 44D, 115A or 293A apply. It may be noted that section 44BB applies only to non-resident assessees.

(iii) However, section 44BB has been amended to provide that such taxpayers may claim lower income than the present presumptive rate of 10%, if they keep and maintain books of accounts and documents as required under sub-section (2) of section 44AA and get their accounts audited under the provisions of section 44AB of the Act. The assessment in all such cases shall be done by the Assessing Officer under section 143(3) of the Act.

3.23 SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS OF THE BUSINESS OF OPERATION OF AIRCRAFT IN THE CASE OF NON-RESIDENTS [SECTION 44BBA]

Under section 44BBA(1), a sum equal to 5% of the aggregate of the amounts specified in sub-section (2) is deemed to be the profits and gains chargeable to tax under the head "Profits and gains of business or profession". Sub-section (2) specifies the following amounts -

(a) the amount paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and

(b) the amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

Illustration 6

Mr. Tiwari, a non-resident, operates an aircraft between Bangkok and Mumbai. He received the following amounts in the course of the business of operation of aircraft during the year ending 31.3.2010:

(i) Rs.3 crore in India on account of carriage of passengers from Mumbai.

(ii) Rs.2 crore in India on account of carriage of goods from Mumbai.

(iii) Rs.1 crore in India on account of carriage of passengers from Bangkok.

(iv) Rs.2 crore in Bangkok on account of carriage of passengers from Mumbai.

The total expenditure incurred by Mr. Tiwari for the purposes of the business during the year ending 31.3.2010 was Rs.1.8 crore.

Compute the income of Mr. Tiwari chargeable to tax in India under the head “Profits and gains of business or profession” for the assessment year 2010-11.

Solution

Keeping in view the provisions of section 44BBA, the income of Mr. Tiwari chargeable to tax in India under the head "Profits and gains of business or profession" is worked out hereunder -

	Rs.
Amount received in India on account of carriage of passengers from Mumbai	3,00,00,000
Amount received in India on account of carriage of goods from Mumbai	2,00,00,000
Amount received in India on account of carriage of passengers from Bangkok	1,00,00,000
Amount received in Bangkok on account of carriage of passengers from Mumbai	2,00,00,000
	8,00,00,000

Income from business under section 44BBA at 5% of Rs.8,00,00,000 is Rs.40,00,000, which is the income of Mr.Tiwari chargeable to tax in India under the head “Profits and gains of business or profession” for the A.Y.2010-11.

3.24 SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS OF FOREIGN COMPANIES ENGAGED IN THE BUSINESS OF CIVIL CONSTRUCTION ETC. IN CERTAIN TURNKEY POWER PROJECTS [SECTION 44BBB]

(i) Under this provision in the case of a foreign company engaged in the business of construction or the business of erection of plant or machinery or testing or commissioning thereof in connection with a turnkey power project approved by the Central Government in this behalf, a sum equal to 10% of the amount paid or payable (whether in or out of India) to the said assessee or to any person on his behalf on account of such civil construction, erection, testing or commissioning shall be deemed to be the profits and gains of such business chargeable to tax under the head ‘profits and gains of business or profession’.

(ii) However, section 44BBB has been amended to provide that such taxpayers may claim lower income than the present presumptive rate of 10%, if they keep and maintain books of accounts and documents as required under sub-section (2) of section 44AA and get their accounts audited under the provisions of section 44AB of the Act. The assessment in all such cases shall be done by the Assessing Officer under section 143(3) of the Act.

3.25 SPECIAL PROVISIONS FOR COMPUTING INCOME BY WAY OF ROYALTIES ETC. IN CASE OF NON-RESIDENTS [SECTION 44DA]

The provisions of this section are as follows -

(i) The income by way of royalty or fees for technical services received from Government or an Indian concern in pursuance of an agreement made by a non-corporate non-resident or a foreign company with Government or the Indian concern after the 31st March, 2003 in respect of such non-corporate non-resident or a foreign company which carries on business in India, shall be computed on the basis of books of accounts required to be maintained under the Ac t.

(ii) Such business should be carried on through a permanent establishment, or the assessee should perform professional services from a fixed place of profession in India

(iii) They should keep and maintain books of account and other documents in accordance with the provisions contained in section 44AA.

(iv) They should get their accounts audited by an accountant as defined in the Explanation below sub-section (2) of section 288 and furnish along with the return of income, the report of such audit in the prescribed form duly signed and verified by such accountant.

(v) No deduction will be allowed while computing income of such non-resident, of the expenditure which is not wholly and exclusively incurred for the business of such permanent establishment or fixed place and also of any amount paid by the permanent establishment to its head office or any of its offices.

3.26 METHOD OF COMPUTING DEDUCTION IN THE CASE OF BUSINESS REORGANISATION OF CO-OPERATIVE BANKS [SECTION 44DB]

(i) This section provides the manner in which the deduction under the following sections are to be allowed in a case where business reorganisation of a co-operative bank has taken place during the financial year –

  (1) Section 32 (Depreciation);

  (2) Section 35D (Amortisation of certain preliminary expenses);

  (3) Section 35DD (Amortisation of expenses in case of amalgamation or demerger);

  (4) Section 35DDA (Amortisation of expenditure incurred under voluntary retirement scheme).

(ii) Business reorganisation means the reorganisation of business involving the amalgamation or demerger of a co-operative bank.

(iii) Co-operative bank shall have the meaning assigned to it in clause (cci) of section 5 of the Banking Regulation Act, 1949 i.e., a primary co-operative bank or Central Co-operative bank or a State co-operative bank.

(iv) Predecessor co-operative bank means the amalgamating co-operative bank or the demerged co-operative bank, as the case may be.

(v) Successor co-operative bank means the amalgamated co-operative bank or the resulting bank, as the case may be.

(vi) The amount of deduction allowable to the predecessor co-operative bank under the above-mentioned sections has to be determined in accordance with the following formula-

$$A \times \frac{B}{C}$$

A = the amount of deduction allowable to the predecessor co-operative bank if the business reorganisation had not taken place;

B = the number of days comprised in the period beginning with the 1st day of the financial year and ending on the day immediately preceding the date of business reorganisation; and

C = the total number of days in the financial year in which the business reorganisation has taken place.

(vii) The amount of deduction allowable to the successor co-operative bank under the above-mentioned sections has to be determined in accordance with the formula -

$$A \times \frac{B}{C}$$

A = the amount of deduction allowable to the predecessor co-operative bank if the business reorganisation had not taken place;

B = the number of days comprised in the period beginning with the date of business reorganisation and ending on the last day of the financial year; and

C = the total number of days in the financial year in which the business reorganisation has taken place.

For example, let us take a case where the deduction allowable under section 32 to the predecessor co-operative bank is, say, Rs.1,20,000 and the business re-organisation took place on 1.11.09. Then, the deduction allowable to the predecessor co-operative

bank under section 32 would be Rs.70,356 i.e. Rs.1,20,000 x 214 / 365. The deduction allowable to the successor co-operative bank would be Rs.49,644 i.e. Rs.1,20,000 x 151/365.

(viii) In a case where an undertaking of the predecessor co-operative bank entitled to the deduction under sections 35D, 35DD or 35DDA is transferred before the expiry of the period specified therein to a successor co-operative bank on account of business reorganisation, the provisions of section 35D, section 35DD or section 35DDA shall apply to the successor co-operative bank in the financial years subsequent to the year of business reorganisation as they would have applied to the predecessor co-operative bank, as if the business reorganisation had not taken place.

(ix) Amalgamated co-operative bank means -

(1) a co-operative bank with which one or more amalgamating co-operative banks merge; or

(2) a co-operative bank formed as a result of merger of two or more amalgamating co-operative banks.

(x) Amalgamating co-operative bank means -

(1) a co-operative bank which merges with another co-operative bank; or

(2) every co-operative bank merging to form a new co-operative bank.

(xi) Amalgamation means the merger of an amalgamating co-operative bank or banks with an amalgamated co-operative bank, in such a manner that -

(1) all the assets and liabilities of the amalgamating co-operative bank or banks immediately before the merger (other than the assets transferred, by sale or distribution on winding up, to the amalgamated co-operative bank) become the assets and liabilities of the amalgamated co-operative bank;

(2) the members holding 75% or more voting rights in the amalgamating co-operative bank become members of the amalgamated co-operative bank; and

(3) the shareholders holding 75% or more in value of the shares in the amalgamating co-operative bank (other than the shares held by the amalgamated co-operative bank or its nominee or its subsidiary, immediately before the merger) become shareholders of the amalgamated co-operative bank.

(xii) Demerger means the transfer by a demerged co-operative bank of one or more of its undertakings to any resulting co-operative bank, in such manner that -

(1) all the assets and liabilities of the undertaking or undertakings immediately before the transfer become the assets and liabilities of the resulting co-operative bank;

(2) the assets and the liabilities are transferred to the resulting co-operative bank at values (other than change in the value of assets consequent to their revaluation) appearing in its books of account immediately before the transfer;

(3) the resulting co-operative bank issues, in consideration of the transfer, its membership to the members of the demerged co-operative bank on a proportionate basis;

(4) the shareholders holding 75% or more in value of the shares in the demerged co-operative bank (other than shares already held by the resulting bank or its nominee or its subsidiary immediately before the transfer), become shareholders of the resulting co-operative bank, otherwise than as a result of the acquisition of the assets of the demerged co-operative bank or any undertaking thereof by the resulting co-operative bank;

(5) the transfer of the undertaking is on a going concern basis; and

(6) the transfer is in accordance with the conditions specified by the Central Government, by notification in the Official Gazette, having regard to the necessity to ensure that the transfer is for genuine business purposes.

(xiii) Demerged co-operative bank means the co-operative bank whose undertaking is transferred, pursuant to a demerger, to a resulting bank.

(xiv) Resulting co-operative bank means -

(1) one or more co-operative banks to which the undertaking of the demerged co-operative bank is transferred in a demerger; or

(2) any co-operative bank formed as a result of demerger.

Illustration 7

Alpha Co-operative Bank amalgamated with Beta Co-operative Bank on 1.12.2009. The depreciation for the year ended 31.3.2010 calculated as per Income-tax Rules allowable to Alpha Co-operative Bank had the amalgamation had not taken place amounts to Rs.2,40,000. Compute the deduction on account of depreciation allowable in the hands of Alpha Co-operative Bank and Beta Co-operative Bank for A.Y. 2010-11.

Solution

(i) The amount of deduction allowable to the amalgamating co-operative bank (i.e. Alpha Co-operative bank, in this case) under section 32 has to be determined in accordance with the following formula -

$$A \times \frac{B}{C}$$

A = the amount of deduction allowable to the predecessor co-operative bank (i.e. Alpha Co-operative bank, in this case) if the business reorganisation had not taken place. In this case, the amount of deduction is Rs.2,40,000.

B = the number of days comprised in the period beginning with the 1st day of the financial year (i.e. 1.4.2009, in this case) and ending on the day immediately preceding the date of business reorganization (i.e. 30.11.2009, in this case); and

C = the total number of days in the financial year in which the business reorganisation has taken place (i.e. 365 days).

(ii) The amount of deduction allowable to the amalgamated co-operative bank (i.e. Beta Co-operative bank, in this case) under section 32 has to be determined in accordance with the formula -

$$A \times \frac{B}{C}$$

A = the amount of deduction allowable to the predecessor co-operative bank (i.e. Alpha Co-operative bank, in this case) if the business reorganisation had not taken place. In this case, the amount of deduction is Rs.2,40,000.

B = the number of days comprised in the period beginning with the date of business reorganisation (i.e. 1.12.2009, in this case) and ending on the last day of the financial year (i.e. 31.3.2010); and

C = the total number of days in the financial year in which the business reorganisation has taken place (i.e. 365 days).

(iii) In this case, the deduction that would have been allowable under section 32 to Alpha co-operative bank had the business reorganization had not taken place is Rs.2,40,000 and the business re-organisation took place on 1.12.09. Therefore, the deduction allowable to Alpha co-operative bank under section 32 would be Rs.1,60,438 i.e. Rs.2,40,000 x 244/365. The deduction allowable to Beta co-operative bank would be Rs.79,562 i.e. Rs.2,40,000 x 121/365.

3.27 COMPUTATION OF BUSINESS INCOME IN CASES WHERE INCOME IS PARTLY AGRICULTURAL AND PARTLY BUSINESS IN NATURE

(i) Income from the manufacture of rubber [Rule 7A]

(1) Income derived from the sale of centrifuged latex or cenex or latex based crepes or brown crepes or technically specified block rubbers manufactured or processed from field latex or coagulum obtained from rubber plants grown by the seller in India shall be computed as if it were income derived from business, and 35% of such income shall be deemed to be income liable to tax.

(2) In computing such income, an allowance shall be made in respect of the cost of planting rubber plants in replacement of plants that have died or become permanently useless in an area already planted, if such area has not previously been abandoned, and for the purpose of determining such cost, no deduction shall be made in respect of the amount of any subsidy which, under the provisions of clause (31) of section 10, is not includible in the total income.

(ii) Income from the manufacture of coffee [Rule 7B]

(1) Income derived from the sale of coffee grown and cured by the seller in India shall be computed as if it were income derived from business, and 25% of such income shall be deemed to be income liable to tax.

(2) Income derived from the sale of coffee grown cured, roasted and grounded by the seller in India, with or without mixing of chicory or other flavouring ingredients, shall be computed as if it were income derived from business, and 40% of such income shall be deemed to be income liable to tax.

(3) In computing such income, an allowance shall be made in respect of the cost of planting coffee plants in such replacement of plants that have died or become permanently useless in an area already planted, if such area has not previously been abandoned, and for the purpose of determining such cost, no deduction shall be made in respect of the amount of any subsidy which, under the provisions of clause (31) of section 10, is not includible in the total income.

(iii) Income from the manufacture of tea [Rule 8]

(1) Income derived from the sale of tea grown and manufactured by the seller in India shall be computed as if it were income derived from business, and 40% of such income shall be deemed to be income liable to tax.

(2) In computing such income an allowance shall be made in respect of the cost of planting bushes in replacement of bushes that have died or become permanently useless in an area already planted, if such area has not previously been abandoned, and for the purpose of determining such cost, no deduction shall be made in respect of the amount of any subsidy which, under the provision of clause (31) of section 10, is not includible in the total income.

Self examination questions

1. An assessee uses plant and machinery for the purpose of carrying on his business. Under section 31, he shall be eligible for deduction on account of -
   a) both capital and revenue expenditure on repairs
   b) current repairs
   c) current repairs plus 1/5th of capital expenditure on repairs.
2. An electricity company charging depreciation on straight line method on each asset separately, sells one of its machinery in April, 2009 at Rs.1,20,000. The WDV of the machinery at the beginning of the year i.e. on 1st April, 2009 is Rs.1,35,000. No new machinery was purchased during the year. The shortfall of Rs.15,000 is treated as -
   a) Terminal depreciation
   b) Short-term capital loss
   c) Normal depreciation.
3. X Ltd. acquires an asset which was previously used for scientific research for Rs.2,75,000. The asset was brought into use for the business of X Ltd., after the research was completed. The actual cost of the asset to be included in the block of assets is -
   a) Nil
   b) Market value of the asset on the date of transfer to business
   c) Rs.2,75,000 less notional depreciation under section 32 upto the date of transfer.
4. A Ltd. has unabsorbed depreciation of Rs.4,50,000 for the P.Y.2009-10. This can be carried forward -
   a) for a maximum period of 8 years and set-off against business income.
   b) Indefinitely and set-off against business income.
   c) Indefinitely and set-off against any head of income.
5. Deduction under section 33AB is allowed to an assessee provided the assessee deposits the profits with NABARD -
   a) before the end of the previous year
   b) within 6 months from the end of the previous year
   c) within 6 months from the end of the previous year or before the due date for filing the return of income, whichever is earlier.
6. XYZ Ltd. incurred capital expenditure of Rs.1,50,000 on 1.4.09 for acquisition of patents and copyrights. Such expenditure is -

a) Eligible for deduction in 14 years from A.Y.2010-11

b) Eligible for deduction in 5 years from A.Y.2010-11

c) Subject to depreciation under section 32

7. Under section 44AE, presumptive taxation is applicable at a particular rate provided the assessee is the owner of a maximum of certain number of goods carriages. The rate per month or part of the month relevant for A.Y.2010-11 and the maximum number specified under the section are -

a) Rs.3,500 for a heavy goods carriage and Rs.3,150 for other goods carriages for an assessee owning not more than 10 goods carriages at any time during the year

b) Rs.3,500 per carriage for an assessee owning not more than 10 goods carriages at the end of the previous year

c) Rs.3,500 for a heavy goods carriage and Rs.3,150 for other goods carriages for an assessee owning not more than 12 goods carriages at the end of the previous year

8. In the case of a non-resident engaged in the business of operation of aircraft, the income is determined under section 44BBA at -

a) 7.5% of turnover

b) 10% of turnover

c) 5% of turnover

9. The W.D.V. of a block (Plant and Machinery, rate of depreciation 15%) as on 31.3.09 is Rs.3,20,000. A machinery costing Rs.50,000 was acquired on 1.9.09 but put to use on 1.11.09. During Jan'10, part of this block was sold for Rs.2,00,000. The depreciation for A.Y.2010-11 would be -

a) Rs.21,750

b) Rs.25,500

c) Rs.21,125

10. Employer's contribution to provident fund/superannuation fund/gratuity fund is allowed as deduction in computing income under the head "Profits and gains of business or profession", provided it has been paid -

a) before the end of the previous year

b) on or before the due date by which the employer is required to credit an employee's contribution to the employee's account in the relevant fund.

c) on or before the due date for filing the return of income under section 139(1).

11. Is it compulsory for an assessee to claim depreciation under section 32 of the Income-tax Act, 1961?

12. Write short notes on -

    (i) Enhanced depreciation

    (ii) Set-off and carry forward of unabsorbed depreciation.

13. Discuss the provisions dealing with the computation of business income on a presumptive basis in case of resident assessees.

14. Discuss the concept of "block of assets" under the Income-tax Act, 1961.

15. Which are the deductions allowable only on actual payment under section 43B?

16. Write short notes on the following -

    (a) Compulsory maintenance of books of accounts

    (b) Compulsory tax audit.

17. What is the tax treatment regarding cash payments in excess of limits prescribed in section 40A(3)?

18. The written down value of plant and machinery in the books of Alpha Ltd. is Rs. 75,00,000 as on 1st April, 2009, on which date, the installed capacity of the company was 12,000 tons. Alpha Ltd. borrowed Rs.10,00,000@10%p.a. from ICICI Bank on 1.8.09 for purchase of new plant and machinery for extension of its existing business, which would increase its installed capacity to 13,000 tons. The new plant and machinery was purchased on the same date but was put to use only w.e.f. 1.11.09. Compute the depreciation admissible under section 32 for the A.Y.2010-11, assuming the applicable rate of depreciation on plant and machinery to be 15%.

Answers

1. b; **2.** a; **3.** a; **4.** c; **5.** c; **6.** c; **7.** a; **8.** c; **9.** a; **10.** c

18. Rs.13,04,375.

UNIT – 4 : CAPITAL GAINS

Learning Objectives

After studying this unit, you would be able to understand –

- what is the scope of income chargeable under this head
- the year in which the capital gains is chargeable to tax
- which assets are "capital assets" for the purposes of chargeability under this head
- the meaning of short-term capital asset and long-term capital asset
- how to compute the period of holding for determining whether an asset is a short-term capital asset or long-term capital asset
- the meaning of transfer for the purpose of capital gains
- which are the transactions not regarded as transfer
- the mode of computation of capital gains
- when cost to previous owner is to be taken as cost of acquisition
- how to compute capital gains in case of depreciable assets
- how to compute capital gains in case of slump sale
- what are the exemptions available in respect of capital gains
- when an Assessing Officer can make a reference to the Valuation Officer
- what is the tax treatment of short-term and long-term capital gains in respect of sale of equity shares/ units of an equity oriented fund
- what is the rate of tax on long-term capital gains

4.1 INTRODUCTION

In this unit on capital gains, the discussion begins with the definition of capital asset and transfer and then the various circumstances under which capital gains tax is levied are enumerated. There are certain transactions which are not to be regarded as transfer for the purposes of capital gains. These transactions have also been discussed in this unit. For computing long-term capital gains, knowledge of cost inflation index is necessary. Again, there is a separate method of computation of capital gains in respect of depreciable assets. Also, there are exemptions from capital gains under certain circumstances. All these are discussed in this unit.

Section 45 provides that any profits or gains arising from the transfer of a capital asset

effected in the previous year will be chargeable to income-tax under the head 'Capital Gains'. Such capital gains will be deemed to be the income of the previous year in which the transfer took place. In this charging section, two terms are important. One is "capital asset" and the other is "transfer".

4.2 CAPITAL ASSET

(1) DEFINITION

According to section 2(14), a capital asset means property of any kind held by an assessee, whether or not connected with his business or profession, but does not include—

(i) any stock-in-trade, consumable stores or raw materials held for the purpose of the business or profession of the assessee;

(ii) personal effects, that is to say, movable property (including wearing apparel and furniture) held for personal use by the assessee or any member of his family dependent on him, but excludes

(a) jewellery;

(b) archaeological collections;

(c) drawings;

(d) paintings;

(e) sculptures; or

(f) any work of art.

Note - Jewellery includes -

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

(b) precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel.

(iii) Rural agricultural land in India i.e. agricultural land in India which is not situated in any specified area.

(iv) 6½% Gold Bonds, 1977, or 7% Gold Bonds, 1980, or National Defence Gold Bonds, 1980, issued by the Central Government;

(v) Special Bearer Bonds, 1991 issued by the Central Government;

(vi) Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 notified by the Central Government.

(2) Rural Agricultural Lands - We can note from the above definition that only rural agricultural lands in India are excluded from the purview of the term 'capital asset'. Hence urban agricultural lands constitute capital assets. Accordingly, agricultural land situated within the limits of any municipality or cantonment board having a population of 10,000 or more according to the latest census will be considered as capital asset. Further, agricultural land situated in areas lying within a distance of 8 kms from the local limits of such municipality or cantonment board will also be considered as capital asset. The condition here is that such areas must be notified by the Central Government having regard to the extent and scope of their urbanisation and other relevant considerations. Consequently, any capital gain arising from the transfer of the abovementioned agricultural lands will be liable to income-tax.

Explanation regarding gains arising on the transfer of urban agricultural land - The Explanation to section 2(1A) clarifies that capital gains arising from transfer of any agricultural land situated in any non-rural area (as explained above) will not constitute agricultural revenue within the meaning of section 2(1A). In other words, the capital gains arising from the transfer of such urban agricultural lands would not be treated as agricultural income for the purpose of exemption under section 10(1). Hence, such gains would be exigible to tax under section 45.

(3) Other capital assets - It is not possible to enumerate the forms which a capital asset can take. Goodwill, leasehold rights, a partner's right or share in the firm, a manufacturing licence and the right to subscribe for share of a company etc. are all examples of capital asset.

(4) Jewellery - As noted above, jewellery is treated as capital asset and the profits or gains arising from the transfer of jewellery held for personal use are chargeable to tax under the head "capital gains". For this purpose, the expression 'jewellery' includes the following:

(i) Ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stones and whether or not worked or sewn into any wearing apparel;

(ii) Precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel.

(5) Zero Coupon Bond – Section 2(48) defines the expression 'Zero Coupon Bond". As per this definition, 'zero coupon bond' means a bond issued by any infrastructure capital company or infrastructure capital fund or a public sector company *or a scheduled bank* 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. Accordingly, the Central Government has specified the following bonds to be issued on or before 31.3.2009 as zero coupon bonds –

(i) 10 year zero coupon bonds of HUDCO, SIDBI, NABARD and IDFC;

(ii) 15 year zero coupon bonds of HUDCO;

(iii) 15 year zero coupon bonds of Power Finance Corporation; and

(iv) 10 year zero coupon bonds of National Housing Bank.

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.

The terms "infrastructure capital company" and "infrastructure capital fund" have been defined in section 2(26A) and 2(26B), respectively. For details, refer Chapter 1- Basic Concepts.

4.3 SHORT-TERM AND LONG-TERM CAPITAL ASSETS

Section 2(42A) defines short-term capital asset as a capital asset held by an assessee for not more than 36 months immediately preceding the date of its transfer. Therefore, a capital asset held by an assessee for more than 36 months immediately preceding the date of its transfer is a long-term capital asset.

However, in the case of company shares, various securities listed in a recognised Stock Exchange in India, units of the Unit Trust of India and of Mutual Funds specified under section 10(23D) or a Zero Coupon Bond, the said assets will be considered as long-term capital assets if they are held for more than 12 months. Further, in the case of a capital asset being a share or any other security or a right to subscribe to any share or security where such right is renounced in favour of any other person, the period shall be calculated for treating the capital asset as a short-term capital asset from the date of allotment of such share or security or from the date of offer of such right by the company or institution concerned.

Security - This term has the same meaning assigned to it in section 2(b) of Securities Contracts (Regulation) Act, 1956.

Determination of period of holding - The following points must be noted in this regard:

(i) In the case of a share held in a company in liquidation, the period subsequent to the date on which the company goes into liquidation should be excluded.

(ii) Section 49(1) specifies some special circumstances under which capital asset becomes the property of an assessee. For example, an assessee may get a capital asset on a distribu-

tion of assets on the partition of a HUF or he may get a gift or he may get the property under a will or from succession, inheritance etc. In such cases, the period for which the asset was held by the previous owner should be taken into account.

(iii) In the case of shares held in an amalgamated company in lieu of shares in the amalgamating company, the period will be counted from the date of acquisition of shares in the amalgamating company.

(iv) In the case of a capital asset being a share or any other security or a right to subscribe to any share or security where such right is renounced in favour of any other person, the period shall be calculated from the date of allotment of such share or security or from the date of offer of such right by the company or institution concerned.

(v) In respect of other capital assets, the period for which any capital asset is held by the assessee shall be determined in accordance with any rules made by the CBDT in this behalf.

(vi) In the case of a capital asset, being a financial asset, allotted without any payment and on the basis of holding of any other financial asset the period shall be reckoned from the date of the allotment of such financial asset.

(vii) In the case of a capital asset being shares in an Indian company, which becomes the property of the assessee in consideration of a demerger, the period of holding shall include the period for which the shares were held in the demerged company by the assessee.

(viii) In the case of a capital asset being equity shares, or trading or clearing rights, of a stock exchange acquired by a person pursuant to demutualization or corporatisation of a recognised stock exchange in India as referred to in clause (xiii) of section 47, there shall be included while calculating the period of holding of such assets the period, for which the person was a member of the recognised stock exchange immediately prior to such demutualization or corporatisation.

(ix) In the case of a capital asset, being any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer free of cost or at concessional rate to his employees (including former employee or employees), the period shall be reckoned from the date of allotment or transfer of such specified security or sweat equity shares.

Specified security" means the securities as defined in section 2(h) of the Securities Contracts (Regulation) Act, 1956 and, where employees' stock option has been granted under any plan or scheme therefor, includes the securities offered under such plan or scheme.

"Sweat equity shares" means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

In respect of capital assets other than those listed above, the period of holding shall be determined subject to any rules which the Board may make in this behalf.

4.4 TRANSFER: WHAT IT MEANS [SECTION 2(47)]

The Act contains an inclusive definition of the term 'transfer'. Accordingly, transfer in relation to a capital asset includes the following types of transactions :—

(i) the sale, exchange or relinquishment of the asset; or

(ii) the extinguishment of any rights therein; or

(iii) the compulsory acquisition thereof under any law; or

(iv) the owner of a capital asset may convert the same into the stock-in-trade of a business carried on by him. Such conversion is treated as transfer; or

(v) the maturity or redemption of a Zero Coupon Bond; or

(vi) Part-performance of the contract : Sometimes, possession of an immovable property is given in consideration of part-performance of a contract. For example, A enters into an agreement for the sale of his house. The purchaser gives the entire sale consideration to A. A hands over complete rights of possession to the purchaser since he has realised the entire sale consideration. Under Income-tax Act, the above transaction is considered as transfer; or

(vii) Lastly, there are certain types of transactions which have the effect of transferring or enabling the enjoyment of an immovable property. For example, a person may become a member of a co-operative society, company or other association of persons which may be building houses/flats. When he pays an agreed amount, the society etc. hands over possession of the house to the person concerned. No conveyance is registered. For the purpose of income-tax, the above transaction is a transfer. Even power of attorney transactions are covered.

4.5 SCOPE AND YEAR OF CHARGEABILITY [SECTION 45]

(i) General Provision [Section 45(1)] - Any profits or gains arising from the transfer of a capital asset effected in the previous year (other than exemptions covered under this chapter) shall be chargeable to Income-tax under this head in the previous year in which the transfer took place.

(ii) Receipts from insurance parties [Section 45(1A)] - Where any person receives any money or other assets under any insurance from an insurer on account of damage to or destruction of any capital asset, as a result of flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature, riot or civil disturbance, accidental fire or explosion or because of action by an enemy or action taken in combating an enemy

(whether with or without declaration of war), then, any profits or gains arising from receipt of such money or other assets shall be chargeable to income-tax under the head "Capital gains" and shall be deemed to be the income of the such person for the previous year in which money or other asset was received.

For the purposes of section 48, the value of any money or the fair market value of other assets on the date of such receipt shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of such capital assets.

(iii) Conversion or treatment of a capital asset as stock-in-trade [Section 45(2)]

A person who is the owner of a capital asset may convert the same or treat it as stock-in-trade of the business carried on by him. As noted above, the above transaction is a transfer. As per section 45(2), the profits or gains arising from the above conversion or treatment will be chargeable to income-tax as his income of the previous year in which such stock-in-trade is sold or otherwise transferred by him. In order to compute the capital gains, the fair market value of the asset on the date of such conversion or treatment shall be deemed to be the full value of the consideration received as a result of the transfer of the capital asset.

Illustration 1

A is the owner of a car. On 1-4-2009, he starts a business of purchase and sale of motor cars. He treats the above car as part of the stock-in-trade of his new business. He sells the same on 31-3-2010 and gets a profit of Rs.1 lakh. Discuss the tax implication.

Solution

Since car is a personal asset, conversion or treatment of the same as the stock-in-trade of his business will not be trapped by the provisions of section 45(2). Hence A is not liable to capital gains tax.

Illustration 2

X converts his capital asset (acquired on June 10, 1988 for Rs.60,000) into stock-in-trade in March 10, 2008. The fair market value on the date of the above conversion was Rs.2,20,000. He subsequently sells the stock-in-trade so converted for Rs.2,50,000 on June 10, 2009. Discuss the tax implication.

Solution

Since the capital asset is converted into stock-in-trade during the previous year relevant to the A.Y. 2008-09, it will be a transfer under section 2(47) during the P.Y.2007-08.

However, the profits or gains arising from the above conversion will be chargeable to tax during the A.Y. 2010-11, since the stock-in-trade has been sold only on June 10, 2009. For this purpose, the fair market value on the date of such conversion (i.e. 10th March, 2008) will be the full value of consideration.

The capital gains will be computed after deducting the indexed cost of acquisition from the full value of consideration. The cost inflation index for 1988-89 *i.e.,* the year of acquisition is 161 and the index for the year of transfer *i.e.,* 2007-08 is 551. The indexed cost of acquisition is 60,000 × 551/161 = Rs.2,05,342. Hence, Rs.14,658 (i.e. Rs.2,20,000 – Rs.2,05,342) will be treated as long-term capital gains chargeable to tax during the A.Y.2010-11. During the same assessment year, Rs.30,000 (Rs.2,50,000 - Rs.2,20,000) will be chargeable to tax as business profits.

Year of chargeability - Capital gains are chargeable as the income of the previous year in which the sale or transfer takes place. In other words, for determining the year of chargeability, the relevant date of transfer is not the date of the agreement to sell, but the actual date of sale *i.e.,* the date on which the effect of transfer of title to the property as contemplated by the parties has taken place [*Alapati Venkatramiah* v. *CIT* [1965] 57 ITR 185 (SC)]. Thus, in the case of any immovable property of the value exceeding Rs. 100, the title to the property cannot pass from the transferor to the transferee until and unless a deed of conveyance is executed and registered. Mere delivery of possession of the immovable property could not itself be treated as equivalent to conveyance of the immovable property. In the case of any movable property, the title to which would pass immediately on delivery of the property in accordance with the agreement to sell, the transfer will be complete on such delivery. However, as already noted, Income-tax Act has recognised certain transactions as transfer in spite of the fact that conveyance deed might not have been executed and registered. Power of Attorney sales as explained above or co-operative society transactions for acquisition of house are examples in this regard.

(iv) Transfer of beneficial interest in securities [Section 45(2A)]

As per section 45(2A), where any person has had at any time during the previous year any beneficial interest in any securities, then, any profits or gains arising from the transfer made by the Depository or participant of such beneficial interest in respect of securities shall be chargeable to tax as the income of the beneficial owner of the previous year in which such transfer took place and shall not be regarded as income of the depository who is deemed to be the registered owner of the securities by virtue of sub-section (1) of section 10 of the Depositories Act, 1996. For the purposes of section 48 and proviso to section 2(42A), the cost of acquisition and the period of holding of securities shall be determined on the basis of the first-in-first-out (FIFO) method.

When the securities are transacted through stock exchanges it is the established procedure that the brokers first enter into contracts for purchase/sale of securities and thereafter, follow it up with delivery of shares, accompanied by transfer deeds duly signed by the registered holders. The seller is entitled to receive the consideration agreed to as on the date of contract. Thus, it is the date of broker's note that should be treated as the date of transfer in case of sale transactions of securities provided such transactions are followed up by delivery of shares and also the transfer deeds. Similarly, in respect of the purchasers of the securities, the holding period shall be reckoned to take place directly between the parties and not through stock exchanges. The date of contract of sale as declared by the parties shall be treated as the date of transfer provided it is followed up by actual delivery of shares and the transfer deeds.

Where securities are acquired in several lots at different points of time, the First-In-First-Out (FIFO) method shall be adopted to reckon the period of the holding of the security, in cases where the dates of purchase and sale could not be correlated through specific numbers of the scrips. In other words, the assets acquired last will be taken to be remaining with the assessee while assets acquired first will be treated as sold. Indexation, wherever applicable, for long-term assets will be regulated on the basis of the holding period determined in this manner - *CBDT Circular No. 704, dated 28.4.1995.*

"Beneficial owner" means a person whose name is recorded as such with a depository.

"Depository" means a company formed and registered under the Companies Act, 1956 and which has been granted a certificate of registration under sub-section (1A) of section 12 of the Securities and Exchange Board of India Act, 1992.

"Security" means such security as may be specified by SEBI.

(v) Introduction of capital asset as capital contribution [Section 45(3)]

Where a person transfers a capital asset to a firm, AOP or BOI in which he is already a partner/member or is to become a partner/member by way of capital contribution or otherwise, the profits or gains arising from such transfer will be chargeable to tax as income of the previous year in which such transfer takes place. For this purpose, the value of the consideration will be the amount recorded in the books of account of the firm, AOP or BOI as the value of the capital asset.

Illustration 3

A is the owner of a foreign car. He starts a firm in which he and his two sons are partners. As his capital contribution, he transfers the above car to the firm. The car had cost him

Rs.2,00,000. The same is being introduced in the firm at a recorded value of Rs.3,50,000. Discuss.

Solution

Car is not capital asset but is a personal effect. Section 45(3), as explained above, covers only cases of transfer of capital asset as contribution and not personal effects. Hence, the above transaction will not be subject to capital gains tax.

(vi) Distribution of capital assets on a firm's dissolution [Section 45(4)]

The profits or gains arising from the transfer of capital assets by way of distribution of capital assets on the dissolution of a firm or AOP or BOI or otherwise shall be chargeable to tax as the income of the firm etc. of the previous year in which such transfer takes place. For this purpose, the fair market value of the asset on the date of such transfer shall be the full value of consideration.

The Bombay High Court made a landmark judgment in *Commissioner of Income-tax v. A.N. Naik Associates (2004) 136 Taxman 107.* The Court applied the "mischief rule" about interpretation of statutes and pointed out that the idea behind the introduction of sub-section (4) in section 45 was to plug in a loophole and block the escape route through the medium of the firm. The High Court observed that the expression 'otherwise' has not to be read *ejusdem generis* with the expression 'dissolution of a firm or body of individuals or association of persons'. The expression 'otherwise' has to be read with the words 'transfer of capital assets by way of distribution of capital assets'. If so read, it becomes clear that even when a firm is in existence and there is a transfer of capital asset, it comes within the expression 'otherwise' since the object of the amendment was to remove the loophole which existed, whereby capital gains tax was not chargeable. Therefore, the word 'otherwise' takes into its sweep not only cases of dissolution but also cases of subsisting partners of a partnership, transferring assets in favour of retiring partners.

(vii) Compensation on compulsory acquisition [Section 45(5)]

Sometimes, a building or some other capital asset belonging to a person is taken over by the Central Government by way of compulsory acquisition. In that case, the consideration for the transfer is determined by the Central Government. When the Central Government pays the above compensation, capital gains may arise. Such capital gains are chargeable as income of the previous year in which such compensation is received.

Enhanced Compensation - Many times, persons whose capital assets have been taken over by the Central Government and who get compensation from the government go to

the court of law for enhancement of compensation. If the court awards a compensation which is higher than the original compensation, the difference thereof will be chargeable to capital gains in the year in which the same is received from the government. For this purpose, the cost of acquisition and cost of improvement shall be taken to be *nil*.

Reduction of enhanced compensation **-** Where capital gain has been charged on the compensation received by the assessee for the compulsory acquisition of any capital asset or enhanced compensation received by the assessee and subsequently such compensation is reduced by any court, tribunal or any authority, the assessed capital gain of that year shall be recomputed by taking into consideration the reduced amount. This re-computation shall be done by way of rectification under section 155.

Death of the transferor - It is possible that the transferor may die before he receives the enhanced compensation. In that case, the enhanced compensation or consideration will be chargeable to tax in the hands of the person who received the same.

(viii) Repurchase of mutual fund units referred to in section 80CCB [Section 45(6)] - The difference between the repurchase price and the amount invested will be chargeable to tax in the previous year in which such repurchase takes place or the plan referred to in section 80CCB is terminated.

Note - *Since the tax treatment accorded to a LLP and a general partnership is the same, the conversion from a general partnership firm to an LLP will have no tax implications if the rights and obligations of the partners remain the same after conversion and if there is no transfer of any asset or liability after conversion. However, if there is a change in rights and obligations of partners or there is a transfer of asset or liability after conversion, then the provisions of section 45 would get attracted.*

4.6 CAPITAL GAINS ON DISTRIBUTION OF ASSETS BY COMPANIES IN LIQUIDATION [SECTION 46]

(1) Where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as a transfer by the company for the purposes of section 45 [section 46(1)]. The above section is restricted in its application to the circumstances mentioned therein *i.e.,* the assets of the company must be distributed in specie to shareholders on the liquidation of the company. If, however, the liquidator sells the assets of the company resulting in a capital gain and distributes the funds so collected, the company will be liable to pay tax on such gains.

(2) Shareholders receive money or other assets from the company on its liquidation. They will be chargeable to income-tax under the head 'capital gains' in respect of the

market value of the assets received on the date of distribution, or the moneys so received by them. The portion of the distribution which is attributable to the accumulated profits of the company is to be treated as dividend income of the shareholder under section 2(22)(*c*). The same will be deducted from the amount received/fair market value for the purpose of determining the consideration for computation of capital gains.

(3) Capital gains tax on subsequent sale by the shareholders - If the shareholder, after receipt of any such asset on liquidation of the company, transfers it within the meaning of section 45 at a price which is in excess of his cost of acquisition determined in the manner aforesaid, such excess becomes taxable in his hands under section 45.

4.7 CAPITAL GAINS ON BUYBACK, ETC. OF SHARES [SECTION 46A]

Any consideration received by a shareholder or a holder of other specified securities from any company on purchase of its own shares or other specified securities held by such shareholder or holder of other specified securities shall be chargeable to tax on the difference between the cost of acquisition and the value of consideration received by the holder of securities or by the shareholder, as the case may be, as capital gains. The computation of capital gains shall be made in accordance with the provisions of section 48.

Such capital gains shall be chargeable in the year in which such shares/securities were purchased by the company. For this purpose, "specified securities" shall have the same meaning as given in Explanation to section 77A of the Companies Act, 1956.

4.8 TRANSACTIONS NOT REGARDED AS TRANSFER [SECTION 47]

Section 47 specifies certain transactions which will not be regarded as transfer for the purpose of capital gains tax:

(1) Any distribution of capital assets on the total or partial partition of a HUF;

(2) Any transfer of a capital asset under a gift or will or an irrevocable trust;

However, this clause shall not include transfer under a gift or an irrevocable trust of a capital asset being shares, debentures or warrants allotted by a company directly or indirectly to its employees under the Employees' Stock Option Plan or Scheme offered to its employees in accordance with the guideliness issued in this behalf by the Central Government.

(3) Any transfer of a capital asset by a company to its subsidiary company.

Conditions -(i) The parent company must hold the whole of the shares of the subsidiary company; (ii) The subsidiary company must be an Indian company.

(4) Any transfer of capital asset by a subsidiary company to a holding company;

Conditions - (i) The whole of shares of the subsidiary company must be held by the holding company; (ii) The holding company must be an Indian company.

Exception - The exemption mentioned in 3 or 4 above will not apply if a capital asset is transferred as stock-in-trade.

(5) Any transfer in a scheme of amalgamation of a capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company.

(6) Any transfer in a scheme of amalgamation of shares held in an Indian company by the amalgamating foreign company to the amalgamated foreign company.

Conditions -(i) At least 25 percent of the shareholders of the amalgamating foreign company must continue to remain shareholders of the amalgamated foreign company; (ii) Such transfer should not attract capital gains in the country in which the amalgamating company is incorporated.

(7) Any transfer, in a scheme of amalgamation of a banking company with a banking institution sanctioned and brought into force by the Central Government under section 45(7) of the Banking Regulation Act, 1949, of a capital asset by such banking company to such banking institution.

(8) Any transfer by a shareholder in a scheme of amalgamation of shares held by him in the amalgamating company.

Conditions - (i) The transfer is made in consideration of the allotment of any share in the amalgamated company to him; (ii) The amalgamated company is an Indian company.

Illustration 4

M held 2000 shares in a company ABC Ltd. This company amalgamated with another company during the previous year ending 31-3-2010. Under the scheme of amalgamation, M was allotted 1000 shares in the new company. The market value of shares allotted is higher by Rs.50,000 than the value of holding in ABC Ltd. The Assessing Officer proposes to treat the transaction as an exchange and to tax Rs.50,000 as capital gain. Is he justified?

Solution

In the above example, assuming that the amalgamated company is an Indian company, the transaction is squarely covered by the exemption explained above and the proposal of

the Assessing Officer to treat the transaction as an exchange is not justified.

(9) Any transfer in a demerger, of a capital asset by the demerged company to the resulting company, if the resulting company is an Indian company.

(10) Any transfer in a demerger, of a capital asset, being a share or shares held in an Indian company, by the demerger foreign company to the resulting foreign company.

Conditions - (i) The shareholders holding at least three-fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and

(ii) Such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated.

However, the provisions of sections 391 to 394 of the Companies Act, 1956, shall not apply in case of demergers referred to in this clause.

*(*11) any transfer in a business reorganisation, of a capital asset by the predecessor co-operative bank to the successor co-operative bank.

(12) any transfer by a shareholder, in a business reorganisation, of a capital asset being a share or shares held by him in the predecessor co-operative bank if the transfer is made in consideration of the allotment to him of any share or shares in the successor co-operative bank.

Note – Refer to section 44DDB for the meanings of "business reorganisation", "predecessor co-operative bank" and "successor co-operative bank".

(13) Any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking.

(14) Any transfer of bonds or shares referred to in section 115AC(1).

Conditions - (*i*) The transfer must be made outside India; (*ii*) The transfer must be made by the non-resident to another non-resident.

(15) Any transfer of agricultural lands effected before 1-3-1970.

(16) Any transfer of any of the following capital asset to the government or to the University or the National Museum, National Art Gallery, National Archives or any other public museum or institution notified by the Central Government to be of (national importance or to be of) renown throughout any State :

(i) work of art

(ii) archaeological, scientific or art collection

(iii) book

(iv) manuscript

(v) drawings

(vi) paintings

(vii) photographs

(viii) printings.

(17) Any transfer by way of conversion of bonds or debentures, debenture stock or deposit certificates in any form, of a company into shares or debentures of that company.

(18) Any transfer by way of conversion of Foreign Currency Exchangeable Bonds into shares or debentures of a company.

(19) Transfer by way of exchange of a capital asset being membership of a recognised stock exchange for shares of a company to which such membership is transferred.

Conditions - (*i*) Such exchange is effected on or before 31st December, 1998 and (*ii*) such shares are retained by the transferor for a period of not less than three years from the date of transfer.

(20) Capital gains arising from the transfer of land under a scheme prepared and sanctioned under section 18 of the Sick Industrial Companies (Special Provisions) Act, 1985, by a sick industrial company which is managed by its workers' co-operative.

Conditions - Such transfer is made in the period commencing from the previous year in which the said company has become a sick industrial company and ending with the previous year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses.

(21) Where a firm is succeeded by a company or where an AOP or BOI is succeeded by a company in the course of demutualisation or corporatisation of a recognised stock exchange in India, any transfer of a capital asset or intangible asset (in the case of a firm).

Conditions - (i) All assets and liabilities of the firm or AOP or BOI relating to the business immediately before the succession become the assets and liabilities of the company;

(ii) All the partners of the firm immediately before the succession become the

shareholders of the company and the proportion in which their capital accounts stood in the books of the firm on the date of succession remains the same;

(iii) The partners of the firm do not receive any consideration or benefit in any form, directly or indirectly, other than by way of allotment of shares in the company.

(iv) The partners of the firm together hold not less than 50% of the total voting power in the company, and their shareholding continues in such manner for a period of 5 years from the date of succession.

(v) The corporatisation of a recognised stock exchange in India is carried out in accordance with a scheme for demutualisation or corporatisation approved by SEBI.

(22) any transfer of a membership right by a member of recognised stock exchange in India for acquisition of shares and trading or clearing rights in accordance with a scheme for demutualization or corporatisation approved by SEBI.

(23) Where a sole proprietary concern is succeeded by a company in the business carried out by it, as a result of which the sole proprietary concern transfers or sells any capital asset or intangible asset to such company.

Conditions - (i) All assets and liabilities of the sole proprietary concern relating to the business immediately before the succession become the assets and liabilities of the company;

(ii) The sole proprietor holds not less than 50% of the total voting power in the company, and his shareholding continues in such manner for a period of 5 years from the date of succession;

(iii) The sole proprietor does not receive any consideration or benefit in any form, directly or indirectly, other than by way of allotment of shares in the company.

(24) Any transfer in a scheme for lending of any securities under an agreement or arrangement which the assessee has entered into with the borrower of such securities and which is subject to the guidelines issued by SEBI or the RBI.

(25) Any transfer of a capital asset in a scheme of reverse mortgage under a scheme made and notified by the Central Government.

Illustration 5

In which of the following situations capital gains tax liability does not arise?

(i) Mr. A purchased gold in 1970 for Rs.25,000. In 2009-10, he gifted it to his son at the time of marriage. Fair market value (FMV) of the gold on the day the gift was made

was Rs.1,00,000.

(ii) A house property is purchased by a Hindu undivided family in 1945 for Rs.20,000. It is given to one of the family members in 2009-2010 at the time of partition of the family. FMV on the day of partition was Rs.12,00,000.

(iii) Mr. B purchased 50 convertible debentures for Rs.40,000 in 1995 which are converted in to 500 shares worth Rs.85,000 in November 2009 by the company.

Solution

We know that capital gains arise only when we transfer a capital asset. The liability of capital gains tax in the situations given above is discussed as follows:

(i) As per the provisions of section 47(iii), transfer of a capital asset under a gift is not regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.

(ii) As per the provisions of section 47(i), transfer of a capital asset (being in kind) on the total or partial partition of Hindu undivided family is not regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.

(iii) As per the provisions of section 47(x), transfer by way of conversion of bonds or debentures, debenture stock or deposit certificates in any form of a company into shares or debentures of that company is not regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.

4.9 IMPORTANT DEFINITIONS

(a) Amalgamation [Section 2(1B)] - "Amalgamation", in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as a result of the merger, as the amalgamated company) in such a manner that -

(i) all the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation;

(ii) all the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation;

(iii) shareholders holding not less than three-fourth in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation, otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first mentioned company.

(b) Demerger [Section 2(19AA)] - "Demerger", in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956, by a demerged company of its one or more undertaking to any resulting company in such a manner that -

(i) all the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger;

(ii) all the liabilities relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;

(iii) the property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;

(iv) the resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis;

(v) the shareholders holding not less than three-fourths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;

(vi) the transfer of the undertaking is on a going concern basis;

(vii) the demerger is in accordance with the conditions, if any, notified under sub-section (5) of section 72A by the Central Government in this behalf.

Explanation 1 - For the purposes of this clause, "undertaking" shall include any part of an undertaking, or a unit or division of an undertaking or a business activity taken as a

whole, but does not include individual assets or liabilities or any combination thereof not constituting a business activity.

Explanation 2 - For the purposes of this clause, the liabilities referred to in sub-section (ii), shall include-

(a) the liabilities which arise out of the activities or operations of the undertaking;

(b) the specific loans or borrowings (including debentures) raised, incurred and utilised solely for the activities or operations of the undertaking; and

(c) in cases, other than those referred to in clause (a) or clause (b), so much of the amounts of general or multipurpose borrowings, if any, of the demerged company as stand in the same proportion which the value of the assets transferred in a demerger bears to the total value of the assets of such demerged company immediately before the demerger.

Explanation 3 - For determining the value of the property referred to in sub-clause (*iii*), any change in the value of assets consequent to their revaluation shall be ignored.

Explanation 4 - For the purposes of this clause, the splitting up or the reconstruction of any authority or a body constituted or established under a Central, State or Provincial Act, or a local authority or a public sector company, into separate authorities or bodies or local authorities or companies, as the case may be, shall be deemed to be a demerger if such split up or reconstruction fulfils such conditions as may be notified by the Central Government in the Official Gazette.

"Demerged company" means the company whose undertaking is transferred, pursuant to a demerger, to a resulting company.

4.10 WITHDRAWAL OF EXEMPTION IN CERTAIN CASES

Section 47A provides for withdrawal of the benefit of exemption given by section 47 in certain cases.

As noted above, capital gains arising from the transfer of a capital asset by a company to its wholly owned subsidiary company is exempt from tax. Similarly, capital gains arising from the transfer of a capital asset by the subsidiary company to the holding company is also exempt from tax, provided under both circumstances the transferee is an Indian company.

Section 47A provides that the above exemption will be withdrawn in the following cases:

(1) Where at any time before the expiry of eight years from the date of transfer of a capital asset referred to above, such capital asset is converted by the transferee company or is treated by it as stock-in-trade of its business;

(2) Where before eight years as noted above, the parent company or its nominee ceases to hold the whole of the share capital of the subsidiary company.

In the above two cases, the amount of capital gains exempt from tax by virtue of the provisions contained in section 47 will be deemed to be the income of the transferor company chargeable under the head 'capital gains' of the year in which such transfer took place.

(3) Capital gains not charged to tax under clause (xi) of section 47 shall be deemed to be the income chargeable under the head "capital gains" of the previous year in which such transfer took place if the shares of the company received in exchange for transfer of membership in a recognised stock exchange are transferred at any time before the expiry of three years of such transfer.

(4) Where any of the conditions laid down in section 47 for succession of a firm or sole proprietary concern by a company are not complied with, the amount of profits or gains arising from the transfer of such capital asset or intangible asset shall be deemed to be the profits and gains chargeable to tax of the successor company for the previous year in which the conditions are not complied with.

4.11 MODE OF COMPUTATION OF CAPITAL GAINS

(i) The income chargeable under the head 'capital gains' shall be computed by deducting the following items from the full value of the consideration received or accruing as a result of the transfer of the capital asset:

(1) Expenditure incurred wholly and exclusively in connection with such transfer.

(2) The indexed cost of acquisition and indexed cost of any improvement thereto.

(ii) However, no deduction shall be allowed in computing the income chargeable under the head "Capital Gains" in respect of any amount paid on account of securities transaction tax under Chapter VII of the Finance (No.2) Act, 2004.

Under section 48, the cost of acquisition will be increased by applying the cost inflation index (CII). Once the cost inflation index is applied to the cost of acquisition, it becomes indexed cost of acquisition. This means an amount which bears to the cost of acquisition, the same proportion as CII for the year in which the asset is transferred bears to the CII

for the first year in which the asset was held by the assessee or for the year beginning on 1st April, 1981, whichever is later. Similarly, indexed cost of any improvement means an amount which bears to the cost of improvement, the same proportion as CII for the year in which the asset is transferred bears to the CII for the year in which the improvement to the asset took place. CII for any year means such index as the Central Government may, having regard to 75% of the average rise in the consumer price index for urban non-manual employees for the immediately preceding previous year to that year by notification in the Official Gazette, specify in this behalf.

Note - The benefit of indexation will not apply to the long-term capital gains arising from the transfer of bonds or debentures other than capital indexed bonds issued by the Government.

In case of depreciable assets (discussed later), there will be no indexation or the capital gains will always be short-term capital gains.

(iii) Cost Inflation Index

The cost inflation indices for the financial years so far have been notified as under:

Financial Year	Cost Inflation Index	Financial Year	Cost Inflation Index
1981-82	100	1996-97	305
1982-83	109	1997-98	331
1983-84	116	1998-99	351
1984-85	125	1999-00	389
1985-86	133	2000-01	406
1986-87	140	2001-02	426
1987-88	150	2002-03	447
1988-89	161	2003-04	463
1989-90	172	2004-05	480
1990-91	182	2005-06	497
1991-92	199	2006-07	519
1992-93	223	2007-08	551
1993-94	244	2008-09	582
1994-95	259	*2009-10*	*632*
1995-96	281		

As noted above, for the financial year 1981-82, CII is 100 and the CII for each subsequent year would be determined in such a way that 75% of the rise in consumer price index for urban non-manual employees would be reflected in the rise in CII. It would be seen that the date of transfer of an asset would be immaterial as long as it is within a particular financial year. That means, transfer of assets in any part of the year would be subject to indexation using the same CII as applicable to an asset transferred on 1st day of April of the year. The effect is that all the assets transferred during the year will be deemed to be sold on the first day of the year.

(iv) Special provision for non-residents

In order to give protection to non-residents who invest foreign exchange to acquire capital assets, section 48 contains a proviso. Accordingly, in the case of non-residents, capital gains arising from the transfer of shares or debentures of an Indian company is to be computed as follows:

The cost of acquisition, the expenditure incurred wholly and exclusively in connection with the transfer and the full value of the consideration are to be converted into the same foreign currency with which such shares were acquired. The resulting capital gains shall be reconverted into Indian currency. The aforesaid manner of computation of capital gains shall be applied for every purchase and sale of shares or debentures in an Indian company. Rule 115A is relevant for this purpose.

4.12 ASCERTAINMENT OF COST IN SPECIFIED CIRCUMSTANCES [SECTION 49]

A person becomes the owner of a capital asset not only by purchase but also by several other methods. Section 49 gives guidelines as to how to compute the cost under different circumstances.

(1) In the following cases, the cost of acquisition of the asset shall be deemed to be cost for which the previous owner of the property acquired it. To this cost, the cost of improvement to the asset incurred by the previous owner or the assessee must be added:

Where the capital asset became the property of the assessee:

(i) on any distribution of assets on the total or partition of a HUF;

(ii) under a gift or will;

(iii) by succession, inheritance or devaluation;

(iv) on any distribution of assets on the liquidation of a company;

(v) under a transfer to revocable or an irrevocable trust;

(vi) under any transfer by a holding company to its 100% subsidiary Indian company or vice versa;

(vii) under any scheme of amalgamation by the amalgamating company to the amalgamated Indian company;

(viii) by transfer of shares held in an Indian company in a scheme of amalgamation by the amalgamating foreign company to the amalgamated foreign company;

(ix) by transfer of capital asset by a banking company to a banking institution in a scheme of amalgamation of the banking company with the banking institution.

(x) under any such transfer of a capital asset in a business reorganization by the predecessor co-operative bank to the successor co-operative bank.

(xi) under any such transfer by a shareholder in a business reorganisation, of a capital asset being a share or shares held by him in the predecessor co-operative bank if the transfer is made in consideration of the allotment to him of any share or shares in the successor co-operative bank.

(xii) by conversion by an individual of his separate property into a HUF property, by the mode referred to in section 64(2).

The cost of acquisition of the asset is the cost for which the previous owner acquired the asset as increased by the cost of any improvement of the assets incurred or borne by the previous owner or the assessee, as the case may be.

(2) Where shares in an amalgamated company which is an Indian company become the property of the assessee in consideration of the transfer of shares held by him in the amalgamating company under a scheme of amalgamation, the cost of acquisition to him of the shares in the amalgamated company shall be taken as the cost of acquisition of the shares in the amalgamating company [Section 49(2)].

This also applies in relation to business reorganization of a co-operative bank as referred to in section 44DB. The cost of acquisition of shares in the amalgamated co-operative bank, which became the property of the assessee by virtue of a transfer as a result of business reorganisation shall be the cost of acquisition to him of the shares in the amalgamating co-operative bank.

(3) It is possible that a person might have become the owner of shares or debentures in a company during the process of conversion of bonds or debentures, debenture stock or deposit certificates. In such a case, the cost of acquisition to the person shall be deemed to be that part of the cost of debentures, debenture stock, bond or deposit certificate in relation to which such asset is acquired by that person [Section 49(2A)].

(4) Where the capital gain arises from the transfer of specified security or sweat equity shares referred to in section 17(2)(vi), the cost of acquisition of such security or shares

shall be the fair market value which has been taken into account for perquisite valuation [Section 49(2AA)].

(5) Where the capital gain arises from the transfer of specified security or sweat equity shares, the cost of acquisition of such security or shares shall be the fair market value which has been taken into account while computing the value of fringe benefits under clause (ba) of sub-section (1) of section 115WC [Section 49(2AB)].

The value of fringe benefits would be the fair market value of the specified security or sweat equity shares on the date on which the option vests with employee as reduced by the amount actually paid by, or recovered from the employee in respect of such security or shares. Fair market value means the value determined in accordance with the method prescribed by the CBDT. This fair market value would be taken as the cost of acquisition of the specified security or sweat equity shares. It may be noted that the amount recovered from the employee is not to be deducted for determining the cost of acquisition.

***Note** – It may be noted that fringe benefit tax is not applicable from A.Y.2010-11 and therefore, the fair market value of the specified securities and sweat equity shares would be taxed as a perquisite in the hands of the employees w.e.f. A.Y.2010-11. Therefore, if specified securities or sweat equity shares have been subject to FBT in the hands of the employer upto A.Y.2009-10, the provisions of section 49(2AB) would apply for determination of the cost of acquisition at the time of transfer. However, if the specified securities or sweat equity shares have been taxed as a perquisite in the hands of the employees w.e.f. A.Y.2010-11, the provisions of section 49(2AA) would apply for determination of the cost of acquisition at the time of transfer of such securities/shares by the employee.*

(6) In the case of a demerger, the cost of acquisition of the shares in the resulting company shall be the amount which bears to the cost of acquisition of shares held by the assessee in the demerged company the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger [Section 49(2C)].

This also applies in relation to business reorganization of a co-operative bank as referred to in section 44DB. The cost of acquisition of the shares in the resulting co-operative bank shall be the amount which bears to the cost of acquisition of shares held by the assessee in the demerged co-operative bank, the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged co-operative bank immediately before demerger i.e.,

Cost of acquisition of shares in the resulting co-operative bank = $A \times \frac{B}{C}$

A = Cost of acquisition of shares held in the demerged co-operative bank

B = Net book value of the assets transferred in a demerger

C = Net worth of the demerged co-operative bank i.e. the aggregate of the paid up share capital and general reserves as appearing in the books of account of the demerged company immediately before the demerger.

(7) Further, the cost of acquisition of the original shares held by the shareholder in the demerged company shall be deemed to have been reduced by the amount as so arrived under the sub-section (2C) [Section 49(2D)].

This also applies in relation to business reorganization of a co-operative bank as referred to in section 44DB. The cost of acquisition of the original shares held by the shareholder in the demerged co-operative bank shall be deemed to have been reduced by the amount so arrived at in (6) above.

For the above purpose, "net worth" means the aggregate of the paid up share capital and general reserves as appearing in the books of account of the demerged company immediately before the demerger.

Normally speaking, capital gains must be computed after deducting from the sale price the cost of acquisition to the assessee. The various provisions mentioned above form an exception to this general principle.

(8) Where the capital gain arises from the transfer of such property which has been subject to tax under section 56(2)(vii), the cost of acquisition of the property shall be deemed to be the value taken into account for the purposes of section 56(2)(vii). [For illustration, see Unit 5 of Chapter 4 "Income from Other Sources" under section 56(2)(vii)]

4.13 COST OF IMPROVEMENT [SECTION 55]

(1) Goodwill of a business, etc.: In relation to a capital asset being goodwill of a business or a right to manufacture, produce or process any article or thing, or right to carry on any business, the cost of improvement shall be taken to be nil.

(2) Any other capital asset: (i) Where the capital asset became the property of the previous owner or the assessee before 1-4-1981, cost of improvement means all expenditure of a capital nature incurred in making any addition or alteration to the capital asset on or after the said date by the previous owner or the assessee.

(ii) In any other case, cost of improvement means all expenditure of a capital nature

incurred in making any additions or alterations to the capital assets by the assessee after it became his property. However, there are cases where the capital asset might become the property of the assessee by any of the modes specified in section 49(1). In that case, cost of improvement means capital expenditure in making any addition or alterations to the capital assets incurred by the previous owner.

However, cost of improvement does not include any expenditure which is deductible in computing the income chargeable under the head "Income from house property", "Profits and gains of business or profession" or "Income from other sources".

Illustration 6

Mr. X & sons, HUF, purchased a land for Rs.40,000 in 1991-92. In 1995-96, a partition takes place when Mr. A, a coparcener, is allotted this plot valued at Rs.80,000. In 1996-97, he had incurred expenses of Rs.1,85,000 towards fencing of the plot. Mr. A sells this plot of land for Rs.15,00,000 in 2009-10 after incurring expenses to the extent of Rs.20,000. You are required to compute the capital gain for the A.Y. 2010-11.

Financial year	Cost Inflation Index
1991-92	199
1995-96	281
1996-97	305
2009-10	632

Solution

Computation of taxable capital gains for the A.Y. 2010-11

Particulars	Rs.	Rs.
Sale consideration		15,00,000
Less: Expenses incurred for transfer		20,000
		14,80,000
Less: (i) Indexed cost of acquisition (40,000 × 632/281)	89,964	
(ii) Indexed cost of improvement (1,85,000 × 632/305)	3,83,344	4,73,308
Long term capital gains		**10,06,692**

Illustration 7

Mr. B purchased convertible debentures for Rs.5,00,000 during August 1998. The debentures were converted into shares in September 2002. These shares were sold for Rs.15,00,000 in August, 2009. The brokerage expenses is Rs.50,000. You are required to compute the capital gains in case of Mr. B for the assessment year 2010-11.

Financial Year	Cost Inflation Index
1998-99	351
2002-03	447
2005-06	497
2009-10	632

Solution

Computation of Capital Gains of Mr. B for the A.Y.2010-11

Particulars	Rs.
Sale consideration	15,00,000
Less: Expenses on transfer i.e. Brokerage paid	50,000
Net consideration	14,50,000
Less: Indexed cost of acquisition (5,00,000 × 632/447)	7,06,935
Long term capital gain	**7,43,065**

Note : For the purpose of computing capital gains, the holding period is considered from the date of allotment of these shares i.e. September 2002 – August 2009.

Illustration 8

Mr. C purchases a house property for Rs.1,06,000 on May 15, 1963. The following expenses are incurred by him for making addition/alternation to the house property:

		Rs.
a.	Cost of construction of first floor in 1972-73	1,35,000
b.	Cost of construction of the second floor in 1983-84	3,10,000
c.	Reconstruction of the property in 1992-93	2,50,000

Fair market value of the property on April 1, 1981 is Rs.4,50,000. The house property is sold by Mr. C on August 10, 2009 for Rs.60,00,000 (expenses incurred on transfer:

Rs.50,000). Compute the capital gain for the assessment year 2010-11.

Financial year	Cost Inflation Index
1981-82	100
1983-84	116
1992-93	223
2009-10	632

Solution

Computation of capital gain of Mr.C for the A.Y.2010-11

Particulars	Rs.	Rs.
Gross sale consideration		60,00,000
Less: Expenses on transfer		50,000
Net sale consideration		59,50,000
Indexed cost of acquisition (Note 1)	28,44,000	
Indexed cost of improvement (Note 2)	23,97,486	52,41,486
Long-term capital gain		7,08,514

Notes:

Indexed cost of acquisition is computed as follows:

Rs.4,50,000 × 632/100 = Rs.28,44,000

Fair market value on April 1, 1981 (actual cost of acquisition is ignored as it is lower than market value on April 1, 1981.)

Indexed cost of improvement is determined as under:	**Rs**.
Construction of first floor in 1972-73	Nil
(expenses incurred prior to April 1, 1981 are not considered)	
Construction of second floor in 1983-84 (i.e., Rs.3,10,000× 632/116)	16,88,966
Alternation/reconstruction in 1992-93 (i.e., Rs.2,50,000 × 632/223)	7,08,520
Indexed cost of improvement	23,97,486

4.14 COST OF ACQUISITION [SECTION 55]

(i) Goodwill of a business or a trademark or brand name associated with a business or a right to manufacture, produce or process any article or thing, or right to carry on any business, tenancy rights, stage carriage permits and loom hours - In the case of the above capital assets, if the assessee has purchased them from a previous owner, the cost of acquisition means the amount of the purchase price. For example, if A purchases a stage carriage permit from B for Rs.2 lacs, that will be the cost of acquisition for A.

(ii) Self-generated assets - There are circumstances where it is not possible to visualise cost of acquisition. For example, suppose a doctor starts his profession. With the passage of time, the doctor acquires lot of reputation. He opens a clinic and runs it for 5 years. After 5 years he sells the clinic to another doctor for Rs.10 lacs which includes Rs.2 lacs for his reputation or goodwill. Now a question arises as to how to find out the profit in respect of goodwill. It is obvious that the goodwill is self-generated and hence it is difficult to calculate the cost of its acquisition. However, it is certainly a capital asset. The Supreme Court in *CIT* v. *B.C. Srinivasa Shetty [1981] 128 ITR 294 (SC)* held that in order to bring the gains on sale of capital assets to charge under section 45, it is necessary that the provisions dealing with the levy of capital gains tax must be read as a whole. Section 48 deals with the mode of computing the capital gains. Unless the cost of acquisition is correctly ascertainable, it is not possible to apply the provisions of section 48. Self-generated goodwill is such a type of capital asset where it is not possible to visualise cost of acquisition. Once section 48 cannot be applied, the gains thereon cannot be brought to charge.

This decision of the Supreme Court was applicable not only to self-generated goodwill of a business but also to other self-generated assets like tenancy rights, stage carriage permits, loom hours etc. In order to supersede the decision of the Supreme Court cited above, section 55 was amended. Accordingly, in case of self-generated assets namely, goodwill of a business or a trademark or brand name associated with a business or a right to manufacture, produce or process any article or thing, or right to carry on any business, tenancy rights, stage carriage permits, or loom hours, the cost of acquisition will be taken to be *nil*. However, it is significant to note that the above amendment does not cover self-generated goodwill of a profession. So, in respect of self-generated goodwill of a profession and other self-generated assets not specifically covered by the amended provisions of section 55, the decision of the Supreme Court in *B. C. Srinivasa Setty's* case will still apply.

(iii) Other assets - In the following cases, cost of acquisition shall not be *nil*, but will be deemed to be the cost for which the previous owner of the property acquired it:

Where the capital asset became the property of the assessee—

(1) On any distribution of assets on the total or partial partition of a Hindu undivided family.

(2) Under a gift or will.

(3) By succession, inheritance or devolution.

(4) On any distribution of assets on the liquidation of a company.

(5) Under a transfer to a revocable or an irrevocable trust.

(6) Under any such transfer referred to in sections 47(iv), (v), (vi), (via) or (viaa).

(7) Where the assessee is a Hindu undivided family, by the mode referred to in section 64(2).

(iv) Financial assets - Many times persons who own shares or other securities become entitled to subscribe to any additional shares or securities. Further, they are also allotted additional shares or securities without any payment. Such shares or securities are referred to as financial assets in Income-tax Act. Section 55 provides the basis for ascertaining the cost of acquisition of such financial assets.

(1) In relation to the original financial asset on the basis of which the assessee becomes entitled to any additional financial assets, cost of acquisition means the amount actually paid for acquiring the original financial assets.

(2) In relation to any right to renounce the said entitlement to subscribe to the financial asset, when such a right is renounced by the assessee in favour of any person, cost of acquisition shall be taken to be *nil* in the case of such assessee.

(3) In relation to the financial asset, to which the assessee has subscribed on the basis of the said entitlement, cost of acquisition means the amount actually paid by him for acquiring such asset.

(4) In relation to the financial asset allotted to the assessee without any payment and on the basis of holding of any other financial assets, cost of acquisition shall be taken to be nil in the case of such assessee. In other words, where bonus shares are allotted without any payment on the basis of holding of original shares, the cost of such bonus shares will be nil in the hands of the original shareholder. However, in respect of bonus shares

allotted before 1.4.81, although the cost of acquisition of the shares is nil, the assessee may opt for the fair market value as on 1.4.81 as the cost of acquisition of such bonus shares.

(5) In the case of any financial asset purchased by the person in whose favour the right to subscribe to such assets has been renounced, cost of acquisition means the aggregate of the amount of the purchase price paid by him to the person renouncing such right and the amount paid by him to the company or institution for acquiring such financial asset.

(6) In relation to equity shares allotted to a shareholder of a recognised stock exchange in India under a scheme for demutualisation or corporatisation approved by SEBI, the cost of acquisition shall be the cost of acquiring his original membership of the exchange.

(7) The cost of a capital asset, being trading or clearing rights of a recognised stock exchange acquired by a shareholder (who has been allotted equity share or shares under such scheme of demutualisation or corporatisation), shall be deemed to be nil.

(v) Any other capital asset - (1) Where the capital asset become the property of the assessee before 1-4-1981 cost of acquisition means the cost of acquisition of the asset to the assessee or the fair market value of the asset on 1-4-1981 at the option of the assessee.

(2) Where the capital asset became the property of the assessee by any of the modes specified in section 49(1), it is clear that the cost of acquisition to the assessee will be the cost of acquisition to the previous owner. Even in such cases, where the capital asset became the property of the previous owner before 1-4-1981, the assessee has got a right to opt for the fair market value as on 1-4-1981.

(3) Where the capital asset became the property of the assessee on the distribution of the capital assets of a company on its liquidation and the assessee has been assessed to capital gains in respect of that asset under section 46, the cost of acquisition means the fair market value of the asset on the date of distribution.

(4) A share or a stock of a company may become the property of an assessee under the following circumstances :

(a) the consolidation and division of all or any of the share capital of the company into shares of larger amount than its existing shares.

(b) the conversion of any shares of the company into stock,

(c) the re-conversion of any stock of the company into shares,

(d) the sub-division of any of the shares of the company into shares of smaller amount, or

(e) the conversion of one kind of shares of the company into another kind.

In the above circumstances the cost of acquisition to the assessee will mean the cost of acquisition of the asset calculated with reference to the cost of acquisition of the shares or stock from which such asset is derived.

(vi) Where the cost for which the previous owner acquired the property cannot be ascertained, the cost of acquisition to the previous owner means the fair market value on the date on which the capital asset became the property of the previous owner.

Illustration 9

ABC Ltd., converts its capital asset acquired for an amount of Rs.50,000 in June, 1991 into stock-in-trade in the month of November, 2005. The fair market value of the asset on the date of conversion is Rs.2,00,000. The stock-in-trade was sold for an amount of Rs.3,50,000 in the month of December, 2009. What will be the tax treatment?

Financial year	Cost Inflation Index
1991-92	199
2005-06	497
2009-10	632

Solution

The capital gains on the sale of the capital asset converted to stock-in-trade is taxable in the given case as the conversion was done after April 1, 1985. It arises in the year of conversion (i.e. P.Y. 2005-06) but will be taxable only in the year in which the stock-in-trade is sold (i.e. P.Y. 2009-10). Profits from business will also be taxable in the year of sale of the stock-in-trade (i.e. P.Y. 2009-10).

Gross Total Income for the A.Y.2010-11 is calculated as under:

Particulars	Rs	Rs
Profits and Gains from Business or Profession		
Sale proceeds of the stock-in-trade	3,50,000	
Less : Cost of the stock-in-trade (FMV on the date of conversion)	2,00,000	1,50,000

Long Term Capital Gains

Full value of the consideration (FMV on the date of the conversion)	2,00,000	
Less : Indexed cost of acquisition (50,000 x 497/199)	1,24,874	75,126
Gross Total Income		2,25,126

Note: For the purpose of indexation, the cost inflation index of the year in which the asset is converted into stock-in-trade should be considered.

Illustration 10

Ms.Usha purchases 1,000 equity shares in X Ltd. at a cost of Rs.15 per share (brokerage 1%) in January 1978. She gets 100 bonus shares in August 1980. She again gets 550 bonus shares by virtue of her holding on February 1985. Fair market value of the shares of X Ltd. on April 1, 1981 is Rs.25. In January 2010, she transfers all her shares @ Rs.120 per share (brokerage 2%).

Compute the capital gains taxable in the hands of Ms. Usha for the assessment year 2010-11 assuming:

(a) X Ltd is an unlisted company and securities transaction tax was not applicable at the time of sale.

(b) X ltd is a listed company and the shares are sold in a recognised stock exchange and securities transaction tax was paid at the time of sale.

Financial year	Cost Inflation Index
1981-82	100
1984-85	125
2009-10	632

Solution

(a) Computation of capital gains for the A.Y. 2010-11.

Particulars	Rs
1000 Original shares	
Sale proceeds (1000 × Rs.120)	1,20,000
Less : Brokerage paid (2% of Rs.1,20,000)	2,400
Net sale consideration	1,17,600

Less : Indexed cost of acquisition [Rs.25 × 1000 × 632/100]	1,58,000
Long term capital loss (A)	40,400
100 Bonus shares	
Sale proceeds (100 × Rs.120)	12,000
Less : Brokerage paid (2% of Rs.12,000)	240
Net sale consideration	11,760
Less : Indexed cost of acquisition [Rs.25 × 100 × 632/100] [note]	15,800
Long term capital loss (B)	4,040
550 Bonus shares	
Sale proceeds (550 × Rs.120)	66,000
Less: Brokerage paid (2% of Rs.66,000)	1,320
Net sale consideration	64,680
Less: Cost of acquisition	NIL
Long term capital gain (C)	64,680
∴ **Long term capital gain (A+B+C)**	**20,240**

Note: Cost of acquisition of bonus shares acquired before 1.4.1981 is the FMV as on 1.4.1981 (being the higher of the cost or the FMV as on 1.4.1981).

(b) The long-term capital gains on transfer of equity shares through a recognized stock exchange on which securities transaction tax is paid is exempt from tax under section 10(38). Hence, the taxable capital gain is Nil.

Illustration 11

On January 31, 2010, Mr. A has transferred self-generated goodwill of his profession for a sale consideration of Rs.70,000 and incurred expenses of Rs.5,000 for such transfer. You are required to compute the capital gains chargeable to tax in the hands of Mr. A for the assessment year 2010-11.

Solution

The transfer of self-generated goodwill of profession is not chargeable to tax. It is based upon the Supreme Court's ruling in *CIT vs. B.C. Srinivasa Setty*. Hence, there is no taxable capital gains.

Illustration 12

Mr. R holds 1000 shares in Star Minus Ltd., an unlimited company, acquired in the year 1981-82 at a cost of Rs.25,000. He has been offered right shares by the company in the month of August, 2009 at Rs.40 per share, in the ratio of 2 for every 5 held. He retains 50% of the rights and renounces the balance right shares in favour of Mr. Q for Rs.10 per share in September 2009. All the shares are sold of by Mr. R for Rs.170 per share in January 2010 and Mr. Q sells his shares in December 2009 at Rs.130 per share.

What are the capital gains taxable in the hands of Mr.R and Mr.Q?

Financial year	Cost Inflation Index
1981-82	100
2009-10	632

Solution

Computation of capital gains in the hands of Mr. R for the A.Y.2010-11

Particulars	Rs
1000 Original shares	
Sale proceeds (1000 × Rs.170)	1,70,000
Less : Indexed cost of acquisition [Rs.25,000 × 632/100]	1,58,000
Long term capital gain (A)	12,000
200 Right shares	
Sale proceeds (200 × Rs.170)	34,000
Less : Cost of acquisition [Rs.40 × 200] [note 1]	8,000
Short term capital gain (B)	26,000
200 Right shares renounced in favour of Mr. Q	
Sale proceeds (200 × Rs.10)	2,000
Less : Cost of acquisition [note 2]	NIL
Short term capital gain (C)	2,000
∴ **Capital Gains (A+B+C)**	**40,000**

Note 1: Since the holding period of these shares is less than 1 year, they are short term capital assets and hence cost of acquisition will not be indexed.

Note 2: The cost of the rights renounced in favour of another person for a consideration is taken to be nil. The consideration so received is taxed as short-term capital gains in full. The period of holding is taken from the date of the rights offer to the date of the renouncement.

Computation of capital gains in the hands of Mr. Q for the A.Y.2010-11

Particulars	Rs
200 shares :	
Sale proceeds (200 × Rs.130)	26,000
Less : Cost of acquisition [200 shares × (Rs.10 + Rs.40)] [note]	10,000
Short term capital gain	16,000

Note: The cost of the rights is the amount paid to Mr. R as well as the amount paid to the company. Since the holding period of these shares is less than 1 year, they are short term capital assets and hence, cost of acquisition should not be indexed.

4.15 COMPUTATION OF CAPITAL GAINS IN CASE OF DEPRECIABLE ASSET [SECTION 50]

(i) Section 50 provides for the computation of capital gains in case of depreciable assets. It may be noted that where the capital asset is a depreciable asset forming part of a block of assets, section 50 will have overriding effect in spite of anything contained in section 2(42A) which defines a short-term capital asset.

Accordingly, where the capital asset is an asset forming part of a block of assets in respect of which depreciation has been allowed, the provisions of sections 48 and 49 shall be subject to the following modification:

Where the full value of consideration received or accruing for the transfer of the asset plus the full value of such consideration for the transfer of any other capital asset falling with the block of assets during previous year exceeds the aggregate of the following amounts namely:

(1) expenditure incurred wholly and exclusively in connection with such transfer;

(2) WDV of the block of assets at the beginning of the previous year;

(3) the actual cost of any asset falling within the block of assets acquired during the previous year

such excess shall be deemed to be the capital gains arising from the transfer of short-term capital assets.

Where all assets in a block are transferred during the previous year, the block itself will cease to exist. In such a situation, the difference between the sale value of the assets and the WDV of the block of assets at the beginning of the previous year together with the actual cost of any asset falling within that block of assets acquired by the assessee during the previous year will be deemed to be the capital gains arising from the transfer of short-term capital assets.

(ii) Cost of acquisition in case of power sector assets [Section 50A]

With respect to the power sector, in case of depreciable assets referred to in section 32(1)(i), the provisions of sections 48 and 49 shall apply subject to the modification that the WDV of the asset (as defined in section 43(6)), as adjusted, shall be taken to be the cost of acquisition.

4.16 CAPITAL GAINS IN RESPECT OF SLUMP SALES [SECTION 50B]

(i) Any profits or gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of long-term capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

Short term capital gains - Any profits and gains arising from such transfer of one or more undertakings held by the assessee for not more than thirty-six months shall be deemed to be short-term capital gains [Sub-section (1)].

(ii) The net worth of the undertaking or the division, as the case may be, shall be deemed to be the cost of acquisition and the cost of improvement for the purposes of sections 48 and 49 in relation to capital assets of such undertaking or division transferred by way of such sale and the provisions contained in the second proviso to section 48 shall be ignored [Sub-section (2)].

(iii) Every assessee in the case of slump sale shall furnish in the prescribed form along with the return of income, a report of a chartered accountant indicating the computation of net worth of the undertaking or division, as the case may be, and certifying that the net worth of the undertaking or division has been correctly arrived at in accordance with the provisions of this section [Sub-section (3)].

Explanation 1 to the section defines the expression "net worth" as the aggregate value of total assets of the undertaking or division as reduced by the value of liabilities of such undertaking or division as appearing in the books of account. However, any change in the value of assets on account of revaluation of assets shall not be considered for this purpose.

Explanation 2 provides that the aggregate value of total assets of such undertaking or division shall be as follows:

(i) In the case of depreciable assets: the written down value of block of assets determined in accordance with the provisions contained in sub-item (C) of item (i) of section 43(6)(c);

(ii) In case of capital assets in respect of which the whole of the expenditure has been allowed or is allowable as a deduction under section 35AD : Nil;

(ii) for all other assets : Book value.

4.17 SPECIAL PROVISION FOR FULL VALUE OF CONSIDERATION IN CERTAIN CASES [SECTION 50C]

(i) Where the consideration received or accruing as a result of transfer of a capital asset, being land or building or both, is less than the value adopted or assessed *or assessable* by any authority of a State Government (Stamp Valuation Authority) for the purpose of payment of stamp duty in respect of such asset, such value adopted or assessed *or assessable* shall be deemed to be the full value of the consideration received or accruing as a result of such transfer. [Sub-section (1)].

(ii) Where the assessee claims before an Assessing Officer that the value so adopted or assessed *or assessable* by the authority for payment of stamp duty exceeds the fair market value of the property as on the date of transfer and the value so adopted or assessed *or assessable* by such authority has not been disputed in any appeal or revision or no reference has been made before any other authority, court or High Court, the Assessing Officer may refer the valuation of the capital asset to a valuation officer as defined in section 2(r) of the Wealth-tax Act, 1957. Where any reference has been made before any other authority, Court or the High Court, the provisions of section 16A (relating to reference to Valuation Officer), section 23A (dealing with appealable orders before Commissioner (Appeals), section 24 (order of Appellate Tribunal), section 34AA (appearance by registered valuer), section 35 (rectification of mistakes) and section 37 (power to take evidence on oath) of the Wealth-tax Act, 1957, shall, with necessary

modifications, apply in relation to such reference as they apply in relation to a reference made by the Assessing Officer under sub-section (1) of section 16A of that Act [Sub-section (2)].

(iii) Where the value ascertained by such valuation officer exceeds the value adopted or assessed *or assessable* by the Stamp authority the value adopted or assessed *or assessable* shall be taken as the full value of the consideration received or accruing as a result of the transfer [Sub-section (3)].

(iv) The term "assessable" has been added to cover transfers executed through power of attorney. The term 'assessable' has been defined to mean the price which the stamp valuation authority would have, notwithstanding anything to the contrary contained in any other law for the time being in force, adopted or assessed, if it were referred to such authority for the purposes of the payment of stamp duty.

4.18 ADVANCE MONEY RECEIVED [SECTION 51]

It is possible for an assessee to receive some advance in regard to the transfer of capital asset. Due to the break-down of the negotiation, the assessee may have retained the advance. Section 51 provides that while calculating capital gains, the above advance retained by the assessee must go to reduce the cost of acquisition. However, if advance has been received and retained by the previous owner and not the assessee himself, then the same will not go to reduce the cost of acquisition of the assessee.

Illustration 13

Mr. Kay purchases a house property on April 10, 1978 for Rs.35,000. The fair market value of the house property on April 1, 1981 was Rs.70,000. On August 31, 1984, Mr. Kay enters into an agreement with Mr. Jay for sale of such property for Rs.1,20,000 and received an amount of Rs.10,000 as advance. However, as Mr. Jay did not pay the balance amount, Mr. Kay forfeited the advance. In May 1987, Mr. Kay constructed the first floor by incurring a cost of Rs.50,000. Subsequently, in September 1987, Mr. Kay gifted the house to his friend Mr. Dee. On February 10, 2010, Mr. Dee sold the house for Rs.8,00,000.

Financial year	Cost Inflation Index
1981-1982	100
1984-1985	125
1987-1988	150
2009-2010	632

You are required to compute the capital gains taxable in the hands of Mr. Dee for the assessment year 2010-11.

Solution

Computation of taxable capital gains of Mr.Dee for A.Y.2010-11

Particulars	Rs.
Sale consideration	8,00,000
Less: Indexed cost of acquisition (note)	2,94,933
Indexed cost of improvement (note)	2,10,667
Long-term capital gain	2,94,400

Note: For the purpose of capital gains, holding period is considered from the date on which the house was purchased by Mr. Kay, till the date of sale. However, indexation of cost of acquisition is considered from the date on which the house was gifted by Mr. Kay to Mr. Dee, till the date of sale. i.e. from September 1987 (P.Y. 1987-88) to February 2010 (P.Y. 2009-10).

Indexed cost of acquisition = $\frac{70,000}{150} \times 632$ = Rs.2,94,933

Indexed cost of improvement = $\frac{50,000}{150} \times 632$ = Rs.2,10,667

Amount forfeited by previous owner, Mr. Kay, will not be considered.

Illustration 14

Mr.X purchases a house property in December 1975 for Rs.1,25,000 and an amount of Rs.75,000 was spent on the improvement and repairs of the property in March, 1981. The property was proposed to be sold to Mr.Z in the month of May, 2003 and an advance of Rs.40,000 was taken from him. As the entire money was not paid in time, Mr.X forfeited the advance and subsequently sold the property to Mr.Y in the month of March, 2010 for Rs.25,00,000. The fair value of the property on April 1, 1981 was Rs.3,90,000. What is the capital gain chargeable in the hands of Mr.X for the A.Y. 2010-11?

Financial year	Cost Inflation Index
1981-82	100

2003-04	463
2009-10	632

Solution

Capital gains in the hands of Mr. X for the A.Y. 2010-11 is computed as under:

Particulars	Rs
Sale proceeds	25,00,000
Less : Indexed cost of acquisition [Note 1]	22,12,000
Indexed cost of improvement [Note 2]	-
Long term capital gains	2,88,000
Note 1: Computation of indexed cost of acquisition	
Cost of acquisition (higher of Fair market value as on April 1, 1981 and the actual cost of acquisition)	3,90,000
Less : Advance taken and forfeited	40,000
Cost for the purposes of indexation	3,50,000
Indexed cost of acquisition (Rs.3,50,000 x 632/100)	22,12,000

Note 2 : Any improvement cost incurred prior to 1.4.1981 is to be ignored when fair market value as on 1.4.1981 is taken into consideration.

4.19 EXEMPTION OF CAPITAL GAINS

(i) Capital Gains on sale of residential house [Section 54]

Eligible assessees – Individual & HUF

Conditions to be fulfilled

- There should be a transfer of residential house (buildings or lands appurtenant thereto)
- It must be a long-term capital asset
- Income from such house should be chargeable under the head "Income from house property"
- A new residential house should be –

- purchased within 1 year before or 2 years after the date of transfer (or)
- constructed within a period of 3 years after the date of transfer.

Quantum of Exemption

- If cost of new residential house = Capital gains, entire capital gains is exempt.
- If cost of new residential house < Capital gains, capital gains to the extent of cost of new residential house is exempt

Examples

- Example 1 - If the capital gains is Rs.5 lakhs and the cost of the new house is Rs.7 lakhs, then the entire capital gains of Rs.5 lakhs is exempt.
- Example 2 - If capital gains is Rs.5 lakhs and cost of new house is Rs.3 lakhs, then capital gains is exempt only upto Rs.3 lakhs. Balance Rs.2 lakhs is taxable @ 20%.

Consequences of transfer of new asset before 3 years

- If the new asset is transferred before 3 years from the date of its acquisition, then cost of the asset will be reduced by capital gains exempted earlier for computing short-term capital gains.
- Continuing Example 1, if the new house was sold after 2 years for Rs.8 lakhs, then short term capital gain chargeable to tax would be –

Net Consideration		8,00,000
Less: Cost of acquisition	7,00,000	
Less: Capital gains exempt earlier	5,00,000	2,00,000
Short term capital gains chargeable to tax		6,00,000

Illustration 15

Mr. Cee purchased a residential house on July 20, 2007 for Rs.10,00,000 and made some additions to the house incurring Rs.2,00,000 in August 2007. He sold the house property in April 2009 for Rs.20,00,000. Out of the sale proceeds, he spent Rs.5,00,000 to purchase another house property in September 2009.

Financial year	Cost Inflation Index
2006-07	519

2007-08	551
2009-10	632

What is the amount of capital gains taxable in the hands of Mr. Cee for the assessment year 2010-11?

Solution

The house is sold before 36 months from the date of purchase. Hence, the house is a short-term capital asset and no benefit of indexation would be available.

Particulars	Rs.
Sale consideration	20,00,000
Less: Cost of acquisition	10,00,000
Cost of improvement	2,00,000
Short-term capital gains	**8,00,000**

Note: The exemption of capital gains under section 54 is available only in case of long-term capital asset. As the house is short-term capital asset, Mr. Cee cannot claim exemption under section 54. Thus, the amount of taxable short-term capital gains is Rs.8,00,000.

(ii) Capital Gains on transfer of agricultural land [Section 54B]

Eligible assessee – Individual

Conditions to be fulfilled

- There should be a transfer of urban agricultural land.
- Such land must have been used for agricultural purposes either by the assessee himself or his parents in the 2 immediately preceding years.
- He should purchase another agricultural land (urban or rural) within 2 years from the date of transfer.

Quantum of exemption

- If cost of new agricultural land = Capital gains (short-term or long-term), entire capital gains is exempt.
- If cost of new agricultural land < Capital gains (short-term or long-term), capital gains to the extent of cost of new agricultural land is exempt.

Examples

- Example 1 - If the capital gains is Rs.3 lakhs and the cost of the new agricultural land is Rs.4 lakhs, then the entire capital gains of Rs.3 lakhs is exempt.
- Example 2 - If capital gains is Rs.3 lakhs and cost of new agricultural land is Rs.2 lakhs, then capital gains is exempt only upto Rs.2 lakhs.

Consequences of transfer of new agricultural land before 3 years

- If the new agricultural land is transferred before 3 years from the date of its acquisition, then cost of the land will be reduced by capital gains exempted earlier for computing short-term capital gains.
- However, if the new agricultural land is a rural agricultural land, there would be no capital gains on transfer of such land.

Continuing Example 1, if the new agricultural land (urban land) is sold after, say, 2 years for Rs.6 lakhs, then short term capital gain chargeable to tax would be –

Net consideration		6,00,000
Less: Cost of new agricultural land		
Cost of acquisition	4,00,000	
Less: Capital gains exempt earlier	3,00,000	
		1,00,000
Short-term capital gains chargeable to tax		**5,00,000**

(iii) Capital Gains on transfer by way of compulsory acquisition of land and building [Section 54D]

Eligible assessee – Any assessee

Conditions to be fulfilled

- There must be compulsory acquisition of land and building forming part of an industrial undertaking.
- The land and building should have been used by the assessee for purposes of the business of the industrial undertaking in the 2 years immediately preceding the date of transfer.
- The assessee must purchase any other land or building or construct any building (for shifting or re-establishing the existing undertaking or setting up a new industrial undertaking) within 3 years from the date of transfer.

Quantum of exemption

- If cost of new asset = Capital gains, entire capital gains (short-term or long-term) is exempt.
- If cost of new asset < Capital gains, capital gains (short-term or long-term) to the extent of cost of new asset is exempt.

Consequences of transfer of new asset before 3 years

- If the new asset is transferred before 3 years from the date of its acquisition, then cost of the asset will be reduced by capital gains exempted earlier for computing short-term capital gains

Illustration 16

PQR Ltd., purchased a building for industrial undertaking in May 2003, at a cost of Rs.4,00,000. The above property was compulsorily acquired by the State Government at a compensation of Rs.7,00,000 in the month of January, 2010. The compensation was received in March, 2010. The company purchased another building for its industrial undertaking at a cost of Rs.1,00,000 in the month of March, 2010. What is the amount of the capital gains chargeable to tax in the hands of the company for the A.Y. 2010-11?

Financial year	Cost Inflation Index
2003-04	463
2009-10	632

Solution

Computation of capital gains in the hands of PQR Ltd. for the A.Y.2010-11

Particulars	Rs
Sale proceeds (Compensation received)	7,00,000
Less : Indexed cost of acquisition [Rs.4,00,000 × 632/463]	5,46,004
	1,53,996
Less : Exemption under section 54D (Cost of acquisition of new undertaking)	1,00,000
Taxable long term capital gain	**53,996**

(iv) Capital Gains not chargeable on investment in certain bonds [Section 54EC]

Eligible assessee – Any assessee

Conditions to be fulfilled

- There should be transfer of a long-term capital asset.
- Such asset can also be a depreciable asset held for more than 36 months.
- The capital gains arising from such transfer should be invested in a long-term specified asset within 6 months from the date of transfer.
- Long-term specified asset means specified bonds, redeemable after 3 years, issued by the National Highways Authority of India (NHAI) or the Rural Electrification Corporation Limited (RECL).
- The assessee should not transfer or convert or avail loan or advance on the security of such bonds for a period of 3 years from the date of acquisition of such bonds.

Other points

- In case of conversion of capital asset into stock in trade and subsequent sale of stock in trade - period of 6 months to be reckoned from the date of sale of stock in trade for the purpose of section 54EC exemption [CBDT Circular No.791 dated 2-6-2000].
- Receipt of money on liquidation of company – is chargeable to tax in the hands of shareholders [Section 46(2)] – However, there is no transfer of capital asset in such a case – Therefore, exemption under section 54EC is not available – *CIT v. Ruby Trading Co. (P) Ltd. 259 ITR 54 (Raj.)*

Quantum of exemption

- Capital gains or amount invested in specified bonds, whichever is lower.

Violation of condition

- In case of transfer or conversion of such bonds or availing loan or advance on security of such bonds before the expiry of 3 years, the capital gain exempted earlier shall be taxed as long-term capital gain in the year of violation of condition.

(v) Capital gains in cases of investment in residential house [Section 54F]

Eligible assessees: Individuals / HUFs

Conditions to be fulfilled

- There must be transfer of a long-term capital asset, not being a residential house.
- Transfer of plot of land is also eligible for exemption

- The assessee should -
  - Purchase a residential house within a period of 1 year before or 2 years after the date of transfer; or
  - Construct a residential house within 3 years from the date of transfer.
- The assessee should not own more than one residential house on the date of transfer.
- The assessee should not –
  - purchase any other residential house within a period of one year or
  - construct any other residential house within a period of 3 years

  from the date of transfer of the original asset.

Quantum of exemption

- If cost of new residential house = Net sale consideration of original asset, entire capital gains is exempt.
- If cost of new residential house < Net sale consideration of original asset, only proportionate capital gains is exempt i.e.

$$LTCG \times \frac{\text{Amount invested in new residential house}}{\text{Net sale consideration}}$$

Illustration 17

From the following particulars, compute the taxable capital gains of Mr.D for A.Y.2010-11-

Cost of jewellery [Purchased in F.Y.1990-91]	Rs.1,82,000
Sale price of jewellery sold in Jan 2010	Rs.7,50,000
Expenses on transfer	Rs.7,000
Residential house purchased in March 2010	Rs.5,00,000

Solution

Computation of taxable capital gains for A.Y.2010-11

Particulars	Rs.
Gross consideration	7,50,000
Less: Expenses on transfer	7,000

Net consideration		7,43,000
Less: Indexed cost of acquisition	$1{,}82{,}000 \times \frac{632}{182}$	6,32,000
		1,11,000
Less: Exemption u/s 54F	$1{,}11{,}000 \times \frac{5{,}00{,}000}{7{,}43{,}000}$	74,697
Taxable capital gains		**36,303**

Consequences if the new house is transferred within a period of 3 years

- Short-term capital gains would arise on transfer of the new house; and
- The capital gains exempt earlier under section 54F would be taxable as long-term capital gains.

In the given illustration, if the new residential house is sold for Rs.6,00,000 after say, 1 year, then

- Rs.1,00,000 [i.e. Rs.6,00,000 (-) Rs.5,00,000] would be chargeable as short-term capital gain of that year in which the new house is sold.
- Rs.74,697, being the capital gains exempt earlier, would be taxable as long-term capital gains of that year in which the new house is sold.

(vi) Capital gains for shifting of industrial undertaking from urban areas [Section 54G]

Eligible assessees: Any assessee

Conditions to be fulfilled

- There should be a shifting of the industrial undertaking from an urban area to any other area
- There should be a transfer of machinery, plant, building or land or any right in building or land used for the business of an industrial undertaking situated in an urban area.

- Such transfer should be in the course of or in consequence of shifting the industrial undertaking from an urban area to any other area.
- The capital gain (short-term or long-term) should be utilized for any of the following purposes within 1 year before or 3 years after the date of transfer –
  - purchase of new plant and machinery
  - acquisition of building or land or construction of building
  - expenses on shifting of the industrial undertaking from the urban area to the other area
  - such other expenditure as the Central Government may specify

Quantum of exemption

- If cost of new assets plus expenses incurred for the specified purpose = Capital gains, entire capital gains (short-term or long-term) is exempt.
- If cost of new assets plus expenses incurred for the specified purpose < Capital gains, capital gains (short-term or long-term) to the extent of such cost and expenses is exempt.

Consequences if the new asset is transferred within a period of 3 years

- If the new asset is transferred within a period of 3 years of its purchase or construction, then the capital gain, which was exempt earlier under section 54G would be deducted from the cost of acquisition of the new asset for the purpose of computation of short-term capital gains in respect of the transfer of the new asset

(vii) Exemption of capital gains on transfer of certain capital assets in case of shifting of an industrial undertaking from an urban area to any SEZ [Section 54GA]

Eligible assesses – Any assessee

Conditions to be fulfilled

- There must be transfer of capital assets
- Such transfer must be effected in the course of, or in consequence of the shifting of an industrial undertaking from an urban area to any SEZ, whether developed in an urban area or not.
- 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.

- The assessee should, within a period of 1 year before or 3 years after the date of transfer,
  - purchase machinery or plant for the purposes of business of the industrial undertaking in the SEZ;
  - acquire building or land or construct building for the purposes of his business in the SEZ;
  - shift the industrial undertaking and transfer the establishment of such undertaking to the SEZ; and
  - incur expenses for such other purposes as may be specified in a scheme framed by the Central Government.

Quantum of exemption

- If cost of new assets plus expenses incurred for shifting = Capital gains, entire capital gains (short-term or long-term) is exempt.
- If cost of new assets plus expenses incurred for shifting < Capital gains, capital gains (short-term or long-term) to the extent of such cost and expenses is exempt.

Consequences if the new asset is transferred within a period of 3 years

- If the new asset is transferred within a period of 3 years of its purchase or construction, then the capital gain, which was exempt earlier under section 54G would be deducted from the cost of acquisition of the new asset for the purpose of computation of short-term capital gains in respect of the transfer of the new asset.

(viii) Capital Gains Account Scheme (CGAS)

Under sections 54, 54B, 54D, 54F, 54G and 54GA, capital gains is exempt to the extent of investment of such gains / net consideration (in the case of section 54F) in specified assets within the specified time. If such investment is not made before the date of filing of return of income, then the capital gain or net consideration (in case of exemption under section 54F) has to be deposited under the CGAS.

Time limit - Such deposit in CGAS should be made before filing the return of income or on or before the due date of filing the return of income, whichever is earlier. Proof of such deposit should be attached with the return. The deposit can be withdrawn for utilization for the specified purposes in accordance with the scheme.

Consequences if the amount deposited in CGAS is not utilized within the stipulated time of 2 years / 3 years - If the amount deposited is not utilized for the specified purpose within the stipulated period, then the **unutilized amount shall be charged as capital gain** of the previous year in which the specified period expires. In the case of section 54F, proportionate amount will be taxable.

CBDT Circular No.743 dated 6.5.96 clarifies that in the event of death of an individual before the stipulated period, the unutilized amount is not chargeable to tax in the hands of the legal heirs of the deceased individual. Such unutilized amount is not income but is a part of the estate devolving upon them.

(ix) Extension of time for acquiring new asset or depositing or investing amount of Capital Gain [Section 54H]

In case of compulsory acquisition of the original asset, where the compensation is not received on the date of transfer, the period available for acquiring a new asset or making investment in CGAS under sections 54, 54B, 54D, 54EC and 54F would be considered from *the date of receipt of such compensation* and not from the date of the transfer.

4.20 REFERENCE TO VALUATION OFFICER [SECTION 55A]

Section 55A provides that the Assessing Officer may refer the valuation of a capital asset to a Valuation Officer in the following circumstances with a view to ascertaining the fair market value of the capital asset for the purposes of capital gains -

(i) In a case where the value of the asset as claimed by the assessee is in accordance with the estimate made by a registered valuer, if the Assessing Officer is of the opinion that the value so claimed is less than its fair market value.

(ii) If the Assessing Officer is of the opinion that the fair market value of the asset exceeds the value of the asset as claimed by the assessee by more than 15% of the value of asset as claimed or by more than Rs.25,000 of the value of the asset as claimed by the assessee.

(iii) The Assessing Officer is of the opinion that, having regard to the nature of asset and other relevant circumstances, it is necessary to make the reference.

Where any such reference is made as per this section, the provisions of section 16A of the Wealth-tax Act shall be applicable in relation to such reference as they apply in relation to a reference made by the Assessing Officer under section 16A of that Act.

4.21 SHORT TERM CAPITAL GAINS TAX IN RESPECT OF EQUITY SHARES/UNITS OF AN EQUITY ORIENTED FUND [SECTION 111A]

(i) This section provides for a concessional rate of tax (i.e. 15%) on the short-term capital gains on transfer of -

(1) an equity share in a company or

(2) a unit of an equity oriented fund.

(ii) The conditions for availing the benefit of this concessional rate are –

(1) the transaction of sale of such equity share or unit should be entered into on or after 1.10.2004, being the date on which Chapter VII of the Finance (No. 2) Act, 2004 came into force; and

(2) such transaction should be chargeable to securities transaction tax under the said Chapter.

(iii) The proviso to this section provides that in the case of resident individuals or HUF, if the basic exemption is not fully exhausted by any other income, then the short-term capital gain will be reduced by the unexhausted basic exemption limit and only the balance would be taxed at 15%. However, the benefit of availing the basic exemption limit is not available in the case of non-residents.

(iv) Deductions under Chapter VI-A cannot be availed in respect of such short-term capital gains on equity shares of a company or units of an equity oriented mutual fund included in the total income of the assessee.

The expression "equity oriented fund" has the same meaning assigned to it in the explanation to section 10(38) of the Act i.e. "Equity oriented fund" means a fund –

(1) where the investible funds are invested by way of equity shares in domestic companies to the extent of more than 65% of the total proceeds of such fund; and

(2) which has been set up under a scheme of a Mutual Fund specified under clause (23D).

4.22 TAX ON LONG-TERM CAPITAL GAINS [SECTION 112]

(i) Where the total income of an assessee includes long-term capital gains, tax is payable by the assessee @20% on such long-term capital gains. The treatment of long-term capital gains in the hands of different types of assessees are as follows -

(1) Resident individual or Hindu undivided family:

Income-tax payable at normal rates on total income as reduced by long-term capital gains plus 20% on such long-term capital gains.

However, where the total income as reduced by such long-term capital gains is below the maximum amount which is not chargeable to income-tax then such long-term capital gains shall be reduced by the amount by which the total income as so reduced falls short of the maximum amount which is not chargeable to income-tax and the tax on the balance of such long-term capital gains will be calculated @ 20%.

(2) Domestic Company:

Long-term capital gains will be charged @ 20%.

(3) Non-corporate non-resident / foreign company:

Long-term capital gains will be charged @20%.

(4) Residents (other than those included in (i) above)

Long-term capital gains will be charged @20%.

(ii) The proviso to section 112 states that where the tax payable in respect of any income arising from the transfer of listed securities or units or zero coupon bonds, being long-term capital assets, exceeds 10% of the amount of capital gains before indexation, then such excess shall be ignored while computing the tax payable by the assessee.

(iii) For this purpose, "listed securities" means securities as defined by section 2(h) of the Securities Contracts (Regulation) Act, 1956; and "unit" means unit of a mutual fund specified under section 10(23D) or of the Unit Trust of India.

(iv) The provisions of section 112 make it clear that the deductions under chapter VIA cannot be availed in respect of the long-term capital gains included in the total income of the assessee.

4.23 EXEMPTION OF LONG TERM CAPITAL GAINS ON SALE OF EQUITY SHARES/ UNITS OF AN EQUITY ORIENTED FUND [SECTION 10(38)]

(i) Section 10(38) exempts long term capital gains on sale of equity shares of a company or units of an equity oriented fund on or after 1.10.2004, being the date on which Chapter VII of the Finance (No.2) Act, 2004 comes into force.

(ii) This exemption is available only if such transaction is chargeable to securities transaction tax.

(iii) However, such long term capital gains exempt under section 10(38) shall be taken into a account in computing the book profit and income tax payable under section 115JB.

(iv) For the purpose of this clause, "Equity oriented fund" means a fund –

(1) where the investible funds are invested by way of equity shares in domestic companies to the extent of more than 65% of the total proceeds of such fund; and

(2) which has been set up under a scheme of Mutual Fund specified under clause (23D).

(v) The percentage of equity share holding of the fund should be computed with reference to the annual average of the monthly averages of the opening and closing figures.

4.24 SECURITIES LENDING AND BORROWING SCHEME

Securities and Exchange Board of India (SEBI) vide Circular No. MRD/DoP/SE/DEP/Cir. 14/2007, dated 20-12-2007, has decided to permit all classes of investors (individuals, institutional, etc.) to short sell. Further, with a view to provide a mechanism for borrowing of securities to enable settlement of securities sold short, SEBI has also decided to put in place a full-fledged Securities Lending and Borrowing (SLB) Scheme for all market participants in the Indian securities market under the overall framework of Securities Lending Scheme, 1997 of SEBI.

In this context, the following taxation issues have arisen in respect of transactions under the scheme of securities lending -

(i) Would the lending/borrowing of securities under the Securities Lending Scheme amount to a transfer under section 2(47) in the hands of the lender?

(ii) Would lending/borrowing of the securities be subject to Securities Transaction Tax (STT)?

The Lending and Borrowing of Securities under the new scheme notified by SEBI vide Circular No. MRD/DoP/SE/DEP/Cir.14/2007, dated 20-12-2007 is in accordance with the overall framework of the Securities Lending Scheme of 1997. Accordingly, the provisions of section 47(xv) will be equally applicable in respect of the transactions under the new scheme.

Securities Transaction Tax (STT) is levied on purchase or sale of an equity share, unit and derivative, under such circumstances as specified in section 98 of the Finance (No. 2) Act, 2004. The transactions in the nature of lending and borrowing under the new scheme do not fall within the scope of section 98 to the Finance (No.2) Act, 2004. Therefore, the transactions of lending and borrowing are not liable to Securities Transaction Tax (STT).

Self-examination questions

1. Distribution of assets at the time of liquidation of a company -

   (a) is not a transfer in the hands of the company or the shareholders

   (b) is not a transfer in the hands of the company but capital gains is chargeable to tax on such distribution in the hands of the shareholders

   (c) is not a transfer in the hands of the shareholders but capital gains is chargeable to tax on such distribution in the hands of the company.

2. For an assessee, who is a salaried employee who invests in shares, what is the benefit available in respect of securities transaction tax paid by him on sale of 100 listed shares of X Ltd. which has been held by him for 14 months before sale?

   (a) Rebate u/s 88E is allowable in respect of securities transaction tax paid

   (b) Securities transaction tax paid is treated as expenses of transfer and deducted from sale consideration.

   (c) Long term capital gains is completely exempt under section 10(38)

3. Under section 50C, the guideline value for stamp duty is taken as the full value of consideration only if -

   (a) the asset transferred is building and the actual consideration is less than the guideline value

   (b) the asset transferred is either land or building or both and the actual consideration is less than the guideline value

   (c) the asset transferred is building, irrespective of the actual consideration.

4. When there is a reduction of capital by a company and amounts are distributed to shareholders,

   (a) the entire distribution is subject to capital gains tax.

   (b) the entire distribution is subject to tax under the head “Income from other sources”.

   (c) The distribution attributable to accumulated profits is chargeable as deemed dividend and distribution attributable to capital is subject to capital gains tax.

5. Where there is a transfer of a capital asset by a partner to the firm by way of capital contribution or otherwise, the consideration would be taken as -

   (a) The market value of the capital asset on the date of transfer

   (b) The cost less notional depreciation of the capital asset

   (c) The value of the asset recorded in the books of the firm.

6. Under section 54EC, capital gains are exempted if invested in the bonds issued by NHAI & RECL -

   (a) within a period of 6 months from the date of transfer of the asset

   (b) within a period of 6 months from the end of the previous year

   (c) within a period of 6 months from the end of the previous year or the due date for filing the return of income under section 139(1), whichever is earlier

7. If an assessee receives advance money in any earlier occasion of transfer, which is forfeited, since the transfer eventually did not materialize, then such forfeited amount would be -

   (a) taxable in the year of receipt

   (b) deducted from the cost of acquisition of the asset or fair market value or written down value, as the case may be

   (c) exempt from taxation

8. Any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 77A of the Companies Act, 1956 -

   (a) shall be regarded as dividend

   (b) shall not be regarded as dividend but capital gains tax liability is attracted in the hands of the shareholder

   (c) shall neither be regarded as dividend nor will it attract capital gains tax in the hands of the shareholder.

9. Discuss the conditions to be satisfied for claiming exemption of tax in respect of -

   (a) Capital gains on compulsory acquisition of agricultural land situated within specified urban limits

   (b) Capital gains on sale of listed equity shares/units of an equity oriented fund.

10. Write short notes on -

    (i) Capital gains in the case of slump sale under section 50B

    (ii) Reference to Valuation Officer under section 55A

11. What is the tax treatment, under the Income-tax Act, of capital gains arising on transfer of assets in case of shifting of industrial undertaking from an urban area to any special economic zone? Discuss.

12. List ten transactions which are not regarded as transfer for the purpose of capital gains. Discuss the provisions relating to the same.

Answers

1. b; **2.** c; **3.** b; **4.** c; **5**. c; **6.** a; **7.** b; **8.** b

UNIT – 5 : INCOME FROM OTHER SOURCES

Learning Objectives

After studying this unit, you would be able to understand -

- which are the income chargeable under the head "Income from other sources"
- what are meant by bond washing transactions and dividend stripping
- what is the rate of tax applicable on casual income
- what are the admissible deductions while computing income under this head
- what are the inadmissible deductions while computing income under this head
- what is the relevance of method of accounting while computing the income under this head.

5.1 INTRODUCTION

Any income, profits or gains includible in the total income of an assessee, which cannot be included under any of the preceding heads of income, is chargeable under the head 'Income from other sources'. Thus, this head is the residuary head of income and brings within its scope all the taxable income, profits or gains of an assessee which fall outside the scope of any other head. Therefore, when any income, profit or gain does not fall precisely under any of the other specific heads but is chargeable under the provisions of the Act, it would be charged under this head.

5.2 INCOMES CHARGEABLE UNDER THIS HEAD [SECTION 56]

(i) The following income shall be chargeable only under the head 'Income from other sources':

(1) Dividend income [covered by sections 2(22)(a) to (e)].

(2) Casual income in the nature of winning from lotteries, crossword puzzles, horse races, card games and other games of any sort, gambling, betting etc. Such winnings are chargeable to tax at a flat rate of 30% under section 115BB.

(3) Any sum of money, received without consideration by an individual or a HUF from any person or persons *before 1.10.2009* , if the aggregate value exceeds Rs.50,000 i.e. where any sum of money is received without consideration by an individual or a Hindu undivided family from any person or persons and the aggregate value of all such sums received during the previous year exceeds Rs.50,000, the whole of the

aggregate value of such sum shall be included in the total income of such individual or Hindu undivided family under the head "Income from other sources".

In order to avoid hardships in genuine cases, certain sums of money received have been exempted –

(1) any sum received from any relative; or

(2) any sum received on the occasion of the marriage of the individual; or

(3) any sum received under a will or by way of inheritance; or

(4) any sum received in contemplation of death of the payer; or

(5) any local authority; or

(6) any fund or foundation or university of other educational institution or hospital or other medical institution or any trust or institution referred to in section 10(23C); or

(7) any trust or institution registered under section 12AA.

For the purpose of this clause, the expression "relative" means –

(i) spouse of the individual,

(ii) brother or sister of the individual,

(iii) brother or sister of the spouse of the individual,

(iv) brother or sister of either of the parents of the individual,

(v) any lineal ascendant or descendant of the individual,

(vi) any lineal ascendant or descendant of the spouse of the individual, and

(vii) spouse of a person referred to in items (2) to (6) mentioned above.

(4) Gift of any sum of money or property or transfer of property for inadequate consideration on or after 1st October, 2009 to be subject to tax in the hands of the recipient

(i) New clause (vii) has been inserted in section 56(2) w.e.f. 1.10.2009 to bring within its scope, in addition to any sum of money, the value of any property received without consideration or for inadequte consideration. For this purpose, "property" means immovable property being land or building or both, shares and securities, jewellery, archaeological collections, drawings, paintings, sculptures or any work of art.

(ii) If an immovable property is received without consideration, the stamp duty value of such property would be taxed as the income of the recipient if it exceeds Rs.50,000.

In case an immovable property is received for inadequate consideration, and the difference between the stamp duty value and such consideration exceeds Rs.50,000, such difference would be taxed as the income of the recipient.

(iii) If the stamp duty value of immovable property is disputed by the assessee, the Assessing Officer may refer the valuation of such property to a Valuation Officer. In such a case, the provisions of section 50C and section 155(15) shall, as far as may be, apply for determining the value of such property.

(iv) If movable property is received without consideration, the aggregate fair market value of such property on the date of receipt would be taxed as the income of the recipient if it exceeds Rs.50,000. In case movable property is received for inadequate consideration, and the difference between the aggregate fair market value and such consideration exceeds Rs.50,000, such difference would be taxed as the income of the recipient. The CBDT would prescribe the method of determination of fair market value of a movable property.

(v) The table below summarises the new scheme of taxability of gifts with effect from 1st October, 2009 -

	Nature of asset	**Particulars**	**Taxable value**
1	Money	Without consideration	The whole amount if the same exceeds Rs.50,000.
2	Immovable property	Without consideration	The stamp value of the property, if it exceeds Rs.50,000.
3	Immovable property	Inadequate consideration	The difference between the stamp value and the consideration, if such difference exceeds Rs.50,000
4	Movable property	Without consideration	The aggregate fair market value of the property, if it exceeds Rs.50,000.
5	Movable property	Inadequate consideration	The difference between the aggregate fair market value and the consideration, if such difference exceeds Rs.50,000

(vi) However, any sum of money or value of property received -

(a) from any relative; or

(b) on the occasion of the marriage of the individual; or

(c) under a will or by way of inheritance; or

(d) in contemplation of death of the payer or donor, as the case may be; or

(e) from any local authority as defined in the Explanation to section 10(20); or

(f) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in section 10(23C); or

(g) from any trust or institution registered under section 12AA

would be outside the ambit of section 56(2)(vii).

Illustration 1

Mr. Z received the following gifts during the P.Y.2009-10 from his friend Mr.Y, -

(1) Cash gift of Rs.1,00,000 on his birthday, 19th June, 2009.

(2) 50 shares of B Ltd., the fair market value of which was Rs.1,00,000, on his birthday, 19th June, 2009.

(3) 100 shares of A Ltd., the fair market value of which was Rs.55,000 on the date of transfer. This gift was received on the occasion of Diwali. Mr.Y had originally purchased the shares on 1.7.2009 at a cost of Rs.40,000.

Further, on 17th December, 2009, Mr.Z purchased land from his brother's father-in-law for Rs.3,50,000. The stamp value of land was Rs.5,00,000.

On 1st March, 2010, he sold the 100 shares of A Ltd. for Rs.80,000

Compute the income of Mr.Z chargeable under the head "Income from other sources" and "Capital Gains" for A.Y.2010-11.

Solution

Computation of "Income from Other Sources" of Mr.Z for A.Y.2010-11

	Particulars		Rs.
(1)	Cash gift received before 1.10.2009 is taxable u/s 56(2)(vi) since it exceeds Rs.50,000		1,00,000
(2)	Value of shares of B Ltd. gifted by Mr.Y on 19th June, 2009 is not taxable since only gift of property after 1st October, 2009 is chargeable to tax u/s 56(2)(vii).		-
(3)	Fair market value of shares of A Ltd. is taxable since the gift was made after 1st October, 2009 and the aggregate fair market value exceeds Rs.50,000.		55,000
(4)	Purchase of land for inadequate consideration on 17.12.2009 would attract the provisions of section 56(2)(vii), since the difference between the stamp value and consideration exceeds Rs.50,000. Brother's father-in-law does not fall within the definition of "relative" u/s 56(2).		
	Stamp Value	5,00,000	
	Less: Consideration	3,50,000	1,50,000
Income from Other Sources			**3,05,000**

Computation of "Capital Gains" of Mr.Z for the A.Y.2010-11

Sale Consideration	80,000
Less: Cost of acquisition [deemed to be the fair market value charged to tax under section 56(2)(vii)]	55,000
Short-term capital gains	**25,000**

(5) Interest received on compensation/enhanced compensation deemed to be income in the year of receipt and taxable under the head "Income from Other Sources" [Sections 56(2)(viii)]

(i) As per section 145(1), income chargeable under the head "Profits and gains of business or profession" or "Income from other sources", shall be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

(ii) Further, the Hon'ble Supreme Court has, in Rama Bai v. CIT (1990) 181 ITR 400, held that arrears of interest computed on delayed or on enhanced compensation shall be taxable on accrual basis. The tax payers are facing genuine difficulty on account of this ruling, since the interest would have accrued over a number of years, and consequently the income of all the years would undergo a change.

(iii) Therefore, to remove this difficulty, clause (b) has been inserted in section 145A to provide that the interest received by an assessee on compensation or on enhanced compensation shall be deemed to be his income for the year in which it is received, irrespective of the method of accounting followed by the assessee.

(iv) Clause (viii) has been inserted in section 56(2) to provide that income by way of interest received on compensation or on enhanced compensation referred to in clause (b) of section 145A shall be assessed as "Income from other sources" in the year in which it is received.

(ii) The following income are chargeable under the head "Income from other sources" only if such income are not chargeable under the head "Profits and gains of business or profession" -

(1) Any sum received by an employer-assessee from his employees as contributions to any provident fund, superannuation fund or any other fund for the welfare of the employees

(2) Interest on securities

(3) Income from letting out on hire, machinery, plant or furniture.

(4) Where letting out of buildings is inseparable from the letting out of machinery, plant or furniture, the income from such letting.

(iii) Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy is chargeable under the head "Income from other sources" if

such income is not chargeable under the head "Profits and gains if business or profession" or under the head "Salaries" i.e. if such sum is received by any person other than the employer who took the policy and the employee in whose name the policy was taken.

(iv) Any income chargeable to tax under the Act, but not falling under any other head of income shall be chargeable to tax under the head "Income from other sources" e.g. Salary received by an MPs/MLAs will not be chargeable to income-tax under the head 'Salary' but will be chargeable as "Income from other sources" under section 56.

5.3 BOND WASHING TRANSACTIONS AND DIVIDEND STRIPPING [SECTION 94]

(i) A bond-washing transaction is a transaction where securities are sold some time before the due date of interest and reacquired after the due date is over. This practice is adopted by persons in the higher income group to avoid tax by transferring the securities to their relatives/friends in the lower income group just before the due date of payment of interest. In such a case, interest would be taxable in the hands of the transferee, who is the legal owner of securities. In order to discourage such practice, section 94(1) provides that where the owner of a security transfers the security just before the due date of interest and buys back the same immediately after the due date and interest is received by the transferee, such interest income will be deemed to be the income of the transferor and would be taxable in his hands.

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

(iii) Section 94(7) provides that where

(a) any person buys or acquires any securities or unit within a period of three months prior to the record date and

(b) such person sells or transfers –

  (1) such securities within a period of three months after such date, or

  (2) such unit within a period of nine months after such date and

(c) the dividend or income on such securities or unit received or receivable by such person is exempted,

then, the loss, if any, arising therefrom shall be ignored for the purposes of computing his income chargeable to tax. Such loss should not exceed the amount of dividend or income received or receivable on such securities or unit.

5.4 APPLICABLE RATE OF TAX IN RESPECT OF CASUAL INCOME [SECTION 115BB]

(i) This section provides that income by way of winnings from lotteries, crossword puzzles, races including horse races or card games and other games of any sort or from gambling or betting of any form would be taxed at a flat rate of 30% plus surcharge, if applicable, plus education cess plus secondary and higher education cess.

(ii) No expenditure or allowance can be allowed from such income.

(iii) Deduction under Chapter VI-A is not allowable from such income.

(iv) Adjustment of unexhausted basic exemption limit is also not permitted against such income.

5.5 DEDUCTIONS ALLOWABLE [SECTION 57]

The income chargeable under the head "Income from other sources" shall be computed after making the following deductions:

(i) In the case of dividends (other than dividends referred to in section 115-O) or interest on securities, any reasonable sum paid by way of commission or remuneration to a banker or any other person for the purpose of realising such dividend or interest on behalf of the assessee.

(ii) Where the income consists of recovery from employees as contribution to any provident fund etc. in terms of clause (x) of section 2(24), then, a deduction will be allowed in accordance with the provisions of section 36(1)(va) i.e. to the extent the contribution is remitted before the due date under the respective Acts.

(iii) Where the income to be charged under this head is from letting on hire of machinery, plant and furniture, with or without building, the following items of deductions are allowable in the computation of such income:

(a) the amount paid on account of any current repairs to the machinery, plant or furniture.

(b) the amount of any premium paid in respect of insurance against risk of damage or destruction of the machinery or plant or furniture.

(c) the normal depreciation allowance in respect of the machinery, plant or furniture, due thereon.

(iv) In the case of income in the nature of family pension, a deduction of a sum equal to $33\frac{1}{3}$ per cent of such income or Rs.15,000, whichever is less, is allowable. For the purposes of this deduction "family pension" means a regular monthly amount payable by the employer to a person belonging to the family of an employee in the event of his death.

(v) Any other expenditure not being in the nature of capital expenditure laid out or expended wholly and exclusively for the purpose of making or earning such income.

(vi) 50% of income by way of compensation/enhanced compensation received chargeable to tax under section 56(2)(viii). No deduction would be allowable under any other clause of section 57 in respect of such income.

Illustration 2

Interest on enhanced compensation received by Mr.G during the previous year 2009-10 is Rs.5,00,000. Out of this interest, Rs.1,50,000 relates to the previous year 2006-07, Rs.1,65,000 relates to previous year 2007-08 and Rs.1,85,000 relates to previous year 2008-09. Discuss the tax implication, if any, of such interest income for A.Y.2010-11.

Solution

The entire interest of Rs.5,00,000 would be taxable in the year of receipt, namely, P.Y.2009-10.

Particulars	Rs.
Interest on enhanced compensation taxable u/s 56(2)(viii)	5,00,000
Less: Deduction under section 57(iv) @50%	2,50,000
Interest chargeable under the head "Income from other sources"	**2,50,000**

Note - The Supreme Court held in *CIT* v. *Rajindra Prasad Moody [1978] 115 ITR 519*, that in order to claim deduction under section 57 in respect of any expenditure, it is not necessary that income should in fact have been earned as a result of the expenditure. In this view of the matter, the Court held that the interest on money borrowed for investment in shares which had not yielded any taxable dividend was admissible as a deduction under section 57 under the head, "Income from other sources".

5.6 DEDUCTIONS NOT ALLOWABLE [SECTION 58]

No deduction shall be made in computing the "Income from other sources" of an assessee in respect of the following items of expenses:

(i) In the case of any assessee:

(1) any personal expense of the assessee;

(2) any interest chargeable to tax under the Act which is payable outside India on which tax has not been paid or deducted at source.

(3) any payment taxable in India as salaries, if it is payable outside India unless tax has been paid thereon or deducted at source.

(ii) In addition to these disallowances, section 58(2) specifically provides that the disallowance of payments to relatives and associate concerns and disallowance of payment *or aggregate of payments* exceeding Rs.20,000 made to a person during a day otherwise than by account payee cheque or draft covered by section 40A will be applicable to the computation of income under the head 'Income from other sources' as well.

(iii) Income-tax and wealth-tax paid.

(iv) No deduction in respect of any expenditure or allowance in connection with income by way of earnings from lotteries, cross word puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever shall be allowed in computing the said income.

The prohibition will not, however, apply in respect of the income of an assessee, being the owner of race horses, from the activity of owning and maintaining such horses. In respect of the activity of owning and maintaining race horses, expenses incurred shall be allowed even in the absence of any stake money earned. Such loss shall be allowed to be carried forward in accordance with the provisions of section 74A.

5.7 DEEMED INCOME CHARGEABLE TO TAX [SECTION 59]

The provisions of section 41(1) are made applicable, so far as may be, to the computation of income under this head. Accordingly, where a deduction has been made in respect of a loss, expenditure or liability and subsequently any amount is received or benefit is derived in respect of such expenditure incurred or loss or trading liability allowed as deduction, then it shall be deemed as income in the year in which the amount is received or the benefit is accrued.

5.8 METHOD OF ACCOUNTING [SECTION 145]

Income chargeable under the head "Income from other sources" has to be computed in accordance with the cash or mercantile system of accounting regularly employed by the

assessee. However, deemed dividend u/s 2(22)(e) is chargeable to tax on payment basis under section 8, irrespective of the method of accounting followed by the assessee.

Self-examination questions

1. Income from letting of machinery, plant and furniture is -
   a) always chargeable to tax under the head "Profits and gains of business and profession"
   b) always chargeable to tax under the head "Income from other sources"
   c) chargeable under the head "Income from other sources" only if not chargeable under the head "Profits and gains of business and profession".
2. In respect of winnings from lottery, crossword puzzle or race including horse race or card game etc.
   a) no deduction under Chapter VI-A is allowed and basic exemption limit cannot be exhausted.
   b) no deduction under Chapter VI-A but unexhausted basic exemption can be exhausted.
   c) Both deduction under Chapter VI-A and basic exemption are allowed.
3. The deduction allowable in respect of family pension taxable under "Income from other sources" is
   a) 33-1/3% of the pension
   b) 30% of the pension or Rs.15,000, whichever is less
   c) 33-1/3% of the pension or Rs.15,000, whichever is less
4. Deemed dividend under section 2(22)(e) is chargeable to tax -
   a) On the basis of method of accounting regularly employed by the assessee
   b) On the basis of mercantile system of accounting only
   c) On payment basis as prescribed under section 8 of the Income-tax Act.
5. Ganesh received Rs.60,000 from his friend on the occasion of his birthday.
   a) The entire amount of Rs.60,000 is taxable.
   b) Rs.25,000 is taxable.

c) The entire amount is exempt.

6. Write short notes on -

a) Bond washing transactions

b) Dividend stripping

7. State the incomes which are chargeable only under the head "Income from other sources".

8. Which are incomes chargeable under the head "Income from other sources" only if they are not chargeable under the head "Profits and gains of business or profession"?

9. What are the deductions allowable from the following income -

a) Dividend

b) Income from letting on hire machinery, plant or furniture.

10. What are the inadmissible deductions while computing income under the head "Income from other sources".

11. Karan's bank account shows the following deposits during the financial year 2009-10. Compute his total income for the A.Y. 2010-11, assuming that his income from house property (computed) is Rs.62,000.

(i)	Gift from his sister in Amsterdam	Rs.2,30,000
(ii)	Gift from his friend on his birthday	Rs.10,000
(iii)	Dividend from shares of various Indian companies	Rs.12,600
(iv)	Gift from his mother's friend on his engagement	Rs.25,000
(v)	Gift from his fianceé	Rs.75,000
(vi)	Interest on bank deposits	Rs.25,000

Answers

1. c; **2.** a; **3.** c; **4.** c; **5.** a

11. Rs.1,97,000

CHAPTER 5

INCOME OF OTHER PERSONS INCLUDED IN ASSESSEE'S TOTAL INCOME

Learning Objectives

After studying this chapter, you would be able to understand -

- why clubbing provisions have been incorporated in the Act
- when clubbing provisions are attracted
- when income of the spouse is clubbed with the income of the individual
- when income of son's wife is clubbed in the hands of the individual.
- that minor's income has to be clubbed in the hands of the parent
- the nature of income of minor, in respect of which clubbing provisions are not attracted
- when income of HUF is clubbed in the hands of a member of the HUF.

1. CLUBBING OF INCOME – AN INTRODUCTION

Under the Income-tax Act, 1961, an assessee is generally taxed in respect of his own income. However, there are certain cases where as assessee has to pay tax in respect of income of another person. The provisions for the same are contained in sections 60 to 65 of the Act. These provisions have been enacted to counteract the tendency on the part of the tax-payers to dispose of their property or transfer their income in such a way that their tax liability can be avoided or reduced.

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

2. TRANSFER OF INCOME WITHOUT TRANSFER OF THE ASSET [SECTION 60]

(i) If any person transfers the income from any asset without transferring the asset itself, such income is to be included in the total income of the transferor.

(ii) It is immaterial whether the transfer is revocable or irrevocable and whether it was made before the commencement of this Act or after its commencement.

(iii) For example, Mr.A confers the right to receive rent in respect of his house property on his wife, Mrs.A, without transferring the house itself to her. In this case, the rent received by Mrs.A will be clubbed with the income of Mr.A.

3. INCOME ARISING FROM REVOCABLE TRANSFER OF ASSETS [SECTION 61]

(i) All income arising to any person by virtue of a revocable transfer of assets is to be included in the total income of the transferor.

(ii) As per section 63, the transfer is deemed to be revocable if—

(a) it contains any provision for the retransfer, directly or indirectly, of the whole or any part of the income or assets to the transferor, or

(b) it gives, in any way to the transferor, a right to reassume power, directly or indirectly, over the whole or any part of the income or the assets.

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

4. EXCEPTIONS WHERE CLUBBING PROVISIONS ARE NOT ATTRACTED EVEN IN CASE OF REVOCABLE TRANSFER [SECTION 62]

Section 61 will not apply in the following two cases -

(i) **Transfer not revocable during the life time of the beneficiary or the transferee -** If there is a transfer of asset which is not revocable during the life time of the transferee, the income from the transferred asset is not includible in the total income of the transferor provided the transferor derives no direct or indirect benefit from such income. If the transferor receives direct or indirect benefit from such income, such income is to be included in his total income even though the transfer may not be revocable during the life time of the transferee.

(ii) **Transfer made before April 1, 1961 and not revocable for a period exceeding six years -** Income arising from the transfer of an asset before 1.4.61, which was not revocable for a period exceeding six years, is not includible in the total income of the transferor provided the transferor does not derive direct or indirect benefit from such income.

In both the above cases, as and when the power to revoke the transfer arises, the income arising by virtue of such transfer will be included in the total income of the transferor.

5. CLUBBING OF INCOME ARISING TO SPOUSE [SECTION 64(1)(ii)]

5.1 Income by way of remuneration from a concern in which the individual has substantial interest

(i) In computing the total income of any individual, all such income which arises, directly or indirectly, to the spouse of such individual by way of salary, commission, fees or any other form of remuneration, whether in cash or in kind, from a concern in which such individual has a substantial interest shall be included.

(ii) However, this provision does not apply where the earning spouse of the said individual possesses technical or professional qualifications and the income to the spouse is solely attributable to the application of his/her technical or professional knowledge or experience. In such an event, the income arising to such spouse is to be assessed in his/her hands.

(iii) Where both husband and wife have substantial interest in a concern and both are in receipt of income by way of salary etc. from the said concern, such income will be includible in the hands of that spouse, whose total income, excluding such income is higher.

(iv) Where any such income is once included in the total income of either spouse, income arising in the succeeding year shall not be included in the total income of the other spouse unless the Assessing Officer is satisfied, after giving that spouse an opportunity of being heard, that it is necessary to do so.

(v) An individual shall be deemed to have substantial interest in a concern under the following circumstances -

(a) If the concern is a company, equity shares carrying not less than 20% of the voting power are, at any time during the previous year, owned beneficially by such person or partly by such person and partly by one or more of his relatives.

(b) In any other case, if such person is entitled, or such person and one or more of his relatives are entitled in the aggregate, at any time during the previous year, to not less than 20% of the profits of such concern.

The term 'relative' in relation to an individual means the husband, wife, brother or sister or any lineal ascendant or descendant of that individual.

Illustration 1

Mr. A is an employee of X Ltd. and he has 25% shares of that company. His salary is Rs.50,000 p.m. Mrs. A is working as a computer software programmer in X Ltd. at a salary of Rs.30,000 p.m. She is, however, not qualified for the job. Compute the gross total income of Mr.A and Mrs. A for the A.Y.2010-11, assuming that they do not have any other income.

Solution

Mr.A is an employee of X Ltd and has 25% shares of X Ltd i.e. a substantial interest in the company. His wife is working in the same company without any professional qualifications for the same.

Thus, by virtue of the clubbing provisions of the Act, the salary received by Mrs. A from X Ltd. will be clubbed in the hands of Mr. A.

Computation of Gross total income of Mr. A

Salary received by Mr. A	[Rs.50,000 × 12]	Rs.6,00,000
Salary received by Mrs. A	[Rs.30,000 × 12]	Rs.3,60,000
Gross total income		**Rs.9,60,000**

The gross total income of Mrs. A is nil.

Illustration 2

Will your answer be different if Mrs. A was qualified for the job?

Solution

If Mrs.A possesses professional qualifications for the job, then the clubbing provisions shall not be applicable.

Gross total income of Mr. A = Salary received by Mr. A [Rs.50,000 × 12]=Rs.6,00,000

Gross total income of Mrs.A = Salary received by Mrs.A [Rs.30,000×12]=Rs.3,60,000

Illustration 3

Mr. B is an employee of Y Ltd. and has substantial interest in the company. His salary is Rs.20,000 p.m. Mrs. B is also working in Y Ltd. at a salary of Rs.12,000 p.m. without any qualifications. Mr. B also receives Rs.30,000 as interest on securities. Mrs. B owns a house property which she has let out. Rent received from tenants is Rs.6000 p.m. Compute the gross total income of Mr. B and Mrs. B for the A.Y.2010-11.

Solution

Since Mrs. B is not professionally qualified for the job, the clubbing provisions shall be applicable.

Computation of Gross total income of Mr.B

		Rs.
Income from Salary		
Salary received by Mr.B	[Rs.20,000 × 12]	2,40,000
Salary received by Mrs.B	[Rs.12,000 × 12]	1,44,000
		3,84,000
Income from other sources		
Interest on securities		30,000
		4,14,000

Computation of Gross total income of Mrs.B

		Rs.	Rs.
Income from Salary [clubbed in the hands of Mr. B]			Nil
Income from house property			
Gross Annual Value	[Rs.6,000 × 12]	72,000	
Less: Municipal taxes paid		-	
Net Annual Value (NAV)		**72,000**	
Less: Deductions u/s 24			
- 30% of NAV i.e. 30% of Rs.72,000		21,600	
- Interest on loan		-	50,400
Gross total income			**50,400**

5.2 INCOME ARISING TO THE SPOUSE FROM AN ASSET TRANSFERRED WITHOUT ADEQUATE CONSIDERATION [SECTION 64(1)(iv)]

(i) Where there is a transfer of an asset (other than house property), directly or indirectly, from one spouse to the other, otherwise than for adequate consideration or in connection with an agreement to live apart, any income arising to the transferee from the transferred asset, either directly or indirectly, shall be included in the total income of the transferor.

(ii) In the case of transfer of house property, the provisions are contained in section 27. If an individual transfers a house property to his spouse, without adequate consideration or otherwise than in connection with an agreement to live apart, the transferor shall be deemed to be the owner of the house property and its annual value will be taxed in his hands.

(iii) It may be noted that any income from the accretion of the transferred asset is not to be clubbed with the income of the transferor.

(iv) The income arising on transferred assets alone have to be clubbed. However, income earned by investing such income (arising from transferred asset) cannot be clubbed.

(v) It is also to be noted that natural love and affection do not constitute adequate consideration. Therefore, where an asset is transferred without adequate consideration, the income from such asset will be clubbed in the hands of the transferor.

(vi) Where the assets transferred, directly or indirectly, by an individual to his spouse are invested by the transferee in the business, proportionate income arising from such investment is to be included in the total income of the transferor. If the investment is in the nature of contribution of capital, proportionate interest on capital will be clubbed with the income of the transferor. Such proportion has to be computed by taking into account the value of the aforesaid investment as on the first day of the previous year to the total investment in the business by the transferee as on that day.

6. TRANSFER OF ASSETS FOR THE BENEFIT OF THE SPOUSE [SECTION 64(1)(vii)] - All income arising directly or indirectly to any persons or association of persons, from the assets transferred, directly or indirectly, without adequate consideration is includible in the income of the transferor to the extent such income is used by the transferee for the immediate or deferred benefit of the transferor's spouse.

7. INCOME ARISING TO SON'S WIFE FROM THE ASSETS TRANSFERRED WITHOUT ADEQUATE CONSIDERATION BY THE FATHER-IN-LAW OR MOTHER-IN-LAW [SECTION 64(1)(vi)]

(i) Where an asset is transferred, directly or indirectly, by an individual to his or her son's wife without adequate consideration, the income from such asset is to be included in the total income of the transferor.

(ii) For this purpose, where the assets transferred directly or indirectly by an individual to his son's wife are invested by the transferee in the business, proportionate income arising from such investment is to be included in the total income of the transferor. If the investment is in the nature of contribution of capital, the proportionate interest on capital will be clubbed with the income of the transferor. Such proportion has to be computed by taking into account the value of the aforesaid investment as on the first day of the previous year to the total investment in the business by the transferee as on that day.

8. TRANSFER OF ASSETS FOR THE BENEFIT OF SON'S WIFE [SECTION 64(1)(viii)] - All income arising directly or indirectly, to any person or association of persons from the assets transferred, directly or indirectly, without adequate consideration will be included in the total income of the transferor to the extent such income is used by the transferee for the immediate or deferred benefit of the transferor's son's wife.

9. CLUBBING OF MINOR'S INCOME [SECTION 64(1A)]

(i) All income of a minor is to be included in the income of his parent.

(ii) However, the income derived by the minor from manual work or from any activity involving his skill, talent or specialised knowledge or experience will not be included in the income of his parent.

(iii) The income of the minor will be included in the income of that parent, whose total income is greater.

(iv) Once clubbing of minor's income is done with that of one parent, it will continue to be clubbed with that parent only, in subsequent years. The Assessing Officer, may, however, club the minor's income with that of the other parent, if, after giving the other parent an opportunity to be heard, he is satisfied that it is necessary to do so.

(v) Where the marriage of the parents does not subsist, the income of the minor will be includible in the income of that parent who maintains the minor child in the relevant previous year.

(vi) Section 10(32) provides that where the income of an individual includes the income of his minor child, the individual shall be entitled to exemption of such income subject to a maximum of Rs.1,500 per child. This provision is to provide relief to the individuals in whose total income, the income of the minor child is included.

(vii) However, the income of a minor child from suffering from any disability of the nature specified in section 80U shall not be included in the hands of the parent but shall be assessed in the hands of the child.

(viii) It may be noted that the clubbing provisions are attracted even in respect of income of minor married daughter.

Illustration 4

Mr. A has three minor children – two twin daughters and one son. Income of the twin daughters is Rs.2,000 p.a. each and that of the son is Rs.1,200 p.a. Compute the income, in respect of minor children, to be clubbed in the hands of Mr. A.

Solution

Taxable income, in respect of minor children, in the hands of Mr. A is

Twin minor daughters	[Rs.2,000 × 2]	Rs.4,000	
Less: Exempt u/s 10(32)	[Rs.1,500 × 2]	Rs.3,000	Rs.1,000
Minor son		Rs.1,200	
Less: Exempt u/s 10(32)		Rs.1,200	Nil
Income to be clubbed in the hands of Mr.A			**Rs.1,000**

10. CROSS TRANSFERS

In the case of cross transfers also (e.g., A making gift of Rs.50,000 to the wife of his brother B for the purchase of a house by her and a simultaneous gift by B to A's minor son of shares in a foreign company worth Rs.50,000 owned by him), the income from the assets transferred would be assessed in the hands of the deemed transferor if the transfers are so intimately connected as to form part of a single transaction, and each transfer constitutes consideration for the other by being mutual or otherwise. Thus, in the instant case, the transfers have been made by A and B to persons who are not their spouse or minor child so as to circumvent the provisions of this section, showing that such

transfers constituted consideration for each other.

The Supreme Court, in case of *CIT* v. *Keshavji Morarji [1967] 66 ITR 142,* observed that if two transactions are inter-connected and are parts of the same transaction in such a way that it can be said that the circuitous method was adopted as a device to evade tax, the implication of clubbing provisions would be attracted. Accordingly, the income arising to Mrs. B from the house property should be included in the total income of B and the dividend from shares transferred to A's minor son would be taxable in the hands of A. This is because A and B are the indirect transferors to their minor child and spouse respectively, of the income yielding assets, so as to reduce their burden of taxation.

11. CONVERSION OF SELF-ACQUIRED PROPERTY INTO THE PROPERTY OF A HINDU UNDIVIDED FAMILY [SECTION 64(2)]

Section 64(2) deals with the case of conversion of self-acquired property into property of a Hindu undivided family.

(i) Where an individual, who is a member of the HUF, converts at any time after 31-12-1969, his individual property into property of the HUF of which he is a member or throws such property into the common stock of the family or otherwise transfers such individual property, directly or indirectly, to the family otherwise than for adequate consideration, the income from such property shall continue to be included in the total income of the individual.

(ii) Where the converted property has been partitioned, either by way of total or partial partition, the income derived from such converted property as is received by the spouse on partition will be deemed to arise to the spouse from assets transferred indirectly by the individual to the spouse and consequently, such income shall also be included in the total income of the individual who effected the conversion of such property.

(iii) Where income from the converted property is included in the total income of an individual under section 64(2), it will be excluded from the total income of the family or, as the case may be, of the spouse of the individual.

12. INCOME INCLUDES LOSS

It is significant to note that as per the *Explanation 2* to section 64, 'income' would include 'loss'. Accordingly, where the specified income to be included in the total income of the individual is a loss, such loss will be taken into account while computing the total income of the individual. It is significant to note that this *Explanation* applies to clubbing provisions under both sections 64(1) and 64(2).

13. DISTINCTION BETWEEN SECTION 61 AND SECTION 64

It may be noted that the main distinction between the two sections is that section 61 applies only to a revocable transfer made by any person while section 64 applies to revocable as well as irrevocable transfers made only by individuals.

14. LIABILITY OF PERSON IN RESPECT OF INCOME INCLUDED IN THE INCOME OF ANOTHER PERSON [SECTION 65]

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

Self-examination questions

1. Income of a minor child suffering from any disability of the nature specified in section 80U is -
   a) to be assessed in the hands of the minor child
   b) to be clubbed with the income of that parent whose total income, before including minor's income, is higher
   c) completely exempt from tax
2. Income arising to a minor married daughter is -
   a) to be assessed in the hands of the minor married daughter
   b) to be clubbed with the income of that parent whose total income, before including minor's income, is higher
   c) completely exempt from tax
3. Where a member of a HUF has converted or transferred his self-acquired property for inadequate consideration into joint family property, income arising therefrom is taxable -
   a) as the income of the transferor-member
   b) in the hands of the HUF
   c) in the hands of the karta of the HUF

4. If such converted property is subsequently partitioned among the members of the family, the income derived from such converted property as is received by the spouse of the transferor will be taxable -

   a) as the income of the transferor-member

   b) as the income of the spouse of the transferor

   c) as the income of the HUF.

5. Exemption of a certain amount (not exceeding the income clubbed) is available under section 10(32), where a minor's income is clubbed with the income of the parent. The maximum exemption available is -

   a) upto Rs.1,200 in respect of each minor child

   b) upto Rs.1,500 in respect of each minor child

   c) upto Rs.2,000 in respect of each minor child

6. Write short notes on the following in the context of clubbing of income -

   a) Substantial interest

   b) Transfer and revocable transfer.

7. Under what circumstances can an income arising to the spouse of an individual be included in the income of the individual? Discuss.

8. State when the income arising to the son's wife can be included in the hands of the individual.

9. When can income arising to a minor child be clubbed in the hands of the father or mother? Discuss.

10. Discuss the tax consequences arising on conversion of self-acquired property into joint family property.

11. Compute the total income of Mr. & Mrs. A for the A.Y.2010-11 from the following information relevant for P.Y.2009-10 -

	Particulars	**Rs.**
(a)	Salary income (computed) of Mrs. A	2,30,000
(b)	Income from profession of Mr. A	3,90,000
(c)	Income of minor son B from company deposit	15,000

(d)	Income of minor daughter C from application of her painting skills	32,000
(e)	Interest from bank received by C on deposit made out of income earned by application of her painting skills	3,000
(f)	Gift received by C from friend of Mrs. A	2,500

12. A proprietory business was started by Smt. Poorna in the year 2007. As on 1.4.2008, her capital in business was Rs.3,00,000.

    Her husband gifted Rs.2,00,000, on 10.4.2008, which amount Smt. Poorna invested in her business on the same date. Smt. Poorna earned profits from her proprietory business for the P.Y.2008-09, Rs.1,50,000 and P.Y.2009-10, Rs.3,90,000. Compute the income to be clubbed in the hands of Poorna's husband for the A.Y.2010-11 with reasons.

Answers

1. a; **2.** b; **3.** a; **4.** a; **5.** b.

11. Mr.A – Rs.4,05,000; Mrs. A – Rs.2,30,000.

12. Rs.1,20,000.

CHAPTER 6

AGGREGATION OF INCOME, SET-OFF AND CARRY FORWARD OF LOSSES

Learning Objectives

After studying this chapter, you would be able to understand –

- the methodology of set-off / carry-forward and set-off of losses
- about inter-source adjustments and the cases where inter-source adjustment is not permitted
- about inter-head adjustments and the cases where inter-head adjustment is not permitted
- the conditions to be satisfied for carry forward and set-off of loss from house property
- the conditions to be satisfied for carry forward and set-off of business loss and speculation business loss
- the conditions to be satisfied for carry forward and set-off of business loss and unabsorbed depreciation in certain cases of amalgamation, demerger etc.
- the manner of inter-source and inter-head set-off in case of capital losses
- the maximum period for which different losses can be carried forward
- treatment of unabsorbed depreciation and business loss, where there is a change in the constitution of the firm
- treatment of unabsorbed depreciation and business loss in the case of closely held companies
- the order of set-off of losses

1. AGGREGATION OF INCOME

In certain cases, some amounts are deemed as income in the hands of the assessee though they are actually not in the nature of income. These cases are contained in sections 68, 69, 69A, 69B, 69C and 69D. These are discussed in detail in Unit 4 of Chapter 1. The Assessing Officer may require the assessee to furnish explanation in such cases. If the assessee does not offer any explanation or the explanation offered by

the assessee is not satisfactory, the amounts referred to in these sections would be deemed to be the income of the assessee. Such amounts have to be aggregated with the assessee's income.

2. CONCEPT OF SET-OFF AND CARRY FORWARD OF LOSSES

Specific provisions have been made in the Income-tax Act, 1961 for the set-off and carry forward of losses. In simple words, "Set-off" means adjustment of losses against the profits from another source/head of income in the same assessment year. If losses cannot be set-off in the same year due to inadequacy of eligible profits, then such losses are carried forward to the next assessment year for adjustment against the eligible profits of that year. The maximum period for which different losses can be carried forward for set-off has been provided in the Act.

3. INTER SOURCE ADJUSTMENT [SECTION 70]

(i) Under this section, the losses incurred by the assessee in respect of one source shall be set-off against income from any other source under the same head of income, since the income under each head is to be computed by grouping together the net result of the activities of all the sources covered by that head. In simpler terms, loss from one source of income can be adjusted against income from another source, both the sources being under the same head.

Example 1: Loss from one house property can be set off against the income from another house property.

Example 2: Loss from one business, say textiles, can be set off against income from any other business, say printing, in the same year as both these sources of income fall under one head of income. Therefore, the loss in one business may be set-off against the profits from another business in the same year.

(ii) Inter-source set-off, however, is not permissible in the following cases -

(a) Long-term capital loss -

(1) Where the net result in respect of any short term capital asset is a loss, such loss shall be allowed to be set-off against income, if any, for that assessment year under the head "capital gains" in respect of any other capital asset, and

(2) Where the net result in respect of any long-term capital asset is a loss, such loss shall be allowed to be set-off against income, if any, for that assessment year under

the head "capital gains" in respect of any other asset not being a short-term capital asset.

Thus, short-term capital loss is allowed to be set off against both short-term capital gain and long-term capital gain. However, long-term capital loss can be set-off only against long-term capital gain and not short-term capital gain.

(b) Speculation loss - A loss in speculation business can be set-off only against the profits of any other speculation business and not against any other business or professional income. However, losses from other business can be adjusted against profits from speculation business.

(c) Loss from the activity of owning and maintaining race horses - See section 74A(3) in para 12 of this chapter.

(iii) It must be noted that loss from an exempt source cannot be set-off against profits from a taxable source of income. For example, long-term capital loss on sale of shares sold through a recognized stock exchange cannot be set-off against long-term capital gains on sale of land.

4. INTER HEAD ADJUSTMENT [SECTION 71]

Loss under one head of income can be adjusted or set of against income under another head. However, the following points should be considered:

(i) Where the net result of the computation under any head of income (other than 'Capital Gains') is a loss, the assessee can set-off such loss against his income assessable for that assessment year under any other head, including 'Capital Gains'.

(ii) Where the net result of the computation under the head "Profits and gains of business or profession" is a loss, such loss cannot be set off against income under the head "Salaries".

(iii) Where the net result of computation under the head 'Capital Gains' is a loss, such capital loss cannot be set-off against income under any other head.

(iv) Speculation loss and Loss from the activity of owning and maintaining race horses cannot be set off against income under any other head.

Illustration 1

Mr. A submits the following particulars pertaining to the A.Y.2010-11:

Particulars	**Rs.**
Income from salary	4,00,000
Loss from self-occupied property	(-)70,000
Business loss	(-)1,00,000
Bank interest received	80,000

Compute the taxable income of Mr. A for the A.Y.2010-11.

Solution

Computation of taxable income of Mr. A for the A.Y. 2010-11

Particulars	**Amount (Rs)**	**Amount (Rs)**
Income from salary	4,00,000	
Income from house property	(-) 70,000	3,30,000
Business income	(-)1,00,000	
Income from other sources (bank interest)	80,000	
Business loss to be carried forward	(-) 20,000	-
Gross total income [See Note below]		**3,30,000**
Less: Deduction under chapter VIA		Nil
Taxable income		**3,30,000**

Note: Gross Total Income includes salary income of Rs.3,30,000 after adjusting house property loss. Business loss of Rs.1,00,000 is set off against bank interest of Rs.80,000 and remaining business loss of Rs.20,000 will be carried forward as it cannot be set off against salary income.

5. SET-OFF AND CARRY FORWARD OF LOSS FROM HOUSE PROPERTY [SECTION 71B]

(i) In any assessment year, if there is a loss under the head 'Income from house property', such loss will first be set-off against income from any other head during the same year.

(ii) If such loss cannot be so set-off, wholly or partly, the unabsorbed loss will be carried forward to the following assessment year to be set-off against income under the head 'Income from house property'.

(iii) The loss under this head is allowed to be carried forward upto 8 assessment years immediately succeeding the assessment year in which the loss was first computed.

(iv) For example, loss from one house property can be adjusted against the profits from another house property in the same assessment year. Any loss under the head 'Income from house property' can be set off against any income under any other head in the same assessment year. However, if after such set off, there is still any loss under the head "Income from house property", then the same shall be carried forward to the next year.

(v) It is to be remembered that once a particular loss is carried forward, it can be set off only against the income from the same head in the forthcoming assessment years.

6. CARRY FORWARD AND SET-OFF OF BUSINESS LOSSES [SECTIONS 72 & 80]

Under the Act, the assessee has the right to carry forward the loss in cases where such loss cannot be set-off due to the absence or inadequacy of income under any other head in the same year. The loss so carried forward can be set-off against the profits of subsequent previous years.

Section 72 covers the carry forward and set-off of losses arising from a business or profession.

Conditions

The assessee's right to carry forward business losses under this section is, however, subject to the following conditions:-

(i) The loss should have been incurred in business, profession or vocation.

(ii) The loss should not be in the nature of a loss in the business of speculation.

(iii) The loss may be carried forward and set-off against the income from business or profession though not necessarily against the profits and gains of the same business or profession in which the loss was incurred. But a loss carried forward cannot, under any circumstances, be set-off against the income from any head other than "Profits and gains of business or profession".

(iv) The loss can be carried forward and set off only against the profits of the assessee who incurred the loss. That is, only the person who has incurred the loss is entitled

to carry forward or set off the same. Consequently, the successor of a business cannot carry forward or set off the losses of his predecessor except in the case of succession by inheritance.

(v) A business loss can be carried forward for a maximum period of 8 assessment years immediately succeeding the assessment year in which the loss was incurred.

(vi) As per section 80, the assessee must have filed a return of loss under section 139(3) in order to carry forward and set off a loss. In other words, the non-filing of a return of loss disentitles the assessee from carrying forward the loss sustained by him. Such a return should be filed within the time allowed under section 139(1). However, this condition does not apply to a loss from house property carried forward under section 71B and unabsorbed depreciation carried forward under section 32(2).

Illustration 2

Mr. B, a resident individual, furnishes the following particulars for the P.Y. 2009-10:

Particulars	Rs.
Income from salary (Net)	45,000
Income from house property	(24,000)
Income from business – non-speculative	(22,000)
Income from speculative business	(4,000)
Short-term capital gains	(25,000)
Long-term capital gains	19,000

What is the total income chargeable to tax for the A.Y. 2010-11?

Solution

The total income chargeable to tax for the A.Y. 2010-11 is calculated as under:

Particulars	Amount (Rs)	Amount (Rs.)
Income from salaries	45,000	
Income from house property	(24,000)	21,000
Profits and gains of business and profession		
Business loss to be carried forward [Note 1]	(22,000)	
Speculative loss to be carried forward [Note 2]	(4,000)	

Capital Gains		
Long term capital gain	19,000	
Short term capital loss	(25,000)	
Short term capital loss to be carried forward [Note 3]	(6,000)	
Taxable income		**21,000**

Note 1: Business loss cannot be set-off against salary income. Therefore, loss of Rs.22,000 from the non-speculative business cannot be set off against the income from salaries. Hence, such loss has to be carried forward to the next year for set-off against business profits, if any.

Note 2: Loss of Rs.4,000 from the speculative business can be set off only against the income from the speculative business. Hence, such loss has to be carried forward.

Note 3: Short term capital loss can be set off against both short term capital gain and long term capital gain. Therefore, short term capital loss of Rs.25,000 can be set-off against long-term capital gains to the extent of Rs.19,000. The balance short term capital loss of Rs.6,000 cannot be set-off against any other income and has to be carried forward to the next year for set-off against capital gains, if any.

7. CARRY FORWARD AND SET-OFF OF ACCUMULATED BUSINESS LOSSES AND UNABSORBED DEPRECIATION ALLOWANCE IN CERTAIN CASES OF AMALGAMATION / DEMERGER, ETC. [SECTION 72A]

(i) Amalgamation - This section applies where there has been an amalgamation of –

(1) a company owning an industrial undertaking or a ship or a hotel with another company or an amalgamation of a banking company with a specified bank; or

(2) public sector companies engaged in the business of operation of aircrafts.

It provides that the accumulated loss and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or depreciation, as the case may be, of the amalgamated company for the previous year in which the amalgamation took place. Other provisions of the Act relating to set off and carry forward shall also apply accordingly.

Conditions for availing benefit under this section

(1) Conditions to be fulfilled by the amalgamating company

(i) The amalgamating company should have been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for 3 or more years.

(ii) The amalgamating company has held continuously as on the date of amalgamation, at least 3/4th of the book value of the fixed assets held by it, 2 years prior to the date of amalgamation.

(2) Conditions to be fulfilled by the amalgamated company

(i) The amalgamated company should hold at least 3/4th in the book value of fixed assets of the amalgamating company acquired as a result of amalgamation for a minimum period of 5 years from the effective date of amalgamation.

(ii) The amalgamated company continues the business of the amalgamating company for at least 5 years.

(iii) The amalgamated company must also fulfill such other conditions prescribed under Rule 9C for the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose -

(1) The amalgamated company shall achieve the level of production of at least 50% of the installed capacity (capacity as on the date of amalgamation) of the said undertaking before the end of 4 years from the date of amalgamation and continue to maintain the said minimum level of production till the end of 5 years from the date of amalgamation. Central Government has the power to modify this requirement on an application made by the amalgamated company.

(2) The amalgamated company shall furnish to the Assessing Officer a certificate in Form No.62 verified by a Chartered Accountant in this regard.

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

(ii) Demerger - Where there has been a demerger of an undertaking, the accumulated loss and the unabsorbed depreciation directly relatable to the undertaking transferred by the demerged company to the resulting company shall be allowed to be carried forward

and set off in the hands of the resulting company.

If the accumulated loss or unabsorbed depreciation is not directly relatable to the undertaking, the same will be apportioned between the demerged company and the resulting company in the same proportion in which the value of the assets have been transferred.

The Central Government is empowered to notify such conditions as it considers necessary to ensure that the demerger or amalgamation is for genuine business purpose.

(iii) Re-organisation of business [Section 72A(4)]

In case of re-organisation of business, whereby a firm is succeeded by a company as per the provisions of section 47(xiii), or a sole proprietary concern is succeeded by a company as per the provisions of section 47(xiv), then the accumulated business loss and the unabsorbed depreciation of the firm / proprietary concern, as the case may be, shall be deemed to be the loss or depreciation allowance of the successor company for the previous year in which the business re-organisation took place. Other provisions of the Act relating to set-off and carry forward will apply accordingly.

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

Meanings of certain terms

"Accumulated loss" means so much of the loss of the predecessor firm or the proprietary concern or the amalgamating company or the demerged company, as the case may be, under the head "Profit and gains of business or profession" (not being a loss sustained in a speculation business) which such predecessor firm or the proprietary concern or amalgamating company or demerged company, would have been entitled to carry forward and set off under the provisions of section 72 if the re-organisation of business or amalgamation or demerger had not taken place.

"Unabsorbed depreciation" means so much of the allowance for depreciation of the predecessor firm or the proprietary concern or the amalgamating company or the demerged company, as the case may be, which remains to be allowed and which would have been allowed to the predecessor firm or the proprietary concern or amalgamating company or demerged company, as the case may be, under the provisions of this Act, if

the re-organisation of business or amalgamation or demerger had not taken place.

"Industrial undertaking" means any undertaking which is engaged in -

(i) the manufacture or processing of goods;

(ii) the manufacture of computer software;

(iii) the business of generation or distribution of electricity or any other form of power;

(iv) providing telecommunication services, whether basic or cellular, including radio paging, domestic satellite service, network of trunking, broad band network and internet services.

(v) mining;

(vi) the construction of ships, aircraft or rail systems.

"Specified bank" means the State Bank of India (SBI) constituted under the SBI Act, 1955 or a subsidiary bank as defined in the SBI (Subsidiary Banks) Act, 1959 or a corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980.

8. SET-OFF OF LOSSES OF A BANKING COMPANY AGAINST THE PROFIT OF A BANKING INSTITUTION UNDER A SCHEME OF AMALGAMATION [SECTION 72AA]

(i) This section provides for carry forward and set off of accumulated loss and unabsorbed depreciation allowance of a banking company against the profits of a banking institution under a scheme of amalgamation sanctioned by the Central Government.

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

(iii) The *Explanation* to this section defines the expressions "accumulated loss", "banking company, "banking institution" and "unabsorbed depreciation" as follows –

(a) "accumulated loss" means so much of the loss of the amalgamating banking company under the head "Profits and gains of business or profession" (not being a loss sustained in a speculation business) which such amalgamating banking

company, would have been entitled to carry forward and set-off under the provisions of section 72 if the amalgamation had not taken place;

(b) "banking company" shall have the same meaning assigned to it in clause (c) of section 5 of the Banking Regulation Act, 1949;

(c) "banking institution" shall have the same meaning assigned to it in sub-section (15) of section 45 of the Banking Regulation Act, 1949;

(d) "unabsorbed depreciation" means so much of the allowance for depreciation of the amalgamating banking company which remains to be allowed and which would have been allowed to such banking company if the amalgamation had not taken place.

9. PROVISIONS RELATING TO CARRY FORWARD AND SET OFF OF ACCUMULATED LOSS AND UNABSORBED DEPRECIATION ALLOWANCE IN BUSINESS REORGANISATION OF CO-OPERATIVE BANKS [SECTION 72AB]

(i) Under this section, in a case where the amalgamation has taken place during the previous year, set-off of accumulated loss and the unabsorbed depreciation of the predecessor co-operative bank will be allowed in the hands of the successor co-operative bank as if the amalgamation had not taken place. All the other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation would apply accordingly.

(ii) The benefit of carry-forward and set-off of accumulated losses under this section would be allowed only on fulfillment of the following conditions -

(a) Conditions to be fulfilled by the predecessor co-operative bank

(1) It should have been engaged in the business of banking for three or more years; and

(2) It has held at least three-fourths of the book value of fixed assets as on the date of the business reorganisation, continuously for two years prior to the date of business reorganisation;

(b) Conditions to be fulfilled by the successor co-operative bank

(1) It should hold at least three-fourths of the book value of fixed assets of the predecessor co-operative bank acquired through business reorganisation, continuously for a minimum period of five years immediately succeeding the date of business reorganisation;

(2) It continues the business of the predecessor co-operative bank for a minimum period of five years from the date of business reorganisation; and

(3) It fulfils such other conditions as may be prescribed to ensure the revival of the business of the predecessor co-operative bank or to ensure that the business reorganisation is for genuine business purpose.

(iii) The amount of set-off of the accumulated loss and unabsorbed depreciation allowable to the resulting co-operative bank has to be calculated in the following manner -

(1) In a case where the whole of the amount of such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting co-operative bank - the entire accumulated loss or unabsorbed depreciation of the demerged co-operative bank is allowed to be set-off.

(2) In a case where the accumulated loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting co-operative bank - the amount which bears the same proportion to the accumulated loss or unabsorbed depreciation of the demerged co-operative bank as the assets of the undertaking transferred to the resulting co-operative bank bears to the assets of the demerged co-operative bank.

For example, if A Co.op Bank is the demerged co-operative bank and B Co. op Bank is the resulting co-operative bank, the amount of set-off of the accumulated loss and unabsorbed depreciation allowable to B Co-op. bank would be –

$$\text{Unabsorbed business loss/depreciation of A Co-Op bank} \times \frac{\text{Assets of the undertaking transferred to B Co-op bank}}{\text{Assets of A Co-op bank}}$$

(iv) The Central Government may specify other conditions by notification in the Official Gazette as it considers necessary, to ensure that the business reorganisation is for genuine business purposes.

(v) The period commencing from the beginning of the previous year and ending on the date immediately preceding the date of business reorganisation, and the period commencing from the date of such business reorganisation and ending with the previous year shall be deemed to be two different previous years for the purposes of set off and carry forward of loss and allowance for depreciation.

For example, if the date on which business re-organisation took place is 1.11.08, then the period between 1.4.08 and 31.10.08 and the period between 1.11.08 and 31.3.09 would be deemed to be two different previous years for the purposes of set-off and carry forward of unabsorbed business losses and depreciation.

(vi) In a case where the conditions specified in (ii) above or notified under (iv) above are not complied with, the set-off of accumulated loss or unabsorbed depreciation allowed in any previous year to the successor co-operative bank shall be deemed to be the income of the successor co-operative bank chargeable to tax for the year in which the conditions are not complied with.

(vii) Accumulated loss means so much of loss of the amalgamating co-operative bank or the demerged co-operative bank, as the case may be, under the head "Profits and gains of business or profession" (not being a loss sustained in a speculation business) which such amalgamating co-operative bank or the demerged co-operative bank, would have been entitled to carry forward and set-off under the provisions of section 72 as if the business reorganisation had not taken place.

(viii) Unabsorbed depreciation means so much of the allowance for depreciation of the amalgamating co-operative bank or the demerged co-operative bank, as the case may be, which remains to be allowed and which would have been allowed to such bank as if the business reorganisation had not taken place.

10. LOSSES IN SPECULATION BUSINESS [SECTION 73]

(i) The meaning of the expression 'speculative transaction' as defined in section 43(5) and the treatment of income from speculation business has already been discussed under the head "Profits and gains of business or profession".

(ii) Since speculation is deemed to be a business distinct and separate from any other business carried on by the assessee, the losses incurred in speculation can be neither set off in the same year against any other non-speculation income nor be carried forward and set off against other income in the subsequent years.

(iii) Therefore, if the losses sustained by an assessee in a speculation business cannot be set-off in the same year against any other speculation profit, they can be carried forward to subsequent years and set-off only against income from any speculation business carried on by the assessee.

(iv) The loss in speculation business can be carried forward only for a maximum period of 4 years from the end of the relevant assessment year in respect of which the loss was computed. Loss from the activity of trading in derivatives, however, is not to be treated as speculative loss.

(v) The *Explanation* to this section discourages companies (other than banking and investment companies) from indulging in speculation business or dealing in shares otherwise than in the ordinary course of their business. It provides that where any part of

the business of a company (other than investment company / banking / financing company) consists of the purchase and sale of the shares of other companies, such a company shall be deemed to be carrying on speculation business to the extent to which the business consists of the purchase and sale of such shares. Thus, companies engaged in the business of banking or the granting of loans and advances as their principal business would be exempted from the operation of this Explanation. Accordingly, both investment companies and banking companies would not be treated as carrying on speculation business in cases where they purchase and sell shares of other companies.

(vi) For this purpose, an investment company means a company whose Gross Total Income consists mainly of income which is chargeable under the heads "Income from house property", "Capital gains" and "Income from the other sources".

11. CARRY FORWARD & SETOFF OF LOSSES BY SPECIFIED BUSINESS [SECTION 73A]

(i) Any loss computed in respect of the specified business referred to in section 35AD shall be set off only against profits and gains, if any, of any other specified business.

(ii) The unabsorbed loss, if any, will be carried forward for set off against profits and gains of any specified business in the following assessment year and so on.

(iii) There is no time limit specified for carry forward and set-off and therefore, such loss can be carried forward indefinitely for set-off against income from specified business.

12. LOSSES UNDER THE HEAD 'CAPITAL GAINS' [SECTION 74]

Section 74 provides that where for any assessment year, the net result under the head 'Capital gains' is short term capital loss or long term capital loss, the loss shall be carried forward to the following assessment year to be set off in the following manner:

(i) Where the loss so carried forward is a short term capital loss, it shall be set off against any capital gains, short term or long term, arising in that year.

(ii) Where the loss so carried forward is a long term capital loss, it shall be set off only against long term capital gain arising in that year.

(iii) Net loss under the head capital gains cannot be set off against income under any other head.

(iv) Any unabsorbed loss shall be carried forward to the following assessment year up to a maximum of 8 assessment years immediately succeeding the assessment year for which the loss was first computed.

Illustration 3

During the P.Y. 2009-10, Mr. C has the following income and the brought forward losses:

Particulars	Rs.
Short term capital gains on sale of shares	1,50,000
Long term capital loss of A.Y. 2008-09	(96,000)
Short term capital loss of A.Y.2009-10	(37,000)
Long term capital gain	75,000

What is the capital gain taxable in the hands of Mr. C for the A.Y.2010-11?

Solution

The capital gains taxable are as under:

Particulars	Rs.	Rs.
Short term capital gains on sale of shares	1,50,000	
Less: Brought forward short term capital loss of the A.Y.2009-10	(37,000)	1,13,000
Long term capital gain	75,000	
Less: Brought forward long term capital loss of A.Y.2008-09 [See note below]	(75,000)	Nil
Taxable short-term capital gains		**1,13,000**

Note: Long-term capital loss cannot be set off against short-term capital gain. Hence, the remaining unadjusted long term capital loss of A.Y. 2008-09 of Rs.21,000 (i.e. Rs.96,000 – Rs.75,000) has to be carried forward to the next year to be set-off against long-term capital gains of that year.

13. LOSSES FROM THE ACTIVITY OF OWNING AND MAINTAINING RACE HORSES [SECTION 74A(3)]

(i) According to provisions of section 74A(3), the losses incurred by an assessee from the activity of owning and maintaining race horses cannot be set-off against the income from any other source other than the activity of owning and maintaining race horses.

(ii) Such loss can be carried forward for a maximum period of 4 assessment years for being set-off against the income from the activity of owning and maintaining race horses

in the subsequent years.

(iii) For this purpose, the "amount of loss incurred by the assessee in the activity of owning and maintaining race horses" means the amount by which such income by way of stake money falls short of the amount of revenue expenditure incurred by the assessee for the purpose of maintaining race horses. i.e. Loss = Stake money – revenue expenditure for the purpose of maintaining race horses.

(iv) Further, the expression 'horse race' means a horse race upon which wagering or betting may be lawfully made.

(v) "Income by way of stake money" means the gross amount of prize money received on a race horse or race horses by the owner thereof on account of the horse or horses or any one or more of the horses winning or being placed second or in any lower position in horse races.

Illustration 4

Mr. D has the following income for the P.Y. 2009-10 -

Particulars	Rs.
Income from the activity of owning and maintaining the race horses	75,000
Income from textile business	85,000
Brought forward textile business loss	50,000
Brought forward loss from the activity of owning and maintaining the race horses (relating to A.Y.2007-08)	96,000

What is the taxable income in the hands of Mr. D for the A.Y. 2010-11?

Solution

The taxable income is calculated as under:

Particulars	Rs.	Rs.
Income from the activity of owning and maintaining race horses	75,000	
Less: Brought forward loss from the activity of owning and maintaining race horses	96,000	
Loss from the activity of owning and maintaining race horses to be carried forward to A.Y.2011-12	(21,000)	

Income from textile business	85,000	
Less: Brought forward business loss from textile business.	50,000	35,000
Taxable business income		**35,000**

Note: Loss from the activity of owning and maintaining race horses cannot be set-off against any other source/head of income.

14. CARRY FORWARD AND SET OFF OF LOSSES IN CASE OF CHANGE IN CONSTITUTION OF FIRM OR SUCCESSION [SECTION 78]

(i) Where there is a change in the constitution of a firm, so much of the loss proportionate to the share of a retired or deceased partner remaining unabsorbed, shall not be allowed to be carried forward by the firm. However, unabsorbed depreciation can be carried forward.

(ii) Where any person carrying on any business or profession has been succeeded in such capacity by another person otherwise than by inheritance, such other person shall not be allowed to carry forward and set off against his income, any loss incurred by the predecessor.

(iii) Where there is a succession by inheritance, the legal heirs (assessable as BOI) are entitled to set-off the business loss of the predecessor. Such carry forward and set-off is possible even if the legal heirs constitute themselves as a partnership firm. In such a case, the firm can carry forward and set-off the business loss of the predecessor.

15. CARRY FORWARD AND SET-OFF OF LOSSES IN CASE OF CLOSELY HELD COMPANIES [SECTION 79]

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

(ii) However, this restriction shall not apply in the following two cases:

(1) where a change in the voting power is consequent upon the death of a shareholder or on account of transfer of shares by way of gift by a shareholder to his relative; and

(2) where the change in shareholding takes place in an Indian company, being a subsidiary of a foreign company, as a result of amalgamation or demerger of the foreign company. However, this is subject to the condition that 51% of the shareholders of the amalgamating/demerged company continue to be shareholders of the amalgamated/resulting company.

(iii) The provisions of this section are applicable only in respect of carry forward of losses and not in respect of carry forward of unabsorbed depreciation, which is covered by section 32(2).

16. ORDER OF SET-OFF OF LOSSES

As per the provisions of section 72(2), brought forward business loss is to be set-off before setting off unabsorbed depreciation. Therefore, the order in which set-off will be effected is as follows -

(a) Current year depreciation / Current year capital expenditure on scientific research and current year expenditure on family planning, to the extent allowed.

(b) Brought forward loss from business/profession [Section 72(1)]

(c) Unabsorbed depreciation [Section 32(2)]

(d) Unabsorbed capital expenditure on scientific research [Section 35(4)].

(e) Unabsorbed expenditure on family planning [Section 36(1)(ix)]

Illustration 5

Mr. E has furnished his details for the A.Y.2010-11 as under:

Particulars	**Rs.**
Income from salaries	1,50,000
Income from speculation business	60,000
Loss from non-speculation business	(40,000)
Short term capital gain	80,000
Long term capital loss of A.Y.2008-09	(30,000)
Winning from lotteries	20,000

What is the taxable income of Mr. E for the A.Y. 2010-11?

Solution

Computation of taxable income of Mr. E for the A.Y.2010-11

Particulars	Rs.	Rs.
Income from salaries		1,50,000
Income from speculation business	60,000	
Less : Loss from non-speculation business	(40,000)	20,000
Short-term capital gain		80,000
Winnings from lotteries		20,000
Taxable income		**2,70,000**

Note: Long term capital loss can be set off only against long term capital gain. Therefore, long term capital loss of Rs.30,000 has to be carried forward to the next assessment year.

Illustration 6

Compute the Gross total income of Mr. F for the A.Y.2010-11 from the information given below

Particulars	Rs.
Net income from house property	1,25,000
Income from business (before providing for depreciation)	1,35,000
Short term capital gains on sale of shares	56,000
Long term capital loss from sale of property (brought forward from A.Y.2009-10)	(90,000)
Income from tea business	1,20,000
Dividends from Indian companies carrying on agricultural operations	80,000
Current year depreciation	26,000
Brought forward business loss (loss incurred six years ago)	(45,000)

Solution

The gross total income of Mr. F for the A.Y. 2010-11 is calculated as under:

Particulars	Rs.	Rs.
Income from house property		1,25,000
Income from business		
Profits before depreciation	1,35,000	

Less : current year depreciation	26,000	
Less : brought forward business loss	45,000	
	64,000	
Income from tea business (40% is business income)	48,000	1,12,000
Income from the capital gains		
Short term capital gains	56,000	
Long term capital loss from property (cannot be set off)	Nil	56,000
Gross Total Income		**2,93,000**

Note: Dividend from Indian companies is exempt from tax. 60% of the income from tea business is treated as agricultural income and therefore, exempt from tax.

Self-examination questions

1. In a case where the business is succeeded by inheritance, and the legal heirs constitute themselves as a partnership firm, then -
   a) the partnership firm can carry forward and set-off the loss of the predecessor.
   b) the partnership firm cannot carry forward and set-off the loss of the predecessor.
   c) the loss of the predecessor can be carried forward and set-off only by the individual partners in proportion to the share of profits of the firm.
2. According to section 80, no loss which has not been determined in pursuance of a return filed in accordance with the provisions of section 139(3), shall be carried forward. The exceptions to this are -
   a) Only loss under the head "Capital Gains" under section 74.
   b) Loss under the head "Capital Gains" and unabsorbed depreciation carried forward under section 32(2)
   c) Loss from house property and unabsorbed depreciation carried forward under section 32(2).
3. Section 70 enables set off of losses under one source of income against income from any other source under the same head. The exceptions to this section are -

a) Loss under the head "Capital Gains", Loss from speculative business and loss from the activity of owning and maintaining race horses

b) Long-term capital loss, Loss from speculative business and loss from the activity of owning and maintaining race horses

c) Short-term capital loss and loss from speculative business

4. The maximum period for which speculation loss can be carried forward is -

a) 4 years

b) 8 years

c) indefinitely

5. Mr.A incurred short-term capital loss of Rs.10,000 on sale of shares through the National Stock Exchange. Such loss can be set-off -

a) only against short-term capital gains

b) against both short-term capital gains and long-term capital gains

c) against any head of income.

6. Write short notes on -

a) Inter-head adjustment

b) Inter-source adjustment.

7. Discuss the correctness of the following statements -

(i) Long term capital loss can be set-off against short-term capital gains arising in that year.

(ii) Business loss can be set-off against salary income arising in that year.

8. Discuss briefly on -

a) Carry forward and set-off of losses by closely held companies

b) Set-off and carry forward of speculation business loss.

9. State the conditions to be fulfilled by an amalgamated company for carry forward of the accumulated loss and unabsorbed depreciation of the amalgamating company.

10. Discuss the provisions of the Income-tax Act, 1961 regarding set-off and carry forward of the following losses -

a) Loss under the head “Capital Gains”

b) Loss from the activity of owning and maintaining race horses.

Answers

1. a; **2.** c; **3.** b; **4.** a; **5.** b

CHAPTER 7

DEDUCTIONS FROM GROSS TOTAL INCOME

Learning Objectives

After studying this chapter, you would be able to understand –

- the types of deductions allowable from gross total income
- what are the permissible deductions in respect of payments
- what are the permissible deductions in respect of incomes
- what is the deduction allowable in the case of a person with disability

1. GENERAL PROVISIONS

As we have seen earlier, section 10 exempts certain incomes. Such income are excluded from total income and do not enter into the computation process at all. On the other hand, Chapter VI-A contains deductions from gross total income. The important point to be noted here is that if there is no gross total income, then no deductions will be permissible. This Chapter contains deductions in respect of certain payments, deductions in respect of certain incomes and other deductions.

1.1 Section 80A

(i) Section 80A(1) provides that in computing the total income of an assessee, there shall be allowed from his gross total income, the deductions specified in sections 80C to 80U.

(ii) According to section 80A(2), the aggregate amount of the deductions under this chapter shall not, in any case, exceed the gross total income of the assessee. Thus, an assessee cannot have a loss as a result of the deduction under Chapter VI-A and claim to carry forward the same for the purpose of set-off against his income in the subsequent year.

(iii) Section 80A(3) provides that in the case of AOP/BOI, if any deduction is admissible under section 80G/80GGA/80GGC/80-IA/80-IB/80-IC/80-ID/80-IE, no deduction under the same section shall be made in computing the total income of a member of the AOP or BOI in relation to the share of such member in the income of the AOP or BOI.

(iv) The profits and gains allowed as deduction under section 10A or section 10AA or section 10B or under any provision of Chapter VIA under the heading "C.-Deductions in

respect of certain incomes" in any assessment year, shall not be allowed as deduction under any other provision of the Act for such assessment year [Sub-section (4)];

(v) The deduction, referred to in (iv) above, shall not exceed the profits and gains of the undertaking or unit or enterprise or eligible business, as the case may be [Sub-section (4)];

(vi) No deduction under any of the provisions referred to in (iv) above, shall be allowed if the deduction has not been claimed in the return of income. [Sub-section (5)];

(vii) The transfer price of goods and services between such undertaking or unit or enterprise or eligible business and any other business of the assessee shall be determined at the market value of such goods or services as on the date of transfer [Sub-section (6)].

(viii) For this purpose, the expression "market value" has been defined to mean,-

(a) in relation to any goods or services sold or supplied, the price that such goods or services would fetch if these were sold by the undertaking or unit or enterprise or eligible business in the open market, subject to statutory or regulatory restrictions, if any;

(b) in relation to any goods or services acquired, the price that such goods or services would cost if these were acquired by the undertaking or unit or enterprise or eligible business from the open market, subject to statutory or regulatory restrictions, if any.

1.2 Section 80AB

This section provides that for the purpose of calculation of deductions specified in Chapter VI-A under the heading “C - Deductions in respect of certain incomes”, the net income computed in accordance with the provisions of the Act (before making any deduction under Chapter VI-A) shall alone be regarded as income received by the assessee and which is included in his gross total income. Accordingly, the deductions specified in the aforesaid sections will be calculated with reference to the net income as computed in accordance with the provisions of the Act (before making deduction under Chapter VI-A) and not with reference to the gross amount of such income. This is notwithstanding anything contained in the respective sections of Chapter VI-A.

1.3 Section 80AC - Furnishing return of income on or before due date mandatory for claiming exemption under sections 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID and 80-IE

(i) Section 80AC stipulates compulsory filing of return of income on or before the due date specified under section 139(1), as a pre-condition for availing benefit under the following sections –

(1) Section 80-IA applicable to undertakings or enterprises engaged in infrastructure development, etc.

(2) Section 80-IAB applicable to undertakings or enterprises engaged in any business of developing a special economic zone.

(3) Section 80-IB applicable to certain industrial undertakings other than infrastructure development undertakings.

(4) Section 80-IC applicable to certain undertakings or enterprises in certain special category States.

(5) Section 80-ID applicable to undertakings engaged in the business of hotels and convention centres in specified area.

(6) Section 80-IE applicable to certain undertakings in North-Eastern States.

(ii) The effect of this provision is that in case of failure to file return of income on or before the stipulated due date, the undertakings would lose the benefit of deduction under these sections.

1.4 Section 80B(5)

"Gross total income" means the total income computed in accordance with the provisions of the Act without making any deduction under Chapter VI-A. "Computed in accordance with the provisions of the Act" implies—

(i) that deductions under appropriate computation section have already been given effect to;

(ii) that income of other persons, if includible under sections 60 to 64, has been included;

(iii) the intra head and/or inter head losses have been adjusted; and

(iv) that unabsorbed business losses, unabsorbed depreciation etc., have been set-off.

Let us first consider the deductions allowable in respect of certain payments.

2. DEDUCTIONS IN RESPECT OF PAYMENTS

2.1 Deduction in respect of investment in specified assets [Section 80C]

(i) Section 80C provides for a deduction from the Gross Total Income, of savings in specified modes of investments.

(ii) Deduction under section 80C is available only to an individual or HUF.

(iii) The maximum qualifying amount is Rs.1 lakh in respect of deductions under section 80C along with sections 80CCC (in respect of contribution to approved pension fund) and 80CCD (contribution to pension scheme of Central Government).

(iv) The following are the investments/contributions eligible for deduction –

(1) Premium paid on insurance on the life of the individual, spouse or child (minor or major) and in the case of HUF, any member thereof. This will include a life policy and an endowment policy. However, where the annual premium on insurance policies, other than a contract for deferred annuity , exceeds 20% of actual capital sum assured, only the amount of premium as does not exceed 20% will qualify for rebate.

For the purpose of calculating the actual capital sum assured under this clause,

(a) the value of any premiums agreed to be returned or

(b) the value of any benefit by way of bonus or otherwise, over and above the sum actually assured,

shall not be taken into account.

(2) Premium paid to effect and keep in force a contract for a deferred annuity on the life of the assessee and/or his or her spouse or child, provided such contract does not contain any provision for the exercise by the insured of an option to receive cash payments in lieu of the payment of the annuity.

It is pertinent to note here that a contract for a deferred annuity need not necessarily be with an insurance company. It follows therefore that such a contract can be entered into with any person.

(3) Amount deducted by or on behalf of the Government from the salary of a Government employee for securing a deferred annuity or making provisions for his spouse or children. The excess, if any, over one-fifth of the salary is to be ignored.

(4) Contributions to any provident fund to which the Provident Funds Act, 1925 applies.

(5) Contributions made to any Provident Fund set up by the Central Government and notified in his behalf (i.e., the Public Provident Fund established under the Public Provident Fund Scheme, 1968). Such contribution can be made in the name of any persons mentioned in (1) above.

(6) Contribution by an employee to a recognised provident fund.

(7) Contribution by an employee to an approved superannuation fund

(8) Subscription to any such security of the Central Government or any such deposit scheme as the Central Government as may notify in the Official Gazette.

(9) Subscription to any Savings Certificates under the Government Savings Certificates Act, 1959 notified by the Central Government in the Official Gazette (i.e. National Savings Certificate (VIII Issue) issued under the Government Savings Certificates Act, 1959).

(10) Contributions in the name of any person specified in (1) above for participation in the

Unit-linked Insurance Plan 1971.

(11) Contributions in the name of any person mentioned in (1) above for participation in any Unit linked Insurance Plan of the LIC Mutual Fund, referred to in section 10(23D) in this behalf.

(12) Contributions to approved annuity plans of LIC (New Jeevan Dhara and New Jeevan Akshay, New Jeevan Dhara I and New Jeevan Akshay I, II and III) or any other insurer as the Central Government may, by notification in the Official Gazette, specify in this behalf.

(13) Subscription to any units of any mutual fund referred to in section 10(23D) or from the Administrator or the specified company under any plan formulated in accordance with such scheme notified by the Central Government;

(14) Contribution by an individual to a pension fund set up by any Mutual Fund referred to in section 10(23D) or by the Administrator or the specified company as the Central Government may specify (i.e. 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).

For the purposes of (13) and (14) above –

(i) "Administrator" means the Administrator as referred to in clause (a) of section 2 of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002.

(ii) "specified company" means a company as referred to in clause (h) of section 2 of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002.

(15) Subscription to any deposit scheme or contribution to any pension fund set up by the National Housing Bank *i.e., National Housing Bank (Tax Saving) Term Deposit Scheme, 2008.*

(16) Subscription to any such deposit scheme of a public sector company which is engaged in providing long-term finance for construction, or purchase of houses in India for residential purposes or any such deposit scheme of any authority constituted in India by or under any law enacted either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages or for both. The deposit scheme should be notified by the Central Government. The Central Government has, vide Notification No.2/2007 dated 11.1.2007, specified the public deposit scheme of HUDCO, subscription to which would qualify for deduction under section 80C.

(17) Payment of tuition fees by an individual assessee at the time of admission or thereafter to any university, college, school or other educational institutions within India for the

purpose of full-time education of any two children of the individual. This benefit is only for the amount of tuition fees for full-time education and shall not include any payment towards development fees or donation or payment of similar nature and payment made for education to any institution situated outside India.

(18) Any payment made towards the cost of purchase or construction of a new residential house property. The income from such property –

(i) should be chargeable to tax under the head "Income from house property";

(ii) would have been chargeable to tax under the head "Income from house property" had it not been used for the assessee's own residence.

The approved types of payments are as follows :

(i) Any installment or part payment of the amount due under any self-financing or other schemes of any development authority, Housing Board or other authority engaged in the construction and sale of house property on ownership basis; or

(ii) Any installment or part payment of the amount due to any company or a cooperative society of which the assessee is a shareholder or member towards the cost of house allotted to him; or

(iii) Repayment of amount borrowed by the assessee from:

(a) The Central Government or any State Government ;

(b) Any bank including a co-operative bank ;

(c) The L.I.C. ;

(d) The National Housing Bank ;

(e) Any public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes which is eligible for deduction under section 36(1)(viii).

(f) Any company in which the public are substantially interested or any cooperative society engaged in the business of financing the construction of houses.

(g) The assessee's employer, where such employer is an authority or a board or a corporation or any other body established or constituted under a Central or State Act;

(h) the assessee's employer where such employer is a public company or public sector company or a university established by law or a college affiliated to such university or a local authority or a co-operative society.

(iv) Stamp duty, registration fee and other expenses for the purposes of transfer of such house property to the assessee.

Inadmissible payments : However, the following amounts do not qualify for rebate:

(i) admission fee, cost of share and initial deposit which a shareholder of a company or a member of a co-operative society has to pay for becoming a shareholder or member; or

(ii) the cost of any addition or alteration or renovation or repair of the house property after the completion of the house or after the house has been occupied by the assessee or any person on his behalf or after it has been let out; or

(iii) any expenditure in respect of which deduction is allowable under section 24.

(19) Subscription to equity shares or debentures forming part of any eligible issue of capital approved by the Board on an application made by a public company or as subscription to any eligible issue of capital by any public financial institution in the prescribed form.

Eligible issue of capital means an issue made by a public company formed and registered in India or a public financial institution and the entire proceeds of the issue are utilised wholly and exclusively for the purposes of any business referred to in section 80-IA(4).

A lock-in period of three years is provided in respect of such equity shares or debentures. In case of any sale or transfer of shares or debentures within three years of the date of acquisition, the aggregate amount of deductions allowed in respect of such equity shares or debentures in the previous year or years preceding the previous year in which such sale or transfer has taken place shall be deemed to be the income of the assessee of such previous year and shall be liable to tax in the assessment year relevant to such previous year.

A person shall be treated as having acquired any shares or debentures on the date on which his name is entered in relation to those shares or debentures in the register of members or of debenture-holders, as the case may be, of the public company.

(20) Subscription to any units of any mutual fund referred to in section 10(23D)] and approved by the Board on an application made by such mutual fund in the prescribed form.

It is necessary that the subscription to such units should be subscribed only in the

eligible issue of capital of any company.

(21) Investment in term deposit

(1) for a period of not less than five years with a scheduled bank; and

(2) which is in accordance with a scheme framed and notified by the Central Government in the Official Gazette

now qualifies as an eligible investment for availing deduction under section 80C.

Scheduled bank means -

(1) the State Bank of India constituted under the State Bank of India Act, 1955, or

(2) a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959, or

(3) a corresponding new bank constituted under section 3 of the -

(a) Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, or

(b) Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980, or

(4) any other bank, being a bank included in the Second Schedule to the Reserve Bank of India Act, 1934.

(22) Subscription to such bonds issued by NABARD (as the Central Government may notify in the Official Gazette).

(23) five year time deposit in an account under Post Office Time Deposit Rules, 1981; and

(24) deposit in an account under the Senior Citizens Savings Scheme Rules, 2004.

Termination of Insurance Policy or Unit Linked Insurance Plan or transfer of House Property or withdrawal of deposit:

Where, in any previous year, an assessee :

(i) terminates his contract of insurance referred to in (1) above, by notice to that effect or where where the contract ceases to be in force by reason of not paying the premium, by not reviving the contract of insurance, -

(a) in case of any single premium policy, within two years after the date of commencement of insurance; or

(b) in any other case, before premiums have been paid for two years; or

(ii) terminates his participation in any Unit Linked Insurance Plan referred to in (10) or (11) above, by notice to that effect or where he ceases to participate by reason of failure to pay any contribution, by not reviving his participation, before contributions in respect of such participation have been paid for five years, or

(iii) transfers the house property referred to in (18) above, before the expiry of five years from the end of the financial year in which possession of such property is obtained by him, or receives back, whether by way of refund or otherwise, any sum specified in (18) above,

then, no deduction will be allowed to the assessee in respect of sums paid during such previous year and the total amount of deductions of income allowed in respect of the previous year or years preceding such previous year, shall be deemed to be income of the assessee of such previous year and shall be liable to tax in the assessment year relevant to such previous year.

Further, where any amount is withdrawn by the assessee from his account under the Senior Citizens Savings Scheme or under the Post Office Time Deposit Rules before the expiry of a period of 5 years from the date of its deposit, the amount so withdrawn shall be deemed to be the income of the assessee of the previous year in which the amount is withdrawn. Accordingly, the amount so withdrawn would be chargeable to tax in the assessment year relevant to such previous year. The amount chargeable to tax shall would also include that part of the amount withdrawn which represents interest accrued on the deposit. However, if any part of the amount so received or withdrawn (including the amount relating to interest) has been subject to tax in any of the earlier years, such amount shall not be taxed again.

Illustration 1

Mr. A, aged about 66 years, has earned a lottery income of Rs.1,20,000 (gross) during the P.Y. 2009-10. He also has a business income of Rs.30,000. He invested an amount of Rs.10,000 in Public Provident Fund account and Rs.24,000 in National Saving Certificates. What is the total taxable income of Mr. A for the A.Y.2010-11?

Solution

Computation of total taxable income of Mr. A for A.Y.2010-11

Particulars	Rs.	Rs.
Profits and gains from business or profession		30,000

Income from other sources - lottery income		1,20,000
Gross Total Income		**1,50,000**
Less: Deductions under Chapter VIA [See Note below]		
Under section 80C - Deposit in Public Provident Fund	10,000	
- Investment in National Saving Certificate	24,000	
	34,000	
Restricted to		30,000
Total Income		**1,20,000**

Note: Though the value of eligible investments is Rs.34,000, however, deductions under chapter VIA cannot exceed the Gross Total Income exclusive of Long Term Capital Gain, Short Term Capital Gain covered under section 111A, winnings of lotteries etc of the assessee.

Therefore maximum permissible deduction under section 80C = Rs.1,50,000 – Rs.1,20,000 = Rs.30,000

Illustration 2

An individual assessee, resident in India, has made the following investments during the previous year 2009-10 :

Particulars	Rs.
Contribution to the public provident fund	50,000
Investment in units of eligible mutual funds	40,000
Insurance premium paid on the life of the spouse (Assured value Rs.1,00,000)	25,000

What is the deduction allowable under section 80C for A.Y.2010-11?

Solution

Computation of deduction under section 80C for A.Y.2010-11

Particulars	Rs.
Deposit in public provident fund	50,000
Investment in units of mutual funds	40,000

Insurance premium paid on the life of the spouse	
(Maximum 20% of the assured value Rs.1,00,000)	20,000
Total	1,10,000
However, the maximum permissible deduction is restricted to	1,00,000

Note: As per section 80CCE, total deduction under section 80C, 80CCC and 80CCD cannot exceed Rs.1,00,000

2.2 Deduction in respect of contribution to certain pension funds [Section 80CCC]

(i) Where an assessee, being an individual, has in the previous year paid or deposited any amount out of his income chargeable to tax to effect or keep in force a contract for any annuity plan of LIC of India or any other insurer for receiving pension from the fund referred to in clause (23AAB) of section 10, he shall be allowed a deduction in the computation of his total income.

(ii) For this purpose, the interest or bonus accrued or credited to the assessee's account shall not be reckoned as contribution.

(iii) The maximum permissible deduction is Rs.1,00,000 (However, the overall limit of Rs.1,00,000 prescribed in section 80CCE will continue to be applicable i.e. the maximum permissible deduction under sections 80C, 80CCC and 80CCD put together is Rs.1,00,000).

(iv) Where any amount standing to the credit of the assessee in a fund referred to in clause (23AAB) of section 10 in respect of which a deduction has been allowed, together with interest or bonus accrued or credited to the assessee's account is received by the assessee or his nominee on account of the surrender of the annuity plan in any previous year or as pension received from the annuity plan, such amount will be deemed to be the income of the assessee or the nominee in that previous year in which such withdrawal is made or pension is received. It will be chargeable to tax as income of that previous year.

(v) Where any amount paid or deposited by the assessee has been taken into account for the purposes of this section, a deduction under section 80C shall not be allowed with reference to such amount.

2.3 Deduction in respect of contribution to pension scheme of Central Government [Section 80CCD]

(i) A "New Restructured Defined Contribution Pension System" applicable to new entrants to Government service has been introduced. As per the scheme, it is mandatory for persons entering the service of the Central Government on or after 1st January, 2004, to contribute ten

per cent their of salary every month towards their pension account. A matching contribution is required to be made by the Government to the said account. The benefit of this scheme is available to individuals employed by any other employer also on or after 1st January, 2004.

(ii) To give effect to the new pension scheme of the Central Government, a new section 80CCD has been inserted.

(iii) This section provides a deduction for the amount paid or deposited by an employee in his pension account subject to a maximum of 10% of his salary.

(iv) The contribution made by the Central Government or any other employer in the previous year to the said account of an employee, is allowed as a deduction in computation of the total income of the assessee. However, the deduction is restricted to 10% of the employee's salary.

(v) The entire employer's contribution would be included in the salary of the employee. However, deduction under section 80CCD would be restricted to 10% of salary.

(vi) This deduction is now extended also to self-employed individuals. The deduction in the case of a self-employed individual would be restricted to 10% of his gross total income in the previous year.

(vii) Further, the amount standing to the credit of the assessee in the pension account (for which deduction has already been claimed by him under this section) and accretions to such account, shall be taxed as income in the year in which such amounts are received by the assessee or his nominee on -

(a) closure of the account or

(b) his opting out of the said scheme or

(c) receipt of pension from the annuity plan purchased or taken on such closure or opting out.

(viii) However, the assessee shall be deemed not to have received any amount in the previous year if such amount is used for purchasing an annuity plan in the same previous year.

(ix) No deduction will be allowed under section 80C in respect of amounts paid or deposited by the assessee, for which deduction has been allowed under section 80CCD(1).

2.4 Limit on deductions under sections 80C, 80CCC & 80CCD [Section 80CCE]

This section restricts the aggregate amount of deduction under section 80C, 80CCC and 80CCD to Rs.1 lakh.

2.5 Deduction in respect of medical insurance premium [Section 80D]

(i) Deduction is allowed under section 80D up to a maximum of Rs.15,000 to an individual in respect of medical insurance premium paid for self, spouse and dependent children.

(ii) An additional deduction of up to Rs.15,000 would be allowed to an individual in respect of medical insurance premium paid for insuring the health of a parent or parents. This would be in addition to the deduction of Rs.15,000 in respect of medical insurance premium paid for self, spouse and dependent children. Such additional deduction would be available even if the parents are not dependent on the individual.

(iii) In case the sum is paid to insure the health of a senior citizen, then the deduction would be Rs.20,000 instead of Rs.15,000.

(iv) In case of an individual, the maximum deduction allowable under this section would, therefore, be Rs.30,000 [i.e. Rs.15,000 + Rs.15,000] and in case any of the persons insured is a senior citizen, Rs.35,000 [i.e. Rs.15,000 + Rs.20,000].

For example, if Mr. Ganesh pays medical insurance premium of Rs.16,000 for insuring the health of himself, his spouse and his children and Rs.21,000 for insuring the health of his parents, then he would be eligible for a deduction of Rs.30,000 [Rs.15,000 + Rs.15,000] under section 80D, whether or not his parents are dependent on him. If either or both of his parents are senior citizens, then he would be entitled to a higher deduction of Rs.35,000 [Rs.15,000 + Rs.20,000].

(v) In the case of a HUF, deduction is allowed under this section in respect of premium paid to insure the health of any member of the family. The maximum deduction available to a HUF would be Rs.15,000 and in case any member is a senior citizen, Rs.20,000.

(vi) The other conditions to be fulfilled are that such premium should be paid by any mode, other than cash, in the previous year out of his income chargeable to tax. Further, the medical insurance should be in accordance with a scheme made in this behalf by -

(a) the General Insurance Corporation of India and approved by the Central Government in this behalf; or

(b) any other insurer and approved by the Insurance Regulatory and Development Authority.

2.6 Deduction in respect of maintenance including medical treatment of a dependent disabled [Section 80DD]

(i) Section 80DD provides deduction to an assessee, who is a resident in India, being an individual or Hindu undivided family. Any amount paid for the medical treatment (including nursing), training and rehabilitation of a dependant, being a person with disability, or any amount paid or deposited under a scheme framed in this behalf by the Life Insurance

Corporation or any other insurer or the Administrator or the Specified Company as referred to in section 2(h) of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002, for the maintenance of a dependant, being a person with disability, qualifies for deduction.

(ii) The benefit of deduction under this section is also available to assessees incurring expenditure on maintenance including medical treatment of persons suffering from autism, cerebral palsy and multiple disabilities.

(iii) The quantum of deduction is Rs.50,000 and in case of severe disability (i.e. person with 80% or more disability) the deduction shall be *Rs.1,00,000*.

(iv) The term 'dependent' has been defined to include in the case of an individual, the spouse, children, parents, brothers and sisters of the individual and in the case of a Hindu Undivided Family (HUF), a member thereof, who is wholly or mainly dependent on the assessee and has not claimed any deduction under section 80U in the computation of his income.

(v) For claiming the deduction, the assessee shall have to furnish a copy of the certificate issued by the medical authority under the Persons with Disability (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 along with the return of income under section 139.

(vi) Where the condition of disability requires reassessment, a fresh certificate from the medical authority shall have to be obtained after the expiry of the period mentioned in the original certificate in order to continue to claim the deduction.

Illustration 3

Mr. X is a resident individual. He deposits a sum of Rs.25,000 with Life Insurance Corporation every year for the maintenance of his handicapped grandfather who is wholly dependent upon him. The disability is one which comes under the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995. A copy of the certificate from the medical authority is submitted. Compute the amount of deduction available under section 80DD for the A.Y. 2010-11.

Solution

Since the amount deposited by Mr. X was for his grandfather, he will not be allowed any deduction under section 80DD. The deduction is available if the individual assessee incurs any expense for a dependant disabled relative. Grandfather does not come within the definition of dependant relative.

Illustration 4

What will be the deduction if Mr. X had made this deposit for his dependant father?

Solution

Since the expense was incurred for a dependant disabled relative, Mr. X will be entitled to claim a deduction of Rs.50,000 under section 80DD, irrespective of the amount deposited. In case his father has severe disability, the deduction would be *Rs.1,00,000.*

2.7 Deduction in respect of medical treatment etc. [Section 80DDB]

(i) This section provides deduction to an assessee, who is resident in India, being an individual and Hindu undivided family. Any amount actually paid for the medical treatment of such disease or ailment as may be specified in the rules made in this behalf by the Board for himself or a dependent, in case the assessee is an individual or for any member of a HUF, in case the assessee is a HUF will qualify for deduction.

(ii) The amount of deduction under this section shall be equal to the amount actually paid or Rs.40,000, whichever is less, in respect of that previous year in which such amount was actually paid. In case the amount is paid in respect of a senior citizen, then the deduction would be the amount actually paid or Rs.60,000, whichever is less.

(iii) The term 'dependent' includes in the case of an individual, the spouse, children, parents, brothers and sisters of the individual and in the case of a Hindu undivided family (HUF), a member of the HUF, who is wholly or mainly dependent on such individual or HUF for his support and maintenance.

(iv) No such deduction shall be allowed unless the assessee furnishes with a return of income, a certificate in such form, as may be prescribed, from a neurologist, an oncologist, a urologist, a hematologist, an immunologist or such other specialist, as may be prescribed, working in a Government hospital.

(v) The term "Government hospital" will also include approved hospitals for the treatment of Government servants.

(vi) The deduction under this section shall be reduced by the amount received, if any, under an insurance from an insurer, or reimbursed by an employer, for the medical treatment of the assessee or the dependent.

2.8 Deduction in respect of interest loan taken for higher education [Section 80E]

(i) Section 80E provides deduction to an individual-assessee in respect of any interest on loan paid by him in the previous year out of his income chargeable to tax.

(ii) The loan must have been taken for the purpose of pursuing his higher education or for the purpose of higher education of his or her relative i.e. spouse or children of the individual *or the student for whom the individual is the legal guardian*.

(iii) "Higher education" means any course of study (including vocational studies) pursued after passing the Senior Secondary Examination or its equivalent from any school, board or university recognised by the Central Government or State Government or local authority or by any other authority authorized by the Central Government or State Government or local authority to do so. Therefore, interest on loan taken for pursuing any course after Class XII or its equivalent, will qualify for deduction under section 80E.

(iv) The loan must have been taken from any financial institution or approved charitable institution.

(v) The deduction is allowed in computing the total income in respect of the initial assessment year (i.e. the assessment year relevant to the previous year, in which the assessee starts paying the interest on the loan) and seven assessment years immediately succeeding the initial assessment year or until the interest is paid in full by the assessee, whichever is earlier.

(vi) "Approved charitable institution" means an institution established for charitable purposes and approved by the prescribed authority under section 10(23C) or an institution referred to in section 80G(2)(a).

(vii) "Financial institution" means –

(1) a banking company to which the Banking Regulation Act, 1949 applies (including a bank or banking institution referred to in section 51 of the Act); or

(2) any other financial institution which the Central Government may, by notification in the Official Gazette, specify in this behalf.

Illustration 5

Mr. B has taken three education loans on April 1, 2009, the details of which are given below:

	Loan 1	Loan 2	Loan 3
For whose education loan was taken	B	Son of B	Daughter of B
Purpose of loan	MBA	B. Sc.	B.A.
Amount of loan (Rs.)	5,00,000	2,00,000	4,00,000
Annual repayment of loan (Rs.)	1,00,000	40,000	80,000
Annual repayment of interest (Rs.)	20,000	10,000	18,000

Compute the amount deductible under section 80E for the A.Y.2010-11.

Solution

Deduction under section 80E is available to an individual assessee in respect of any interest paid by him in the previous year in respect of loan taken for pursuing his higher education or higher education of his spouse or children. Higher education means any course of study pursued after senior secondary examination.

Therefore, interest repayment in respect of all the above loans would be eligible for deduction.

Deduction under section 80E = Rs.20,000 + Rs.10,000 + Rs.18,000 = Rs.48,000

2.9 Deduction in respect of donations to certain Funds, Charitable Institutions etc. [Section 80G]

(i) Where an assessee pays any sum as donation to eligible funds or institutions, he is entitled to a deduction, subject to certain limitations, from the gross total income.

(ii) The following table gives the details of the institutions and funds to which donations can be made for the purpose of claiming deduction under section 80G, the qualifying amount and the deductions allowable -

Eligible institutions / funds		Permissible deduction
1		2
1.	The National Defence Fund set up by the Central Government.	100%
2.	The Jawaharlal Nehru Memorial Fund.	50%
3.	Prime Minister's Drought Relief Fund.	50%
4.	Prime Minister's National Relief Fund.	100%
5.	Prime Minister's Armenia Earthquake Relief Fund.	100%
6.	The Africa (Public Contributions-India) Fund.	100%
7.	The National Children's Fund.	50%
8.	Indira Gandhi Memorial Trust.	50%
9.	Rajiv Gandhi Foundation.	50%
10.	The National Foundation for Communal Harmony.	100%
11.	Approved University or educational institution of national eminence.	100%
12.	Maharashtra Chief Minister's Earthquake Relief Fund.	100%

13.	Any fund set up by the State Government of Gujarat exclusively for providing relief to the victims of the Gujarat earthquake.	100%
14.	Any Zila Saksharta Samiti for primary education in villages and towns and for literacy and post-literacy activities	100%
15.	National Blood Transfusion Council or any State Blood Transfusion Council whose sole objective is the control, supervision, regulation or encouragement of operation and requirements of blood banks.	100%
16.	Any State Government Fund set up to provide medical relief to the poor.	100%
17.	The Army Central Welfare Fund or Indian Naval Benevolent Fund or Air Force Central Welfare Fund established by the armed forces of the Union for the welfare of past and present members of such forces or their dependents.	100%
18.	The National Illness Assistance Fund.	100%
19.	The Chief Minister's Relief Fund or Lieutenant Governor's Relief Fund.	100%
20.	The National Sports Fund set up by the Central Government.	100%
21.	The National Cultural Fund set up by the Central Government.	100%
22.	The Fund for Technology Development and Application set up by the Central Government.	100%

23. National Trust for welfare of persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities.	100%
24. Any Institution or Fund established in India for charitable purposes fulfilling certain prescribed conditions under section 80G(5)	50% subject to qualifying limit
25. The Government or any local authority for utilisation for any charitable purpose other than the purpose of promoting family planning.	50% subject to qualifying limit
26. An authority constituted in India or under any other law enacted either for dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages, or both.	50% subject to qualifying limit
27. Any Corporation established by the Central Government or any State Government for promoting the interests of the members of a minority community.	50% subject to qualifying limit
28. The Government or to any approved local authority, institution or association for promotion of family planning.	100% subject to qualifying limit
29. Notified temple, mosque, gurdwara, church or other place of historic, archaeological or artistic importance or which is a place of public worship of renown throughout any State or States.	50% subject to qualifying limit

30.	Sum paid by a company as donation to the Indian Olympic Association or any other association/institution established in India, as may be notified by the Government for the development of infrastructure for sports or games, or the sponsorship of sports and games in India.	100% subject to qualifying limit

(iii) The conditions mentioned in item No. 24 above are as follows:

(1) The institution or fund is:

(a) constituted as a public charitable trust, or

(b) registered under the Societies Registration Act, 1960 or under any corresponding law or under section 25 of the Companies Act, 1956, or

(c) a University established by law or

(d) any other educational institution recognized by the Government or

(e) an institution financed wholly or in part by the Government or a local authority.

(2) Where such Institution or Fund derives any income, such income should not be liable to inclusion in its total income under the provisions of section 10(23AA), 10(23C) or 11 or 12.

The Institution, referred to in the above clauses of section 10 are as follows :

(i) Regimental fund or Non-public Fund established by the armed forces of the Union for the welfare of its members and their dependants [Section 10(23AA)]

(ii) The Prime Minister Fund (Promotion of Folk Art) [Section 10(23C)]

(iii) The Prime Minister Aid to Students Fund [Section 10(23C)]

(iv) National Foundation for communal harmony [Section 10(23C)]

(v) Charitable Trusts and Institutions [Sections 11 and 12].

However, it may be noted that the assessee will not lose the benefit of deduction if :

(a) subsequent to the donation, any part of the income of the Institution has become chargeable to tax due to non-compliance with any of the provisions of section 11 or 12 or 12A.

(b) as a result of the operation of section 11(1)(*c*), exemption under section 11 or 12 is denied to the institution.

(3) No part of the income or assets of the Institution or Fund is transferable or applicable at any time for any purposes other than charitable purpose. Such charitable purpose however does not include any purpose the whole or substantially the whole of which is of a religious nature.

For the purposes of this section, an association or institution having as its object the control, supervision, regulation or encouragement in India of such games or sports as the Central Government may, by notification in the Official Gazette, specify in this behalf, shall be deemed to be an institution established in India for a charitable purpose.

(4) The Institution or Fund is not expressed to be for the benefit of any particular religious community or caste. An institution or fund established for the benefit of women and children or of Scheduled Castes, Backward classes or Scheduled Tribes is not however to be treated as an institution or fund for the benefit of a religious community or caste.

(5) The Institution or Fund maintains regular accounts of its receipt and expenditure.

(iv) Section 80G(4) clarifies that the limits prescribed therein will apply with reference to aggregate amount of donations qualifying for deduction and not with reference to the quantum of deduction admissible. For applying the qualification limit, all the eligible donations should be aggregated and the sum total should be limited to 10% of the adjusted gross total income. The excess shall be ignored in computing the aggregate in respect of which deduction is allowable.

Adjusted gross total income means the gross total income as reduced by the following:

(1) amount of deductions under sections 80C to 80U (but not including section 80G),

(2) Any income on which income tax is not payable,

(3) Long term capital gains and

(4) Income referred to in sections 115A, 115AB,115AC, 115AD, 115BB and 115D.

(v) Where an assessee has claimed and has been allowed any deduction under this section in respect of any amount of donation, the same amount will not qualify for deduction under any other provision of the Act for the same or any other assessment year [Sub-section (5A)].

(vi) Where an institution or fund incurs expenditure of a religious nature for an amount not exceeding 5% of its total income in that previous year, such institution or fund shall be deemed to be a fund or institution to which the provisions of this section apply [Sub-section (5B)].

(vii) Donations in kind shall not qualify for deduction.

(viii) The deduction under section 80G can be claimed whether it has any nexus with the business of the assessee or not.

(ix) In respect of donations made after 31.3.1992 to any institution or fund, such institution or fund must be approved by the Commissioner in accordance with the rules made in this behalf.

(x) As per Circular No.2/2005 dated 12.1.2005, in cases where employees make donations to the Prime Minister's National Relief Fund, the Chief Minister's Relief Fund or the Lieutenant Governor's Relief Fund through their respective employers, it is not possible for such funds to issue separate certificate to every such employee in respect of donations made to such funds as contributions made to these funds are in the form of a consolidated cheque. An employee who makes donations towards these funds is eligible to claim deduction under section 80G. It is, hereby, clarified that the claim in respect of such donations as indicated above will be admissible under section 80G of the Income-tax Act, 1961 on the basis of the certificate issued by the Drawing and Disbursing Officer(DDO)/Employer in this behalf.

2.10 Deduction in respect of rent paid [Section 80GG]

(i) This section provides for deduction in respect of rent paid.

(ii) The following conditions have to be satisfied for claiming deduction under section 80GG -

(1) The assessee should not be receiving any house rent allowance exempt under section 10(13A).

(2) The expenditure incurred by him on rent of any furnished or unfurnished accommodation should exceed 10% of his total income arrived at after all deductions under Chapter VI A except section 80GG.

(3) The accommodation should be occupied by the assessee for the purposes of his own residence.

(4) The assessee should fulfil such other conditions or limitations as may be prescribed, having regard to the area or place in which such accommodation is situated and other relevant considerations.

(5) The assessee or his spouse or his minor child or an HUF of which he is a member should not own any accommodation at the place where he ordinarily resides or perform duties of his office or employment or carries on his business or profession; or

(6) If the assessee owns any accommodation at any place other than that referred to above, such accommodation should not be in the occupation of the assessee and its annual value is not required to be determined under section 23(2)(a) or section 23(4)(a).

(7) The assessee should file a declaration in Form 10BA, confirming the details of rent paid and fulfillment of other conditions, with the return of income.

(iii) The deduction admissible will be the least of the following:

(1) Actual rent paid minus 10% of the total income of the assessee before allowing the deduction, or

(2) 25% of such total income (arrived at after making all deductions under Chapter VI A but before making any deduction under this section), or

(3) Amount calculated at Rs.2,000 p.m.

Total income for the above purpose will not include long term capital gains, if any, and any income referred to in sections 115A to 115D.

Illustration 6

An assessee, whose total income is Rs.46,000, paid house rent at Rs.1,200 p.m. in respect of residential accommodation occupied by him at Mumbai. Compute the deduction allowable under section 80GG.

Solution

The deduction under section 80GG will be computed as follows:

(i) Actual rent less 10 per cent of total income

$$14{,}400 \text{ minus } \frac{(10 \times 46{,}000)}{100} = \text{Rs.}9{,}800(A)$$

(ii) 25 per cent of total income

$$\frac{25 \times 46{,}000}{100} = \text{Rs.}11{,}500(B)$$

(iii) Amount calculated at Rs.2,000 p.m.= Rs.24,000(C)

Deduction allowable (least of A, B and C) = Rs.9,800

2.11 Deduction in respect of donations for scientific research and rural development [Section 80GGA]

(i) Section 80GGA grants deduction in respect of the donations made for scientific research or rural development by any not having income chargeable under the head “Profits and gains of business or profession”.

(ii) The following donations would qualify for deduction under this section -

(1) Any sum paid by the assessee in the previous year to a scientific research association which has, as its object, the undertaking of scientific research or to a University, college or other institution to be used for scientific research; and

(2) Any sum paid by the assessee in the previous year to an association or institution which has as its object the undertaking of any programme of rural development to be used for carrying out any programme of rural development approved by the prescribed authority for purposes of section 35CCA or to an institution or association which has as its object the training of persons for implementing programmes of rural development.

It is, however, essential that in respect of both the aforesaid donations, the association or institution to which the donation is given must be approved by the prescribed authority; in the case of donation for scientific research, the donation must be to the institution approved under section 35(1)(ii) whereas in the case of donation for rural development the institution or association must be approved by the prescribed authority under section 35CCA(2) of the Income-tax Act.

(3) Any sum paid to a University, College or other institution to be used for research in social science or statistical research.

Such University, College or institution must be approved under section 35(1)(iii).

(4) Any sum paid to a public sector company or a local authority or to an association or institution approved by the National Committee for carrying out any eligible project or scheme.

However, the assessee must furnish a certificate referred to in section 35AC from such public sector company or local authority or association or institution.

The expression "National Committee" and "eligible project or scheme" shall have the meanings respectively assigned to them in the Explanation to section 35AC.

Note – It has been clarified that the deduction to which an assessee is entitled in respect of any sum paid to a scientific research association, university, college or other institution or to an association or institution for carrying out the programme of rural development, or to a public sector company, or to a local authority or to an association or institution for carrying out the eligible project or scheme referred to in section 35AC, respectively, shall not be denied merely on the ground that subsequent to the payment of such sum by the assessee the approval granted or, as the case may be, the notification has been withdrawn.

(5) Any sum paid to a rural development fund set up and notified under section 35CCA.

(6) Any sum paid by the assessee in the previous year to National Urban Poverty Eradication Fund (NUPEF).

(iii) Restrictions on deduction -

(1) No deduction under this section would be allowed in the case of an assessee whose gross total income includes income which is chargeable under the head "Profits and gains of business or profession."

(2) Where a deduction under this section is claimed and allowed for any assessment year, deduction shall not be allowed in respect of such payment under any provision of this Act for the same or any other assessment year.

2.12 Deduction in respect of contributions given by companies to political parties [Section 80GGB]

(i) This section provides for deduction of any sum contributed in the previous year by an Indian company to any political party *or an electoral trust.*

(ii) For the purposes of this section, the word "contribute" has the same meaning assigned to it under section 293A of the Companies Act, 1956, which provides that -

(a) a donation or subscription or payment given by a company to a person for carrying on any activity which is likely to effect public support for a political party shall also be deemed to be contribution for a political purpose;

(b) the expenditure incurred, directly or indirectly, by a company on advertisement in any publication (being a publication in the nature of a souvenir, brochure, tract, pamphlet or the like) by or on behalf of a political party or for its advantage shall also be deemed to be a contribution to such political party or a contribution for a political purpose to the person publishing it.

(iii) "Political party" means a political party registered under section 29A of the Representation of the People Act, 1951.

2.13 Deduction in respect of contributions given by any person to political parties [Section 80GGC]

(i) This section provides for deduction of any sum contributed in the previous year by any person to a political party *or an electoral trust.*

(ii) However, the deduction will not be available to a local authority and an artificial juridical person, wholly or partly funded by the Government.

(iii) "Political party" means a political party registered under section 29A of the Representation of the People Act, 1951.

3. DEDUCTION IN RESPECT OF INCOMES

3.1 Deductions in respect of profits and gains from undertakings or enterprises engaged in infrastructure development, etc. [Section 80-IA]

(i) Applicability

Section 80-IA(1) provides a ten year tax holiday to an assessee, whose gross total income includes any profits and gains derived by an undertaking or enterprise from an eligible business i.e., business referred to in sub-section (4), namely :

(1) Infrastructure facility - Any enterprise carrying on the business of :

(a) developing

(b) operating and maintaining; or

(c) developing, operating and maintaining any infrastructure facility.

Conditions: However, such enterprise must fulfil the following conditions :

(i) It must be owned by a company registered in India or by a consortium of such companies or by an authority or a board or a corporation or any other body established or constituted under any Central or State Act.

(ii) It has entered into an agreement with the Central or a State Government or a local authority or statutory body for (i) developing or (ii) operating and maintaining, or (iii) developing, operating and maintaining a new infrastructure facility.

(iii) It starts operating and maintaining such infrastructure facility on or after 1-4-1995.

(iv) However, where an enterprise which developed such infrastructure facility transfers it to another enterprise on or after 1-4-1999, and such transferee enterprise operates and maintains it according to the agreement drawn up with the Government, etc., this section will apply to the transferee enterprise for the unexpired period of deduction (which was available to the first enterprise).

Meaning of "infrastructure facility": For this purpose, 'infrastructure facility' means :

(i) a road, including toll road, a bridge or a rail system;

(ii) a highway project including housing or other activities being an integral part of the highway project;

(iii) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system; and

(iv) a port, airport, inland waterway or inland port or navigational channel in the sea.

Note –

1. 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, if the concerned port authority has issued a certificate that the said structures form part of the port.
2. Effluent treatment and conveyance system is a part of water treatment system and would accordingly, qualify as an infrastructure facility for the purpose of section 80-IA.

(2) Telecom undertakings : Any undertaking providing telecommunication services, whether basic or cellular, including radio paging, domestic satellite service or network of trunking (NOT), broadband network and internet services on or after 1 April, 1995 but on or before 31 March, 2005.

Meaning of "domestic satellite": 'Domestic satellite' has been defined by sub-section (12)(a) as "a satellite owned and operated by an Indian company for providing telecommunication services."

(3) Industrial parks / Special Economic Zones: Any undertaking which develops, develops and operates, or maintains and operates an industrial park or develops, or develops and operates, or maintains and operates, a special economic zone.

Conditions:

(i) The undertaking begins to operate an industrial park or special economic zone in accordance with the scheme framed and notified by the Central Government.

(ii) The scheme is notified by the Government for the period beginning on 1-4-1997 and ending on (i) *31-3-2011 for industrial parks* and (ii) 31.3.2006 for SEZs.

Rule 18C lays down the following eligibility criteria for Industrial Parks to claim benefit under section 80-IA (4)(iii) -

(1) The undertaking should begin to develop, develop and operate or maintain and operate an industrial park any time during the period from 1.4.2006 to 31.3.2009.

(2) The undertaking and the Industrial Park should be notified by the Central Government under the Industrial Park Scheme, 2008.

(3) The undertaking should continue to fulfill the conditions envisaged in the Industrial Park Scheme, 2008.

(iii) However, where an undertaking develops an industrial park on or after 1.4.99 or a special economic zone on or after 1.4.01 and transfers the operation and maintenance to another undertaking (transferee undertaking), the deduction to the

transferee undertaking shall be available for the remaining period in the ten consecutive assessment years, in such a manner as would have been available to the transferor undertaking, as if the operation and maintenance were not so transferred to the transferee undertaking.

(4) Power undertakings: Any undertaking which

(i) is set up in any part of India for the generation or generation and distribution of power. However, such undertaking must begin to generate power at any time during the period between 1.4.1993 *and 31.3.2011*.

(ii) starts transmission or distribution by laying a network of new transmission or distribution lines at any time during the period from 1.4.1999 *and 31.3.2011.* However, the deduction shall be allowed only in respect of profits derived from the laying of such network of new lines for transmission or distribution.

(iii) undertakes substantial renovation and modernisation of the existing network of transmission or distribution lines at any time during the period beginning on 1.4.2004 and ending on *31.3.2011*.

'Substantial renovation and modernisation' means an increase in the plant and machinery in the network of transmission or distribution lines by at least fifty per cent of the book value of such plant and machinery as on 1st April, 2004.

Telecom and Power undertakings should fulfill the following conditions:

(a) It is not formed by splitting up or reconstruction of a business already in existence. However, this condition shall not apply in the case of an undertaking which is formed as a result of reconstruction, re-establishment or revival of the business of any undertaking which has been discontinued in any previous year due to extensive damage or destruction of any building, machinery, plant or furniture owned by the assessee and used for the purposes of such business. Further, the reason for damage or destruction is due to any natural calamity or other unforeseen circumstances such as the following:

(i) Flood, typhoon, hurricane, cyclone, earthquake or other natural calamity, or

(ii) riot or civil disturbance, or

(iii) accidental fire or explosion, or

(iv) enemy action or action taken in combat,

and such business is re-established or revived within 3 years from the end of such previous year.

(b) The undertaking should not be formed by the transfer of machinery or plant previously used for any purpose.

However, these conditions do not apply in case of transfer, either in whole or in part, of machinery or plant previously used by a State Electricity Board. This is irrespective of whether or not such transfer is in pursuance of the splitting up or reconstruction of such State Electricity Board or reorganisation of the State Electricity Board under Part XIII of the Electricity Act, 2003.

Also, this condition shall not apply to second-hand machinery or plant imported by the assessee if the following conditions are fulfilled:

(i) Such machinery or plant was not used in India prior to the date of installation by the assessee.

(ii) No deduction on account of depreciation was allowed to any person prior to the date of installation by the assessee.

Further, where the total value of any plant or machinery previously used and now transferred to the new business does not exceed 20% of the total value of the machinery or plant used in the new business, such plant or machinery will be considered as new for this purpose.

(5) Undertakings owned by an Indian company and set up for reconstruction or revival of a power generating plant

(i) Clause (v) provides 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 *31.3.2011*.

(ii) Rate of Deduction

(1) The amount of deduction available will be 100% of the profits and gains derived from such business for ten consecutive assessment years commencing at any time during the periods specified in (iii) below.

(2) However, in case of telecom undertakings covered under (2) above, the deduction will be 100% for the first 5 assessment years and thereafter 30% for the further 5 assessment years.

(iii) Period of tax holiday/concession

(1) The assessee has the option to claim deduction for any 10 consecutive assessment years out of 15 years beginning from the year in which the undertaking or the enterprise develops or begins to operate the eligible business.

(2) The assessee may also claim deduction for 10 out of 15 years beginning from the year in which an undertaking undertakes substantial renovation and modernization of the existing transmission or distribution lines.

(3) In case of an infrastructure facility being a public facility like–

(i) a road, including a toll road, bridge or rail system; or

(ii) a highway project including housing or other activities which are an integral part of the highway project; or

(iii) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system,

the assessee can claim deduction for any 10 consecutive assessment years out of 20 years beginning from the year of operation.

(iv) Other provisions

(1) For the purpose of computing deduction under this section, the profits and gains of the eligible business shall be computed as if such eligible business were the only source of income of the assessee during the relevant previous years [Sub-section (5)].

(2) Where housing or other activities are an integral part of a highway project and the profits and gains have been calculated in accordance with the section, the profits shall not be liable to tax if the following conditions have been fulfilled:

(a) The profit has been transferred to a special reserve account; and

(b) the same is actually utilised for the highway project excluding housing and other activities before the expiry of 3 years following the year of transfer to the reserve account;

(c) The amount remaining unutilised shall be chargeable to tax as income of the year in which the transfer to the reserve account took place [Sub-section (6)].

(3) The deduction shall be allowed to the industrial undertaking only if the accounts of

the industrial undertaking for the relevant previous year have been audited by a chartered accountant and the assessee furnishes the audit report in the prescribed form, duly signed and verified by such accountant along with his return of income [Sub-section (7)].

(4) Where any goods or services held for the purposes of the eligible business are transferred to any other business carried on by the assessee, or vice versa, and if the consideration for such transfer does not correspond with the market value of the goods or services then the profits and gains of the eligible business shall be computed as if the transfer was made at market value. However, if, in the opinion of the Assessing Officer, such computation presents exceptional difficulties, the Assessing Officer may compute the profits on such reasonable basis as he may deem fit [Sub-section (8)].

For the above purpose, "market value" means the price such goods or services would ordinarily fetch in the open market.

(5) The deductions claimed and allowed under this section shall not exceed the profits and gains of the eligible business. Further, where deduction is claimed and allowed under this section for any assessment year no deduction in respect of such profits will be allowed under any other section under this chapter [Sub-section (9)].

(6) Where it appears to the Assessing Officer that the assessee derives more than ordinary profits from the eligible business due to close connection between the assessee and any other person, or due to any other reason, the Assessing Officer may consider such profits as may be reasonable for the purpose of computing deduction under this section [Sub-section (10)].

(7) The section empowers the Central Government to declare any class of industrial undertaking or enterprise as not being entitled to deduction under this section. The denial of exemption shall be with effect from such date as may be specified in the notification issued in the Official Gazette [Sub-section (11)].

(8) In the case of any amalgamation or demerger, by virtue of which the Indian company carrying on the eligible business is transferred to another Indian company, deduction under this section will be available as follows:

(a) No deduction will be available to the amalgamating company or the demerged company, as the case may be, in the year of amalgamation/demerger.

(b) The provisions of this section will apply to the amalgamated/resulting company as they would have applied to the amalgamating/demerged company if the amalgamation/demerger had not taken place [Sub-section (12)].

However, such transfer of benefit of deduction to the amalgamated/resulting company would not be available in respect of any enterprise or undertaking which is transferred in a

scheme of amalgamation or demerger effected on or after 1.4.2007 [Sub-section (12A)].

(9) 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) [Sub-section (13)].

(10) The tax holiday under section 80-IA would not be available in relation to a business referred to in sub-section (4) which is in the nature of a works contract awarded by any person (including the Central or State Government) and executed by the undertaking or enterprise referred to in section 80-IA(1).

3.2 Deduction 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.

3.3 Deductions in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings, etc. [Section 80-IB]

(i) Applicability

This section will be applicable to assesses, whose gross total income includes any profits and gains derived from any of the following business activities -

(1) An industrial undertaking including a small scale industrial undertaking (SSI)

(2) A ship

(3) A hotel, multiplex theatre or convention centre.

(4) Any company carrying on scientific and industrial research and development

(5) An undertaking which begins commercial production or refining of mineral oil *or commercial production of natural gas in licensed blocks*

(6) An undertaking engaged in construction and development of housing projects approved by a local authority

(7) An industrial undertaking deriving profits from the business of setting up and operating a cold chain facility for agricultural produce.

(8) An undertaking deriving profits from the business of processing, preservation and packaging of fruits or vegetables *or meat and meat products or poultry or marine or dairy products* or from the integrated business of handling, storage and transportation of foodgrains.

(9) An undertaking operating and maintaining a hospital in a rural area.

(ii) Conditions to be fulfilled, amount of deduction and period of deduction

The rate and period of deduction and the conditions required to be satisfied by the different categories of businesses are given below :

(1) Industrial undertakings [Sub-sections (2), (3), (4) and (5)]

Conditions: In order to be eligible to claim deduction under section 80-IB, an industrial undertaking must fulfill the following conditions:

(i) It is not formed by splitting up, or the reconstruction of, an existing business.

(ii) It is not formed by the transfer to a new business of any plant or machinery previously used for any other purpose.

In order to satisfy this condition, the total value of the plant or machinery so transferred should not exceed 20% of the value of the total plant or machinery used in the new business.

For the purpose of this condition, machinery or plant would not be regarded as previously used if it had been used by any person other than the assessee provided the following conditions are satisfied:

(a) such plant or machinery was not used in India at any time prior to the date of its installation by the assessee;

(b) the plant or machinery was imported into India from a foreign country;

(c) no deduction in respect of depreciation of such plant or machinery has been allowed to any person at any time prior to the date of installation by the assessee.

(iii) It manufactures or produces any article or thing (except those specified in the Eleventh Schedule) or operates a cold storage plant, in any part of India. However, in the case of an SSI, restriction regarding goods specified in the Eleventh Schedule shall not apply.

(iv) In case of a manufacturing industrial unit, it should employ 10 or more workers (if manufacture is carried on with the aid of power), or 20 or more workers (if manufacture is carried on without the use of power).

Rate and period of deduction : The rate and period of deduction for different categories of industrial undertakings are given below :

(i) The amount of deduction for an industrial undertaking will be 25% of the profits and gains derived from such industrial undertaking for a period of 10 consecutive assessment years starting with the initial assessment year, i.e. the assessment year relevant to the previous year in which the industrial undertaking begins to manufacture or produce articles or things. In the case of a company, the rate of deduction will be 30%. Again, where the assessee is a co-operative society, the period of 10 consecutive years will become 12 consecutive assessment years.

However, in order to claim the amount of deduction specified here, the assessee must fulfil the following conditions:

(a) It must have begun to manufacture or produce articles or things or operate the plants at any time between 1-4-1991 and 31-3-1995, or such further period as specified by the Central Government in the Official Gazette with respect to such class of industries.

(b) In case of an SSI, the period specified for the above purpose is 1-4-1995 and 31-3-2002.

"Small-scale industrial undertaking" means an industrial undertaking which is, as on the last day of the previous year, regarded as a small-scale industrial undertaking under section 11B of the Industrial (Development and Regulation) Act, 1951.

(ii) In case of the following categories of industrial undertakings, the amount and period of deduction will be 100% of the profits and gains derived from the industrial undertaking for the initial 5 assessment years and thereafter 25% of such profits and gains (in case of a company, the rate is 30%):

(a) an industrial undertaking located in an industrially backward State specified in the Eighth Schedule. In this case, the total period of deduction should not exceed 10 consecutive assessment years provided the industrial undertaking begins manufacture or production of articles or things or operation of cold storage plant between 1-4-1993 and 31-3-2004. Where the industrial undertaking is a co-operative society, the deduction will be available for 12 assessment years (instead of 10), including the initial assessment year [Sub-section (4)]

However, the terminal date for setting up of industrial undertakings in the State of Jammu and Kashmir is 31.3.2012. A negative list has also been provided in Part C of the Thirteenth Schedule to specify the commodities which should not be manufactured or produced by such undertakings. The list includes Cigarettes/cigars of tobacco, manufactured tobacco and substitutes, distilled/brewed alcoholic drinks and aerated branded beverages and their concentrates.

The Eighth Schedule specifies the following to be industrially backward States and Union Territories: (1) Arunachal Pradesh (2) Assam (3) Goa (4) Himachal Pradesh (5) Jammu & Kashmir (6) Manipur (7) Meghalaya (8) Mizoram (9) Nagaland (10) Sikkim (11) Tripura (12) Andaman and Nicobar Islands (13) Dadra and Nagar Haveli (14) Daman & Diu (15) Lakshadweep (16) Pondicherry

In case of notified industries in the North-eastern region of India, the amount of deduction will be 100% of the profits and gains for 10 consecutive assessment years. However, no such deduction shall be allowed to any undertaking or enterprise which

is eligible for claiming benefit under section 80-IC.

"North-eastern region" means the region comprising the States of Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim and Tripura.

(b) an industrial undertaking located in such industrially backward districts of Category A or B, as the Central Government may, having regard to the prescribed guidelines, specify in the Official Gazette.

In case of Category A industries, the total period of deduction is 10 consecutive assessment years (except in case of a co-operative society where it is 12 years) provided the undertaking begins manufacture or production of articles or things or operation of cold storage plant between 1-10-1994 and 31-3-2004.

In case of Category B industries, the total period of deduction is 8 consecutive assessment years (except in case of a co-operative society where it is 12 years) provided the undertaking begins manufacture or production of articles or things or operation of cold storage plant between 1-10-1994 and 31-3-2004.

(2) Ships [Sub-section (6)]

Conditions: In order to claim deduction under this section, the following conditions must be fulfilled:

(i) It should be owned by an Indian company and should be wholly used for its business purposes.

(ii) It was not owned or used in Indian territorial waters by any person resident in India prior to the date of its acquisition by the Indian company.

(iii) It was brought into use by the Indian company at any time between 1.4.91 and 31.3.95.

Rate and period of deduction : The amount of deduction will be 30% of the profits and gains derived from such a ship for a period of 10 consecutive assessment years including the initial assessment year i.e., the assessment year relevant to the previous year in which the ship is first bought into use.

(3) Hotels [Sub-section (7)]

Conditions: In order to claim deduction under this section, the following conditions must be fulfilled:

(i) The business of the hotel is not formed by splitting up, or the reconstruction of, an existing business or by the transfer to the new business of a building previously used as a hotel or of any plant or machinery previously used for any purpose.

(ii) The business of the hotel is owned and carried on by a company registered in India with a paid up capital of not less than Rs.5,00,000.

(iii) The hotel is approved by the prescribed authority.

Rate and period of deduction: The rate and period of deduction for different categories of hotels are given below.

(i) In case of hotels located in a hilly area or a rural area or a place of pilgrimage or such other place as the Central Government, having regard to the need for development of infrastructure for tourism in any place or such other considerations, may specify in the Official Gazette, the amount of deduction will be 50% of the profits and gains derived from such business.

The deduction will be available for a period of 10 consecutive assessment years beginning with the initial assessment year i.e. the assessment year relevant to the previous year in which the business of the hotel starts functioning.

In order to claim the deduction, the hotel must start functioning at any time between 1-4-1990 and 31-3-1994 or between 1-4-1997 and 31-3-2001, and should be approved by the prescribed authority for the purpose of deduction under this clause.

However, hotels situated within the municipal jurisdiction of Calcutta, Chennai, Mumbai and Delhi which has started functioning between 1-4-1997 and 31-3-2001 would not be eligible for this deduction.

"Hilly area" means any area located at a height of one thousand metres or more above the sea level.

"Place of pilgrimage" means a place where any temple, mosque, gurdwara, church or other place of public worship of renown throughout any State or States is situated.

"Rural area" means any area other than-

(a) an area which is comprised within the jurisdiction of a municipality or a cantonment board which has a population of not less than 10,000 according to the preceding census of which relevant figures have been published before the first day of the previous year; or

(b) an area within such distance not being more than 15 kilometers from the local limits of any municipality or cantonment board referred to in sub-clause (i), as the Central Government may, having regard to the stage of development of such area including the extent of, and scope for, urbanisation of such area and other relevant considerations specify in this behalf by notification in the Official Gazette.

(ii) In case of hotels located in any place other than those specified in (i) above, the amount of deduction will be 30% of the profits and gains derived from such business.

The deduction will be available for a period of 10 consecutive assessment years beginning with the initial assessment year.

In order to claim the deduction, the hotel must start functioning at any time between 1-4-1991 and 31-3-1995 or between 1-4-1997 and 31-3-2001, and should be approved by the prescribed authority for the purpose of deduction under this clause. However, hotels situated within the municipal jurisdiction of Calcutta, Chennai, Mumbai and Delhi which have started functioning between 1-4-1997 and 31-3-2001 would not be eligible for this deduction.

(4) Multiplex theatres located in cities other than Kolkata, Chennai, Delhi or Mumbai [Sub-section (7A)]

Conditions: (i) The multiplex theatre should be constructed at any time between 1.4.2002 and 31.3.2005,

(ii) The business of the multiplex theatre is not formed by the splitting up, or the reconstruction, of a business already in existence or by the transfer of any building or machinery or plant previously used, to the new business.

(iii) The assessee should furnish along with the return of income, an audit report from a chartered accountant in the prescribed form and manner certifying that the deduction has been correctly claimed.

Rate and period of deduction: The amount of deduction shall be 50% of the profits from the business of building, owning and operating the multiplex theatre. The deduction shall be available for 5 consecutive years beginning with the initial assessment year i.e. the assessment year relevant to the previous year in which a cinema hall being a part of the multiplex theatre, starts operating on a commercial basis for the above purposes, the related terms have been defined as follows:

"Multiplex theatre" means a building of a prescribed area, comprising of two or more

cinema theatres and commercial shops of such size and number and having such other facilities and amenities as may be prescribed.

(5) Convention Centre [Sub-section (7B)]

Conditions: (i) The convention centre should be constructed at any time between 1.4.2002 and 31.3.2005.

(ii) The business of the convention centre is not formed by the splitting up, or the reconstruction, of a business already in existence or by the transfer of any building or machinery or plant previously used, to the new business.

(iii) The assessee should furnish along with the return of income, an audit report from a chartered accountant in the prescribed form and manner certifying that the deduction has been correctly claimed.

Rate and period of deduction: The amount of deduction shall be 50% of the profits from the business of building, owning and operating the convention centre. The deduction shall be available for 5 consecutive years beginning with the initial assessment year i.e. the assessment year relevant to the previous year in convention centre starts operating on a commercial basis.

For the above purpose, "convention centre" means a building of a prescribed area comprising of convention halls to be used for the purpose of holding conferences and seminars being of such size and number and having such facilities and amenities as may be prescribed.

(6) Companies carrying on scientific and industrial research and development [Sub-section (8) & (8A)]

(i) The company is registered in India.

(ii) The company has the main object of scientific and industrial research and development.

(iii) The company is approved by the prescribed authority at any time before 1-4-1999.

Rate and period of deduction : Deduction will be calculated at 100% of the profits and gains from such business for 5 assessment years including the initial assessment year.

Sub-section (8A) provides for deduction in case of a company carrying on scientific research and development if such company fulfils the following conditions:

(i) It is registered in India.

(ii) It has the main object of scientific and industrial research and development.

(iii) It is for the time being approved by the prescribed authority at any time after 31.3.2000 but before 1.4.2007.

(iv) It fulfils such other conditions as may be prescribed.

The amount of deduction shall be 100% of the profits and gains of such business.

The deduction will be available for a period of 10 consecutive assessment years starting with the initial assessment year i.e. the assessment year relevant to the previous year in which the company is approved by the prescribed authority.

(7) Undertakings engaged in commercial production or refining of mineral oil or commercial production of natural gas in licensed blocks [Sub-section (9)]

Conditions: In order to claim deduction under the section, the undertaking should be engaged in commercial production or refining of mineral oil *or commercial production of natural gas in licensed blocks*.

The following further conditions should be fulfilled –

(1) In case of an undertaking engaged in commercial production of mineral oil -

(i) Where such operations are carried out in the North Eastern Region, it has begun commercial production before 1-4-1997.

(ii) Where such operations are carried out in any other part of India, it begins commercial production on or after 1-4-1997.

(2) In case of an undertaking engaged in refining of mineral oil, it begins refining of mineral oil on or after 1-10-1998 *but not later than 31.3.2012*.

(3) In case of an undertaking engaged in commercial production of natural gas in licensed blocks –

(1) the blocks are licensed under the VIII Round of bidding for award of exploration contracts ("NELP-VIII") under the New Exploration Licencing Policy announced by the Government of India vide Resolution No.O-19018/22/95-ONG.DO.VL, dated 10th February, 1999; or

(2) the blocks are licensed under the IV Round of bidding for award of exploration contracts for Coal Bed Methane blocks

and begins commercial production of natural gas on or after 1st April, 2009.

Note – *All blocks licensed under a single contract to be treated as a single "undertaking"*

For the purposes of claiming deduction under sub-section (9), all blocks licensed under a single contract, which has been awarded -

(1) under the New Exploration Licencing Policy announced by the Government of India vide Resolution No.O-19018/22/95-ONG.DO.VL, dated 10.2.1999 or

(2) in pursuance of any law for the time being in force or

(3) by Central or a State Government in any other manner

shall be treated as a single "undertaking".

This definition of "undertaking" will be applicable both in relation to mineral oil and natural gas.

Rate and period of deduction: The deduction will be allowed at 100% of the profits and gains from such business for 7 consecutive assessment years including the initial assessment year i.e. the assessment year relevant to the previous year in which the undertaking commences the commercial production or refining of mineral oil.

(8) Housing projects [Sub-section (10)]

Conditions: In order to be eligible to claim deduction under section 80-IB, an undertaking developing and building housing projects must fulfil the following conditions:

(i) The undertaking has commenced or commences development and construction of the housing project on or after 1.10.1998. The housing project should be completed within 4 years from the end of the financial year in which the project is approved by the local authority. In respect of projects approved by the local authority before 1.4.2004, the construction should be completed on or before 31.3.2008. For this purpose, the date of approval would be the date on which the building plan is first approved by the local authority and the date of completion of the housing project would be the date on which the completion certificate is issued by such authority.

(ii) The projects must be approved before *31.3.2008* by a local authority.

(iii) The project is on a plot of land which is at least one acre.

In order to encourage the reconstruction and redevelopment of slum dwellings, the conditions that the construction should be completed within 4 years and that the minimum plot size should be one acre have been relaxed. The relaxation is in respect of housing

projects carried out in accordance with a scheme framed by the Central Government or a State Government for reconstruction or redevelopment of existing buildings in areas declared to be slum areas. Such a scheme should be notified by the Board in this behalf.

(iv) The residential unit has a maximum built-up area of 1000 sq.ft. (if such residential unit is situated in Delhi or Mumbai or within 25 km from the municipal limits of these cities) or 1500 sq.ft. at any other place.

(v) the built-up area of the shops and other commercial establishments included in the housing project should not exceed five percent. of the aggregate built-up area of the housing project or 2000 sq. ft., whichever is less.

The expression "built-up area" has been defined to mean the inner measurements of the residential unit at the floor level, including the projections and balconies, as increased by the thickness of the walls but not including the common areas shared with other residential units.

(vi) The undertaking which develops and builds the housing project shall not be allowed to allot more than one residential unit in the housing project to the same person, not being an individual. Where the person is an individual, no other residential unit in such housing project should be allotted to any of the following persons:-

(1) the individual himself or spouse or minor children of such individual;

(2) the Hindu undivided family in which such individual is the karta;

(3) any person representing such individual, the spouse or minor children of such individual or the Hindu undivided family in which such individual is the karta.

Rate and period of deduction: The deduction will be allowed at 100% of the profits derived from such project in any previous year relevant to any assessment year.

Note – *The main aim of the tax concession under section 80-IB(10) is to provide tax benefit to the person undertaking the investment risk i.e. the actual developer. However, any person undertaking pure contract risk is not entitled to the tax benefit. Accordingly, the benefit under sub-section (10) would not be available to any undertaking which executes the housing project as a works contract awarded by any other person (including the Central or State Government).*

(9) Cold chain facilities for agricultural produce [Sub-section (11)]

Conditions: In order to claim deduction under this section, the assessee must fulfil the following conditions:

(i) The industrial undertaking should be deriving profit from the business of setting up and operating a cold chain facility for agricultural produce.

(ii) The undertaking must begin to operate such facility on or after 1-4-1999 but before 1-4-2004.

For the purposes of this section, "cold chain facility" means a chain of facilities for storage or transportation of agricultural produce under scientifically controlled conditions including refrigeration and other facilities necessary for the preservation of such produce.

Rate and period of deduction: The amount of deduction will be 100% of the profits and gains derived from such industrial undertaking for a period of 5 consecutive assessment years starting with the initial assessment year i.e. the assessment year relevant to the previous year in which the industrial undertaking begins to operate the cold chain facility. Thereafter, the deduction allowable is 25% of such profits and gains (30% in case of a company) for the next 5 assessment years.

Where the assessee is a co-operative society, the period of 10 consecutive years will become 12 consecutive assessment years.

(10) Undertakings engaged in handling of foodgrains etc. [Sub-section (11A)]

Conditions: In order to claim deduction, the undertaking should fulfill the following conditions:

(i) It should be deriving profits from the business of processing, preservation and packaging of fruits or vegetables or from the integrated business of handling, storage and transportation of foodgrains.

(ii) It should begin to operate such business on or after 1.4.2001.

(iii) The benefit of deduction under sub-section (11A) has now been extended to an undertaking deriving profit from the business of processing, preservation and packaging of meat or meat products or poultry or marine or dairy products, if it begins to operate such business on or after 1.4.2009.

Rate and period of deduction: The amount of deduction shall be 100% of the profits and gains derived from such business for 5 assessment years beginning with the initial assessment year i.e. the assessment year relevant to the previous year in which the undertaking begins such business. Thereafter, the deduction allowable is 25%. In the case of a company, the rate of 25% shall be substituted by 30%. The total period of deduction should not exceed 10 consecutive assessment years.

(11) Undertakings operating and maintaining a hospital in a rural area [Sub-section (11B)]

(i) The profits derived by an undertaking from the business of operating and maintaining a hospital in a rural area is eligible for a deduction of hundred per cent of such profits and gains.

(ii) The deduction is available for a period of five consecutive assessment years beginning from the initial assessment year (i.e. assessment year relevant to the previous year in which the undertaking begins to provide medical services).

(iii) The undertaking would be eligible for the deduction if such hospital -

(a) is constructed during the period beginning on the 1st October, 2004 and ending on 31st March, 2008;

(b) has at least one hundred beds for patients; and

(c) is constructed in accordance with the regulations in force of the local authority.

(iv) Further, for claiming the deduction, the assessee has to file along with the return of income, an audit report in the prescribed form and in the prescribed manner, duly signed and verified by a chartered accountant.

(12) Undertakings operating and maintaining a hospital located anywhere in India, other than the excluded area [Sub-section (11C)]

(i) Sub-section (11C) provides a five year tax holiday to hospitals set up in other than the excluded areas. Excluded area means the area comprising the urban agglomerations of Greater Mumbai, Delhi, Kolkata, Chennai, Hyderabad, Bangalore and Ahmedabad, the districts of Faridabad, Gurgaon, Ghaziabad, Gautam Budh Nagar and Gandhi Nagar and the city of Secunderabad.

(ii) To be eligible for this benefit, the hospital should be constructed and should start functioning between 1.4.08 to 31.3.2013. Further, it should have at least 100 beds for patients. For claiming this benefit, it is necessary that the audit report signed and verified by a Chartered Accountant certifying that deduction has been correctly claimed should be filed along with the company's return of income.

(iii) The construction of the hospital should be in accordance with the regulations or bye-laws of the local authority. The hospital shall be deemed to have been constructed on the date on which a completion certificate in respect of such construction is issued by the local authority concerned.

(iii) Other Provisions

(1) For the purpose of computing deduction under this section, the profits and gains of the eligible business shall be computed as if such eligible business were the only source of income of the assessee during the relevant previous years.

(2) The accounts of the industrial undertaking for the relevant previous year should be audited by a chartered accountant and the assessee should furnish the audit report in the prescribed form, duly signed and verified by such accountant along with the return of income.

(3) Where any goods held for the purposes of the eligible business are transferred to any other business carried on by the assessee, or vice versa, and if the consideration for such transfer does not correspond with the market value of the goods, then, the profits and gains of the eligible business shall be computed as if the transfer was made at market value. However, if, in the opinion of the Assessing Officer, such computation presents exceptional difficulties, the Assessing Officer may compute the profits on such reasonable basis as he may deem fit.

For the above purpose, "market value" means the price such goods would ordinarily fetch on sale in the open market.

(4) The deduction claimed and allowed under this section shall not exceed the profits and gains of the eligible business. Further, where deduction is claimed and allowed under this section for any assessment year, no deduction in respect of such profits will be allowed under any other section under this Chapter.

(5) Where it appears to the Assessing Officer that the assessee derives more than ordinary profits from the eligible business due to close connection between him and any other person, or due to any other reason, the Assessing Officer may consider such profits as may be reasonable for the purpose of computing deduction under this section.

(6) The section empowers the Central Government to declare any class of industrial undertaking or enterprise as not being entitled to deduction under this section. The denial of exemption shall be with effect from such date as may be specified in the notification issued in the Official Gazette.

(7) In the case of any amalgamation or demerger, by virtue of which the Indian company carrying on the eligible business is transferred to another Indian company, deduction under this section will be available as follows:

(a) No deduction will be available to the amalgamating company or the demerged company, as the case may be, in the year of amalgamation/demerger.

(b) The provisions of this section will apply to the amalgamated/resulting company as they would have applied to the amalgamating/demerged company, if the amalgamation/demerger had not taken place.

3.4 Special provisions in respect of certain undertakings or enterprises in certain undertakings or enterprises in certain special category States [Section 80-IC]

(i) This section allows tax holiday to the new undertakings or existing undertakings on their substantial expansion in the states of Himachal Pradesh, Uttaranchal, Sikkim and North-Eastern States.

(ii) For this purpose, substantial expansion means increase in the investment in plant and machinery by at least 50% of the book value of the plant and machinery (before taking depreciation in any year), as on the first day of the previous year in which the substantial expansion is undertaken.

(iii) The tax holiday in the states of Himachal Pradesh and Uttaranchal will be 100% for the first five assessment years and 25% (30% in the case of a company) for the next five assessment years.

(iv) However, tax holiday in the states of Sikkim and North-Eastern States will be 100% for ten assessment years commencing from the initial assessment year.

(v) For the purpose of exemption, two classifications have been made and the Thirteenth Schedule and Fourteenth Schedule have been inserted in the Income-tax Act. The said Schedules specify the list of articles and the States for the purposes of availing deduction under this section.

(vi) The first classification is applicable to undertakings or enterprises which manufacture or produce any article or thing, not being any article or thing specified in the 13th Schedule (namely, tobacco, aerated beverages, pollution causing paper and paper products etc.) in any export processing zone or integrated infrastructure development centre or industrial growth centre or industrial estate or industrial park or software technology park or industrial areas or theme park in these States as notified by the Board.

(vii) The second classification is applicable to those undertakings or enterprises which manufacture or produce article or thing specified in the 14th Schedule only in these States without any specification of the specified zone, area etc.

(viii) The period during which the undertakings in different States should begin or should have begun to manufacture or produce are given hereunder -

Himachal Pradesh and Uttaranchal	From 7.1.03 and ending before 1.4.2012
Sikkim	From 23.12.02 and ending before 1.4.2007
North-Eastern States	From 24.12.97 and ending before 1.4.2007

(ix) No benefit to these undertakings will be available under any of the sections in Chapter VIA or section 10A or section 10B in relation to the profits and gains of such undertakings.

(x) While computing the total period of 10 years the period for which the benefit under section 80IB or under section 10C has already been availed, if any, shall also be included.

(xi) The other conditions such as that it should not be formed by splitting or reconstruction of a business already in existence, or by transfer to a new business of plant and machinery previously used for any purpose are the same as are applicable for claiming benefit under section 80IA.

3.5 Tax holiday in respect of profits and gains from the business of hotel or business of building, owning and operating a convention centre in NCR [Section 80-ID]

(i) Section 80-ID provides for a deduction of 100% of profits and gains derived by an undertaking from the eligible business i.e. business of hotel or business of building, owning and operating a convention centre in a specified area, for a period of 5 consecutive assessment years beginning from the year in which such hotel starts functioning or convention centre starts operating on a commercial basis.

(ii) However, such hotel or convention centre should be constructed at any time during the period from 1.4.2007 to 31.3.2010.

(iii) Specified area means the National Capital Territory of Delhi and the districts of Faridabad, Gurgaon, Gautam Budh Nagar and Ghaziabad. This is to boost the construction activity in NCR in view of the upcoming Common Wealth Games in 2010.

(iv) The benefit of this five year tax holiday has now been extended to new two, three or four star hotels located in specified districts having a World Heritage Site. The specified districts are Agra, Jalgaon, Aurangabad, Kancheepuram, Puri, Bharatpur, Chhatarpur, Thanjavur, Bellary, South 24 Parganas, Chamoli, Raisen, Gaya, Bhopal, Panchmahal, Kamrup, Goalpara, Nagaon, North Goa, South Goa, Darjeeling and

Nilgiri. For availing this benefit, the hotel should be constructed and should start functioning between 1.4.08 to 31.3.2013.

(v) "Convention centre" means a building of a prescribed area comprising of convention halls to be used for the purpose of holding conferences and seminars, being of such size and number and having such other facilities and amenities, as may be prescribed.

Rule 18DE prescribes the following conditions to be fulfilled by a convention centre in order to be eligible for deduction under section 80-ID:

(a) the convention centre shall have a minimum covered plinth area of 25,000 sq. mts;

(b) it shall have minimum of 3,000 seating capacity;

(c) there shall be minimum of 10 convention halls;

(d) the convention centre shall have convention halls, whether called conference halls or seminar halls or auditorium for holding seminars and conferences;

(e) each convention hall of the convention centre shall be equipped with modern public address system, slide and power-point projection system and LCD projector or video screening facility;

(f) the convention centre shall have a documentation centre with computers and printers, telephone with STD or ISD facilities, e-mail, photocopy and scanning facility along with trained operators to provide these facilities;

(g) the convention centre shall be completely centrally air-conditioned;

(h) the convention centre shall have adequate parking facility and other public convenience as per local building regulations and should also fulfill all local building regulations in respect of fire and safety.

In addition to the above facilities, the convention centers may have the following:

(a) an amphitheatre and landscaped open spaces for outdoor conference or seminar related activities;

(b) a kitchen, dining facility, cafeteria or restaurant only to support events in the convention centre.

(vi) "Hotel" means a hotel of two-star, three-star or four-star category as classified by the Central Government;

(vii) Such business should not be formed by the splitting up, or the reconstruction, of a business already in existence. It should not be formed by the transfer to a new business of a building previously used as a hotel or convention center. Further, it should not be formed by the transfer to a new business of machinery or plant previously used for any purpose exceeding 20% of the total value of machinery and plant used in the business.

(viii) For this purpose, any machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose if the following conditions are fulfilled:

(a) such machinery or plant was not at any time used in India;

(b) such machinery or plant is imported into India from any country outside India; and

(c) no deduction on account of depreciation has been allowed in respect of such machinery or plant to any person earlier.

(ix) 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.

(x) The deduction under this section should not exceed the profits of such eligible business of the undertaking.

(xi) The deduction shall be allowed only if the accounts are audited by a Chartered Accountant, who is also required to certify that the deduction has been correctly claimed. Further, the audit report should be furnished along with the return of income.

(xii) 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 or section 10AA is allowable in respect of such profits.

(xiii) 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.

(xiv) 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.

(xv) The Central Government may notify that the benefit conferred by this section shall not apply to any class of undertaking with effect from any specified date.

3.6 Tax holiday in respect of profits and gains from eligible business of certain undertakings in North-Eastern States [Section 80-IE]

(i) This section provides for an incentive to an undertaking which has during the period between 1st April, 2007 and 1st April, 2017, begun or begins, in any of the North-Eastern States (i.e., the States of Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim and Tripura) -

(1) to manufacture or produce any eligible article or thing;

(2) to undertake substantial expansion to manufacture or produce any eligible article or thing;

(3) to carry on any eligible business.

(ii) Eligible article or thing means the article or thing other than the following-

(a) goods falling under Chapter 24 of the First Schedule to the Central Excise Tariff Act, 1985 which pertains to tobacco and manufactured tobacco substitutes;

(b) pan masala as covered under Chapter 21 of the First Schedule to the Central Excise Tariff Act, 1985;

(c) plastic carry bags of less than 20 microns; and

(d) goods falling under Chapter 27 of the First Schedule to the Central Excise Tariff Act, 1985 produced by petroleum oil or gas refineries.

(iii) Substantial expansion means increase in the investment in the plant and machinery by at least 25% of the book value of plant and machinery (before taking depreciation in any year), as on the first day of the previous year in which the substantial expansion is undertaken.

(iv) Eligible business means the business of -

(a) hotel (not below two star category);

(b) adventure and leisure sports including ropeways;

(c) providing medical and health services in the nature of nursing home with a minimum capacity of 25 beds;

(d) running an old-age home;

(e) operating vocational training institute for hotel management, catering and food craft, entrepreneurship development, nursing and para-medical, civil aviation related training, fashion designing and industrial training;

(f) running information technology related training centre;

(g) manufacturing of information technology hardware; and

(h) Bio-technology.

(v) Where the gross total income of an assessee includes any profits and gains derived by such an undertaking, a deduction of 100% of the profits and gains derived from such business for 10 consecutive assessment years commencing with the initial assessment year shall be allowed in computing the total income of the assessee. Initial assessment year means the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or things, or completes substantial expansion.

(vi) However, the following conditions have to be fulfilled by the undertaking for claiming benefit of deduction under this section -

(1) It should not be formed by splitting up, or the reconstruction, of a business already in existence (except in circumstances provided in section 33B)

(2) It should not be formed by the transfer to a new business of machinery or plant previously used for any purpose exceeding 20% of the total value of machinery and plant used in the business.

(vii) For this purpose, any machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose if the following conditions are fulfilled:

(a) such machinery or plant was not at any time used in India;

(b) such machinery or plant is imported into India from any country outside India; and

(c) no deduction on account of depreciation has been allowed in respect of such machinery or plant to any person earlier.

(viii) Where deduction has been allowed under this section in computing the total income of the assessee, no deduction shall be allowed under any other section contained in Chapter VIA or in section 10A or section 10AA or section 10B or section 10BA, in relation to the profits and gains of the undertaking.

(ix) Further, no deduction shall be allowed to any undertaking under this section, where the total period of deduction inclusive of the period of deduction under this section, or under section 80-IC or under the second proviso to sub-section (4) of section 80-IB or under section 10C, as the case may be, exceeds 10 assessment years.

(x) 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.

(xi) The deduction under this section should not exceed the profits of such eligible business of the undertaking.

(xii) The deduction shall be allowed only if the accounts are audited by a Chartered Accountant, who is also required to certify that the deduction has been correctly claimed. Further, the audit report should be furnished along with the return of income.

(xiii) 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.

(xiv) 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.

(xv) The Central Government may notify that the benefit conferred by this section shall not apply to any class of undertaking with effect from any specified date.

(xvi) 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.

3.7 Deduction in respect of profits and gains from business of collecting and processing of bio-degradable waste [Section 80JJA]

(i) This section provides for deduction in respect of profits and gains from the business of collecting and processing bio-degradable waste.

(ii) The deduction is allowable where the gross total income of an assessee includes any profits and gains derived from any of the following businesses -

(1) collecting and processing or treating of bio-degradable waste for generating power, or

(2) producing bio-fertilizers, bio-pesticides or other biological agents, or

(3) producing bio-gas, or

(4) making pellets or briquettes for fuel or organic manure.

(iii) The deduction allowable under this section is an amount equal to the whole of such profits and gains for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which the business commences.

3.8 Deduction in respect of employment of new workmen [Section 80JJAA]

(i) In order to encourage the employers to further generate more employment opportunities, section 80JJAA provides an incentive in the form of a special deduction against business profits of a company.

(ii) The deduction shall amount to 30% of additional wages paid to the new regular workmen employed by the assessee in the previous year. The deduction shall be available for three assessment years including the assessment year relevant to the previous year in which the employment is provided.

(iii) The following conditions have to be fulfilled in order to be eligible for the deduction provided in the section:

(1) The assessee should be an Indian company.

(2) Its gross total income should include profits and gains derived from an industrial undertaking.

(3) The industrial undertaking should be engaged in the manufacture or production of any article or thing.

(4) The industrial undertaking should not have been formed by splitting up of an existing undertaking.

(5) The industrial undertaking should not have been formed by amalgamation with another industrial undertaking.

(6) The assessee should furnish along with the return of income a report of a chartered accountant in Form No. 10DA giving the prescribed particulars.

(7) In case of a new industrial undertaking, in the first previous year, it employs more than 100 regular workmen.

(8) In the case of an existing industrial undertaking, the number of regular workers employed during the relevant previous year is equal to at least 110% of the regular workmen employed in such undertaking as on the last day of the preceding year.

(iv) Meaning of "Workman"

As explained above, the industrial undertaking should employ more than 100 workmen. 'Workman' shall have the meaning assigned to it in section 2(s) of the Industrial Disputes Act, 1947 i.e., any person (including an apprentice) employed in any industry to do any manual, unskilled, skilled, technical, operational, clerical or supervisory work for hire or reward, whether the terms of employment be express or implied, and for the purposes of any proceedings under this Act in relation to an industrial dispute, includes any such person who has been dismissed, discharged or retrenched in connection with, or as a consequence of, that dispute, or whose dismissal, discharge or retrenchment has led to that dispute, but does not include any such person—

(1) who is subject of the Air Force Act, 1950, or the Army Act, 1950, or the Navy Act, 1957; or

(2) who is employed in the police service or as an officer or other employee of a prison; or

(3) who is employed mainly in a managerial or administrative capacity; or

(4) who, being employed in a supervisory capacity, draws wages exceeding one thousand six hundred rupees per menses or exercises, either by the nature of the duties attached to the office or by reason of the powers vested in him, functions mainly of a managerial nature.

(v) Meaning of "Regular Workmen"- he section defines regular workmen as not including:

(1) a casual workman; or

(2) a workman employed through contract labour; or

(3) any other workman employed for a period of less than 300 days during the previous year.

3.9 Deduction in respect of certain income of Offshore Banking Units and International Financial Services Centre [Section 80LA]

(i) This section is applicable to the following assessees -

(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).

(ii) The deduction will be allowed on account of the following income included in the gross total income of such assessees -

(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.

(iii) 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.

(iv) 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.

3.10 Deduction in respect of income of co-operative societies [Section 80P]

(i) Under this section, certain specified income of a co-operative society would be allowed as a deduction, provided such income is included in the gross total income of the society.

(ii) The following items of income would be fully allowed as deduction -

(1) income from the business of banking or providing credit facilities to its members; or

(2) income from a cottage industry; or

(3) income from the marketing of the agricultural produce grown by its members; or

(4) income derived from the purchase of agricultural implements, seeds, livestock or other articles intended for agriculture or for the purpose of supplying them to its members; or

(5) income from processing without the aid of power, of the agricultural produce of its members; or

(6) the business income of labour co-operative societies and societies engaged in fishing and other allied pursuits, such as catching, curing, processing, preserving, storing and marketing of fish or the purchase of materials and equipment in connection therewith for the purpose of supplying them to their members. However, the exemption in respect of this type of income will be available only in the case of those co-operative societies which, under their rules and by-laws, restrict the voting rights to members who constitute the labour force or who actually carry on the fishing or other allied activities, the co-operative credit societies which provide financial assistance to the society and the State Government.

(iii) This section also provides that in case of a co-operative society being a primary society engaged in supplying milk, oilseeds, fruits or vegetables raised by its members to a federal milk co-operative society or the Government or a local authority or a Government company or a corporation established by or under a Central, State or Provincial Act (being a company or corporation engaged in supplying milk, oilseeds, fruits or vegetables, as the case may be, to the public), the whole of the amount of profits and gains of such business would be exempt from tax by way of deduction from the gross total income of the co-operative society.

(iv) Further, a co-operative society which is engaged in activities other than or in addition to those mentioned above, is not liable to pay any income tax on the first Rs.50,000 of its business income arising from other activities. The limit is Rs.1,00,000 in the case of consumer co-operative societies. Thus, a co-operative society which is engaged in any business activity besides any of the business activities mentioned in (1) to (6) of (ii) above would not be liable to pay any income tax on the whole of its income derived from any of the activities specified and also on the first Rs.1,00,000 or Rs.50,000, as the case may be, of its business income from activities other than those aforesaid.

(v) Any income arising to a co-operative society by way of any interest and dividends derived from its investments with any other co-operative society is deductible in full under this section.

(vi) Any income arising to a co-operative society by way of 'Interest on securities' or 'Income from house property' (chargeable under section 22) is fully deductible under this section where the gross total income of the co-operative society does not exceed Rs.20,000 and it is not a housing society or an urban consumer's society or a society carrying on transport business or a society engaged in the performance of any manufacturing operations with the aid of power. Thus, a majority of small co-operative societies would not have to pay any income-tax.

(vii) The income derived by a co-operative society from the letting out of godowns or warehouses for storage, processing or facilitating the marketing of commodities is fully allowable as deduction.

(viii) Further, where the co-operative society is also entitled to the deduction available under section 80-IA, the deduction under this section shall be allowed with reference to the gross total income as reduced by the deduction allowable under section 80-IA.

(ix) The benefit under section 80P has been withdrawn in respect of all co-operative banks, other than primary agricultural credit societies (i.e. as defined in Part V of the Banking Regulation Act, 1949) and primary co-operative agricultural and rural development banks (i.e. societies having its area of operation confined to a taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities). This is for the purpose of treating co-operative banks at par with other commercial banks, which do not enjoy similar tax benefits. The scope of the definition of 'income' as given in section 2(24) has accordingly been widened to include within its ambit, the profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members.

3.11 Deduction in respect of royalty income, etc., of authors of certain books other than text books [Section 80QQB]

(i) Under section 80QQB, deduction of up to a maximum Rs. 3,00,000 is allowed to an individual resident in India in respect of income derived as author i.e the deduction shall be the income derived as author or Rs.3,00,000, whichever is less.

(ii) This income may be received either by way of a lumpsum consideration for the assignment or grant of any of his interests in the copyright of any book.

(iii) Such book should be a work of literary, artistic or scientific nature, or of royalties or copyright fees (whether receivable in lump sum or otherwise) in respect of such book.

(iv) However, this deduction shall not be available in respect of royalty income from textbook for schools, guides, commentaries, newspapers, journals, pamphlets and other publications of similar nature.

(v) Where an assessee claims deduction under this section, no deduction in respect of the same income may be claimed under any other provision of the Income-tax Act, 1961.

(vi) For the purpose of calculating the deduction under this section, the amount of eligible income (before allowing expenses attributable to such income) shall not exceed 15% of the value of the books sold during the previous year. However, this condition is not applicable where the royalty or copyright fees is receivable in lump sum in lieu of all rights of the author in the book.

(vii) For claiming the deduction, the assessee shall have to furnish a certificate in the prescribed manner in the prescribed format, duly verified by the person responsible for

making such payment, setting forth such particulars as may be prescribed.

(viii) Where the assessee earns any income from any source outside India, he should bring such income into India in convertible foreign exchange within a period of six months from the end of the previous year in which such income is earned or within such further period as the competent authority may allow in this behalf for the purpose of claiming deduction under this section.

(ix) The competent authority shall mean the Reserve Bank of India or such other authority as is authorised under any law for the time being in force for regulating payments and dealings in foreign exchange.

3.12 Deduction in respect of royalty on patents [Section 80RRB]

(i) This section allows deduction to a resident individual in respect of income by way of royalty of a patent registered on or after 1.4.03 up to an amount of Rs.3 lakhs.

(ii) This deduction shall be available only to a resident individual who is registered as the true and first inventor in respect of an invention under the Patents Act, 1970, including the co-owner of the patent.

(iii) This exemption shall be restricted to the royalty income including consideration for transfer of rights in the patent or for providing information for working or use thereof in India.

(iv) The exemption shall not be available on any consideration for sale of product manufactured with the use of the patented process or patented article for commercial use.

(v) In respect of any such income which is earned from sources outside India, the deduction shall be restricted to such sum as is brought to India in convertible foreign exchange within a period of 6 months or extended period as is allowed by the competent authority (Reserve Bank of India). For claiming this deduction the assessee shall be required to furnish a certificate in the prescribed form signed by the prescribed authority, alongwith the return of income.

(vi) No deduction in respect of such income will be allowed under any other provision of the Income-tax Act.

(vii) Where the patent is subsequently revoked or the name of the assessee was

excluded from the patents register as patentee in respect of that patent, the deduction allowed during the period shall be deemed to have been wrongly allowed and the assessment shall be rectified under the provisions of section 155.

(viii) The period of 4 years for rectification shall be reckoned from the end of the previous year in which the order of the revocation of the patent is passed.

4. OTHER DEDUCTIONS

Deduction in the case of a person with disability [Section 80U]

(i) Section 80U harmonizes the criteria for defining disability as existing under the Income-tax Rules with the criteria prescribed under the Persons with Disability (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995.

(ii) This section is applicable to a resident individual, who, at any time during the previous year, is certified by the medical authority to be a person with disability. A deduction of Rs.50,000 in respect of a person with disability and *Rs.1,00,000* in respect of a person with severe disability (having disability over 80%) is allowable under this section.

(iii) The benefit of deduction under this section has also been extended to persons suffering from autism, cerebral palsy and multiple disabilities.

(iv) The assessee claiming a deduction under this section shall furnish a copy of the certificate issued by the medical authority in the form and manner, as may be prescribed, along with the return of income under section 139, in respect of the assessment year for which the deduction is claimed.

(v) Where the condition of disability requires reassessment, a fresh certificate from the medical authority shall have to be obtained after the expiry of the period mentioned on the original certificate in order to continue to claim the deduction.

Self-examination questions

1. Mr. Srivastav, aged 72 years, paid medical insurance premium of Rs.22,000 by cheque and Rs.1,000 by cash during May, 2009 under a Medical Insurance Scheme of the General Insurance Corporation. The above sum was paid for insurance of his own health. He would be entitled to a deduction under section 80D of a sum of -

   a) Rs.22,000

b) Rs.20,000

c) Rs.15,000

2. Mr. Ramesh pays a rent of Rs.5,000 per month. His total income is Rs.2,40,000 (i.e. Gross Total Income as reduced by deductions under Chapter VIA except section 80GG). He is also in receipt of HRA. He would be eligible for a deduction under section 80GG of an amount of -

a) Rs.24,000

b) Rs.36,000

c) Nil.

3. The deduction allowable under section 80LA in respect of eligible income of Offshore Banking Units and International Financial Services Centre is -

a) 50% of such income for 5 consecutive assessment years

b) 100% of such income for 10 consecutive assessment years

c) 100% of such income for 5 consecutive assessment years and 50% of such income for 5 consecutive assessment years thereafter

4. The deduction under section 80QQB in respect of royalty income of authors of certain books is subject to a maximum limit of -

a) Rs.1,00,000

b) Rs.3,00,000

c) Rs.5,00,000

5. The deduction under section 80-IC permissible to an undertaking or an enterprise, being a company located in the State of Himachal Pradesh, which newly commences business of manufacture or production of an article or thing other than what is specified in the Thirteenth Schedule is-

a) 100% of profits for the first 5 assessment years and 25% of the profit for the next 5 assessment years thereafter

b) 100% of profits for the first 5 assessment years and 30% of the profit for the

next 5 assessment years thereafter

c) 100% of profits for the first 10 assessment years

6. Under section 80GGB, deduction is allowable in respect of contribution to political parties by -

a) any person other than local authority and every artificial juridical person wholly or partly funded by the Government

b) Local authority and every artificial juridical person wholly or partly funded by the Government

c) An Indian company

7. Rs.1 lakh is the maximum qualifying limit for deduction under -

a) Section 80C alone.

b) Sections 80C and 80CCC

c) Sections 80C, 80CCC and 80CCD.

8. Write short notes on -

(i) Deduction in respect of royalty income on patents

(ii) Deduction in respect of royalty income of authors of certain books.

9. What is the deduction available from the gross total income of a company in respect of any contribution given to a political party?

10. Who are the assessees eligible to claim deduction under section 80LA? What is the quantum of deduction available under this section? What are the conditions to be fulfilled for claiming such deduction?

11. Discuss the provisions of section 80-IAB relating to deduction in respect of profits and gains derived by an undertaking or enterprise engaged in the development of a special economic zone.

12. What are the special provisions in respect of certain undertakings or enterprises in certain special category states as laid down under section 80-IC of the Act.

13. What are the conditions to be fulfilled by a convention centre to be eligible for

deduction under section 80-ID?

14. List the conditions to be satisfied for claiming deduction under section 80E.

15. Medical insurance premium paid is deductible under section 80D. What are the conditions to be fulfilled to claim such deduction and what is the maximum deduction that can be claimed if such conditions are fulfilled?

Answers

1. b; **2.** c; **3.** c; **4.** b; **5.** b; **6.** c; **7.** c

CHAPTER 8

COMPUTATION OF TOTAL INCOME AND TAX PAYABLE

Learning Objectives

After studying this chapter, you would be able to –

- comprehend as to what is meant by total income
- identify the income earned in different capacities by an individual which are to be considered while computing his total income
- understand the steps involved in computation of total income and tax liability of an individual

1. MEANING OF TOTAL INCOME

The Total income of an individual is arrived at after making deductions under Chapter VIA from the Gross Total Income. As we have learnt earlier, Gross Total Income is the aggregate of the net income computed under the 5 heads of income, after giving effect to the provisions for clubbing of income and set-off and carry forward and set-off of losses.

2. INCOME TO BE CONSIDERED WHILE COMPUTING TOTAL INCOME OF INDIVIDUALS

	Capacity in which income is earned by an individual	Treatment of income earned in each capacity
(1)	In his personal capacity (under the 5 heads of income)	Income from salaries, Income from house property, Profits and gains of business or profession, Capital gains and Income from other sources.
(2)	As a partner of a firm	(i) Salary, bonus etc. received by a partner is taxable as his business income.

		(ii) Interest on capital and loans to the firm is taxable as business income of the partner. The income mentioned in (i) and (ii) above are taxable to the extent they are allowed as deduction to the firm. (iii) Share of profit in the firm is exempt in the hands of the partner.
(3)	As a member of HUF	(i) Share of income of HUF is exempt in the hands of the member (ii) Income from an impartible estate of HUF is taxable in the hands of the holder of the estate who is the eldest member of the HUF (iii) Income from self-acquired property converted into joint family property.
(4)	Income of other persons included in the income of the individual	(i) Transferee's income, where there is a transfer of income without transfer of assets (ii) Income arising to transferee from a revocable transfer of an asset. In cases (i) and (ii), income is includible in the hands of the transferor. (iii) Income of spouse as mentioned in section 64(1) (iv) Income from assets transferred to son's wife or to any person for the benefit of son's wife. (v) Income of minor child as mentioned in section 64(1A)

3. SPECIAL PROVISION FOR SPOUSES GOVERNED BY PORTUGUESE CIVIL CODE [SECTION 5A]

This section relates to the computation of total income of husband and wife governed by the **system of community of property** as in force in the State of Goa and in the Union Territories of Dadra and Nagar Haveli and Daman and Diu. Such income shall not be assessed as that of the community of property. The income under each head of income (other than under the head 'Salaries') should be apportioned equally between the husband and wife and should be included separately in their respective total income. However, in the case of salary income, it will be assessed in the hands of the spouse who has actually earned it.

4. COMPUTATION OF TOTAL INCOME AND TAX LIABILITY OF INDIVIDUALS

Income-tax is levied on an assessee's total income. Such total income has to be computed as per the provisions contained in the Income-tax Act, 1961. The procedure of computation of total income for the purpose of levy of income-tax is detailed hereunder –

Step 1 – Determination of residential status

The residential status of a person has to be determined to ascertain which income is to be included in computing the total income. In the case of an individual, the duration for which he is present in India determines his residential status. Based on the time spent by him, he may be (a) resident and ordinarily resident, (b) resident but not ordinarily resident, or (c) non-resident. The residential status of an individual determines the taxability of income earned by him. For e.g., income earned outside India will not be taxable in the hands of a non-resident but will be taxable in case of a resident and ordinarily resident.

Step 2 – Classification of income under different heads

The Act prescribes five heads of income. These heads of income exhaust all possible types of income that can accrue to or be received by an individual. An individual has to classify the income earned by him under the relevant head of income.

Step 3 – Exclusion of income not chargeable to tax

There are certain income which are wholly exempt from income-tax e.g. agricultural income. These income have to be excluded and will not form part of Gross Total Income. Also, some incomes are partially exempt from income-tax e.g. House Rent Allowance, Education Allowance. These incomes are excluded only to the extent of the limits specified in the Act. The balance income over and above the prescribed limits would enter computation of total income and have to be classified under the relevant head of income.

Step 4 – Computation of income under each head

Income is to be computed in accordance with the provisions governing a particular head of income. Under each head of income, there is a charging section which defines the scope of income chargeable under that head. There are deductions and allowances prescribed under each head of income. These deductions and allowances have to be considered before arriving at the net income chargeable under each head

Step 5 – Clubbing of income of spouse, minor child etc.

In case of individuals, income-tax is levied on a slab system on the total income. The tax system is progressive i.e. as the income increases, the applicable rate of tax increases. Some taxpayers in the higher income bracket have a tendency to divert some portion of their income to their spouse, minor child etc. to minimize their tax burden. In order to prevent such tax avoidance, clubbing provisions have been incorporated in the Income-tax Act, under which income arising to certain persons (like spouse, minor child etc.) have to be included in the income of the person who has diverted his income to such persons for the purpose of computing tax liability. Effect has to be given to these clubbing provisions.

Step 6 – Set-off or carry forward and set-off of losses

An individual may have different sources of income under the same head of income. He might have profit from one source and loss from the other. For instance, an individual may have profit from his let-out house property and loss from his self-occupied property. This loss can be set-off against the profits of the let-out property to arrive at the net income chargeable under the head "Income from house property".

Similarly, an assessee can have loss under one head of income, say, Income from house property and profits under another head of income, say, Profits and gains of business or profession. There are provisions in the Income-tax Act for allowing inter-head adjustment in certain cases. Further, losses which cannot be set-off in the current year due to inadequacy of eligible profits can be carried forward for set-off in the subsequent years as per the provisions contained in the Income-tax Act.

Effect has to be given to these provisions for set-off/carry forward and set-off of losses.

Step 7 – Computation of Gross Total Income.

The final figures of income or loss under each head of income, after allowing the deductions, allowances and other adjustments, are then aggregated, after giving effect to the provisions for clubbing of income and set-off and carry forward of losses, to arrive at the gross total income.

Step 8 – Deductions from Gross Total Income

There are deductions prescribed from gross total income. The allowable deductions in case of an individual are deductions under sections 80C, 80CCC, 80CCD, 80D, 80DD, 80DDB, 80E, 80G, 80GG, 80GGA, 80GGC, 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID, 80-IE, 80JJA, 80QQB, 80RRB and 80U. These deductions are allowable subject to satisfaction of the conditions prescribed in the relevant sections.

Step 9 – Total income

The total income of an individual is arrived at, after claiming the above deductions from the gross total income

Step 10 – Application of the rates of tax on the total income

For individuals, there is a slab rate and basic exemption limit. At present, the basic exemption limit is *Rs.1,60,000*. This means that no tax is payable by individuals with total income of up to *Rs.1,60,000*. The rates of tax and level of total income are as under -

	Level of total income	***Rate of tax***
(i)	*where the total income does not exceed Rs.1,60,000*	*Nil;*
(ii)	*where the total income exceeds Rs.1,60,000 but does not exceed Rs.3,00,000*	*10% of the amount by which the total income exceeds Rs.1,60,000*
(iii)	*where the total income exceeds Rs.3,00,000 but does not exceed Rs.5,00,000*	*Rs.14,000 plus 20% of the amount by which the total income exceeds Rs.3,00,000;*
(iv)	*where the total income exceeds Rs.5,00,000*	*Rs.54,000 plus 30% of the amount by which the total income exceeds Rs.5,00,000.*

It is to be noted that for a woman resident below the age of 65 years at any time during the previous year, the basic exemption limit is Rs.1,90,000 and for a senior citizen (being a resident individual who is of the age of 65 years or more at any time during the previous year), the basic exemption limit is Rs.2,40,000. Therefore, the tax slabs for these assessees would be as follows –

For resident women below the age of 65 years

(i)	*where the total income does not exceed Rs.1,90,000*	*Nil;*

(ii) where the total income exceeds Rs.1,90,000 but does not exceed Rs.3,00,000	*10% of the amount by which the total income exceeds Rs.1,90,000*
(iii) where the total income exceeds Rs.3,00,000 but does not exceed Rs.5,00,000	*Rs.11,000 plus 20% of the amount by which the total income exceeds Rs.3,00,000;*
(iv) where the total income exceeds Rs.5,00,000	*Rs.51,000 plus 30% of the amount by which the total income exceeds Rs.5,00,000.*

For senior citizens (being resident individuals of the age of 65 years or more)

(i) where the total income does not exceed Rs.2,40,000	*Nil;*
(ii) where the total income exceeds Rs.2,40,000 but does not exceed Rs.3,00,000	*10% of the amount by which the total income exceeds Rs.2,40,000;*
(iii) where the total income exceeds Rs.3,00,000 but does not exceed Rs.5,00,000	*Rs.6,000 plus 20% of the amount by which the total income exceeds Rs.3,00,000;*
(iv) where the total income exceeds Rs.5,00,000	*Rs.46,000 plus 30% of the amount by which the total income exceeds Rs.5,00,000.*

Further, the rates of tax for long-term capital gains, certain short-term capital gains and winnings from lotteries, crossword puzzles, races etc. are prescribed in sections 112, 111A and 115BB respectively. The rates of tax are 20%,15% and 30% respectively, in the above cases.

These tax rates have to be applied on the total income to arrive at the income-tax liability.

Step 11 – Education cess and "Secondary and higher education cess"

The income-tax is to be increased by education cess@2% and secondary and higher education cess@1% on income-tax. This is payable by all individuals who are liable to pay income-tax irrespective of their level of total income.

Step 12 – Credit for advance tax and TDS

From the total tax due, deduct the TDS and advance tax paid for the relevant assessment year. The balance is the net tax payable by an individual which must be paid as self-assessment tax before submitting the return of income.

An illustration is given for better understanding of the procedure of computation of total income and tax liability of individuals.

Illustration

Compute the total income and tax liability of Harish for the A.Y. 2010-11 from the following particulars:

	Particulars	Rs.
(i)	Income from house property (computed)	3,15,000
(ii)	Income from textile business before adjusting the following	1,20,000
	(a) Business loss brought forward	80,000
	(b) Current depreciation	40,000
	(c) Unabsorbed depreciation brought forward	1,20,000
(iii)	Short-term capital gains on sale of land	1,25,000
(iv)	Long-term capital loss on sale of shares sold through a recognised stock exchange (securities transaction tax paid)	25,000
(v)	Long-term capital gain on sale of debentures	50,000
(vi)	Dividend on shares held as stock-in-trade	5,000
(vii)	Dividend from a company carrying on agricultural operation	7,000
(viii)	Income from growing and manufacturing coffee (cured and roasted)	80,000

During the previous year 2009-10, Harish has donated Rs.50,000 to an approved Local Authority for promotion of family planning and repaid Rs.90,000 towards principal portion of housing loan.

Solution

Computation of total income of Mr. Harish for A.Y.2010-11

Particulars	Rs.	Rs.	Rs.
Income from house property			3,15,000
Profits and gains of business or profession			
Income from textile business	1,20,000		
Income from coffee business (40% of Rs.80,000)	32,000	1,52,000	

Less: (i) Current year depreciation	40,000		
(ii) Brought forward business loss	80,000	1,20,000	32,000
Capital gains			
Short-term capital gain - land		1,25,000	
Long-term capital gain – debentures		50,000	1,75,000
Income from other sources			
Dividend on shares held as stock-in-trade [Exempt u/s 10(34)]		-	
Dividend from agricultural company [Exempt u/s 10(34)]		-	-
			5,22,000
Less: Unabsorbed depreciation			1,20,000
Gross total income			**4,02,000**
Less:			
Deduction u/s 80C – Repayment of housing loan	90,000		
Deduction u/s 80G @ 100% of Rs.50,000 subject to [10% of (4,02,000 – 90,000 (80C) - 50,000(LTCG)]	26,200		1,16,200
Total income			**2,85,800**

Computation of tax liability

Particulars	**Rs.**	**Rs.**
Tax on agricultural income plus non-agricultural income i.e. Rs.48,000(i.e. 60% of Rs.80,000) + Rs.2,85,800 = Rs.3,33,800		
Tax on LTCG of Rs.50,000 @ 20%	10,000	
Tax on balance income Rs.2,83,800	12,380	22,380
Less: Tax on agricultural income plus basic exemption limit i.e. Rs.48,000 + Rs.1,60,000 = Rs.2,08,000		4,800
Tax payable		17,580

Add: Education cess @ 2%	352
Add: Secondary and higher education cess @ 1%	176
Total tax payable	**18,108**

Total tax payable (rounded off)	**18,110**

Note – Loss from an exempt source cannot be set-off against income from a taxable source. Therefore, long-term capital loss on sale of shares cannot be set-off against long-term capital gains on sale of debentures.

Self-examination questions

1. Income under the Income-tax Act is to be computed under -
   a) five heads
   b) six heads
   c) four heads
2. What is the basic exemption limit for a woman assessee below the age of 65 years at any time during the previous year 2009-10?
   a) Rs.1,80,000
   b) Rs.1,85,000
   c) Rs.1,90,000
3. What is the rate of surcharge applicable to individuals?
   a) 10%
   b) 2.5%
   c) Nil
4. What is the basic exemption limit for Mrs.X, who is of the age of 70 years as on 13.7.2009?
   a) Rs.1,95,000

b) Rs.2,25,000

c) Rs.2,40,000

5. Share of profit of Mr. P, who is a partner in M/s PQR is –

a) exempt from tax

b) taxable as his business income

c) taxable as his salary

6. Explain the meaning of total income under the Income-tax Act.

7. Explain briefly the tax treatment of the following income of Mr. X, who is a partner in the firm M/s. XYZ–

(i) Salary received by Mr. X from M/s. XYZ.

(ii) Interest (on loan) received from M/s. XYZ.

(iii) Share of profit from the firm.

8. Discuss the tax treatment of the following income of Mr. A, who is a member of a HUF-

(i) Share of income from HUF.

(ii) Income from an impartible estate of the HUF.

(iii) Income from self-acquired property converted into joint family property.

9. Explain the various steps involved in computation of total income and tax liability of individuals.

Answers

1. a; **2.** c; **3.** c; **4.**c; **5.** a

CHAPTER 9

PROVISIONS CONCERNING ADVANCE TAX AND TAX DEDUCTED AT SOURCE

Learning Objectives

After studying this chapter, you would be able to understand –

- the modes of recovery of income-tax from an assessee
- the provisions governing deduction of tax at source from certain specified income and payments
- the cases where tax is not required to be deducted at source and the conditions to be satisfied for this purpose
- how to avail credit for tax deducted at source
- what is the duty of the person deducting tax
- the consequences of failure to deduct tax at source or make payment of the tax deducted at source
- who are the "persons responsible for paying" tax deducted at source
- when the liability to pay advance tax arises
- how advance tax is computed
- the schedule of instalments for payment of advance tax
- the consequence of non-payment or short-payment of advance tax
- the consequence of deferment of advance tax.

1. DEDUCTION OF TAX AT SOURCE AND ADVANCE PAYMENT [SECTION 190]

The total income of an assessee for the previous year is taxable in the relevant assessment year. For example, the total income for the P.Y.2009-10 is taxable in the A.Y.2010-11. However, the income-tax is recovered from the assessee in the previous

year itself through –

(1) Tax deduction at source (TDS)

(2) Payment of advance tax

Another mode of recovery of tax is from the employer through tax paid by him under section 192(1A) on the non-monetary perquisites provided to the employee.

These taxes are deductible from the total tax due from the assessee. The assessee, while filing his return of income, has to pay self-assessment tax under section 140A, if tax is due on the total income as per his return of income after adjusting, *inter-alia,* TDS and advance tax.

2. DIRECT PAYMENT [SECTION 191]

Section 191 provides that in the following cases, tax is payable by the assessee directly –

(1) in the case of income in respect of which tax is not required to be deducted at source; and

(2) income in respect of which tax is liable to be deducted but is not actually deducted.

In view of these provisions of section 191, the proceedings for recovery of tax necessarily had to be taken against the assessee whose tax was liable to be deducted, but not deducted.

In order to overcome this difficulty, the Explanation to this section provides that if –

(1) any person, including the principal officer of the company, who is required to deduct tax at source or

(2) an employer paying tax on non-monetary perquisites under section 192(1A),

does not deduct the whole or part of the tax, or after deducting fails to pay such tax deducted, then such person shall be deemed to be an assessee in default.

However, if the assessee himself has paid the tax, this provision will not apply.

3. DEDUCTION OF TAX AT SOURCE

3.1 Salary [Section 192]

(1) This section casts an obligation on every person responsible for paying any income chargeable to tax under the head 'Salaries' to deduct income-tax on the amount payable.

(2) Such income-tax has to be calculated at the average rate of income-tax computed on

the basis of the rates in force for the relevant financial year in which the payment is made, on the estimated total income of the assessee. Therefore, the liability to deduct tax at source in the case of salaries arises only at the time of payment.

(3) Average rate of income-tax means the rate arrived at by dividing the amount of income-tax calculated on the total income, by such total income.

(4) However, deduction at a rate lower than that prescribed may be made if a certificate has been obtained under section 197 from the Assessing Officer.

(5) Every year, the CBDT issues a circular giving details and direction to all employers for the purpose of deduction of tax from salaries payable to the employees during the relevant financial year. These instructions should be followed.

(6) The concept of payment of tax on non-monetary perquisites has been provided in sections 192(1A) and (1B). These sections provide that the employer may pay this tax, at his option, in lieu of deduction of tax at source from salary payable to the employee. Such tax will have to be worked out at the average rate applicable to aggregate salary income of the employee and payment of tax will have to be made every month along with tax deducted at source on monetary payment of salary, allowances etc.

(7) In cases where an assessee is simultaneously employed under more than one employer or the assessee takes up a job with another employer during the financial year after his resignation or retirement from the services of the former employer, he may furnish the details of the income under the head “Salaries” due or received by him from the other employer, the tax deducted therefrom and such other particulars to his current employer. Thereupon, the subsequent employer should take such information into consideration and then deduct the tax remaining payable in respect of the employee’s remuneration from both the employers put together for the relevant financial year.

(8) For purposes of deduction of tax out of salaries payable in a foreign currency, the value of salaries in terms of rupees should be calculated at the prescribed rate of exchange as specified in Rule 26 of the Income-tax Rules.

(9) In respect of salary payments to employees of Government or to employees of companies, co-operative societies, local authorities, universities, institutions, associations or bodies, deduction of tax at source should be made after allowing relief under section 89(1), where eligible.

(10) A tax payer having salary income in addition to other income chargeable to tax for that financial year, may send to the employer the following:

(i) particulars of such other income

(ii) particulars of any tax deducted under any other provision

(iii) loss, if any, under the head 'Income from house property'

The employer shall take the above particulars into account while calculating tax deductible at source.

It is also provided that except in cases where loss from house property has been adjusted against salary income, the tax deductible from salary should not be reduced as a consequence of making the above adjustments.

(11) Sub-section (2C) provides that the employer shall furnish to the employee a statement giving correct and complete particulars of perquisites or profits in lieu of salary provided to him and the value thereof. The statement shall be in the prescribed form (Form 12BA) and manner. This requirement is applicable only where the salary paid/payable to an employee exceeds Rs.1,50,000. For other employees, the particulars of perquisites/profits in lieu of salary shall be given in Form 16 itself.

3.2 Interest on securities [Section 193]

(1) This section casts responsibility on every person responsible for paying to a resident any income by way of interest on securities.

(2) Such person is vested with the responsibility to deduct income-tax at the rates in force from the amount of interest payable.

The rate at which tax is deductible under section 193 is 10%, both in the case of domestic companies and resident non-corporate assessees.

(3) Tax should be deducted at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

(4) However, no tax deduction is to be made from any interest payable:

(i) on 4¼% National Defence Bonds 1972, where the bonds are held by an individual not being a non-resident;

(ii) on 4¼% National Defence Loan, 1968 or 4¾% National Defence Loan, 1972, where the interest is payable to an individual;

(iii) on National Development Bonds;

(iv) on 7-year National Savings Certificates (IV Issue);

(v) on debentures issued by any institution or authority or any public sector company or any co-operative society (including a co-operative land mortgage bank or a co-operative land development bank), as notified by the Central Government;

(vi) on 6½% Gold Bonds, 1977 or 7% Gold Bonds, 1980, where the bonds are held by an individual (other than a non-resident), provided that the holders of the bonds make a written declaration that the total nominal value of the bonds held by him or on his behalf did not in either case exceed Rs.10,000 at any time during the period to which the interest relates;

(vii) on any security of the Central Government or a State Government;

Note – It may be noted that tax has to be deducted at source in respect of interest payable on 8% Savings (Taxable) Bonds, 2003, if such interest payable exceeds Rs.10,000 during the financial year.

(viii) on debentures issued by the company in which the public are substantially interested to a resident individual. However:

(a) such debentures must be listed in a recognised stock exchange;

(b) the interest should be paid by the company by an account payee cheque;

(c) the amount of such interest or the aggregate thereof paid or likely to be paid during the financial year to the resident individual should not exceed Rs.2,500.

(ix) on securities to LIC, GIC, subsidiaries of GIC or any other insurer, provided –

(a) the securities are owned by them or

(b) they have full beneficial interest in such securities.

(x) on any security issued by a company, where such security is in dematerialised form and is listed on a recognised stock exchange in India in accordance with the Securities Contracts (Regulation) Act, 1956 and the rules made thereunder.

(5) In all the above cases, the declaration shall be made by the recipient to the person responsible for paying such interest on securities.

(6) If the person entitled to receive interest produces a certificate under section 197 from the Assessing Officer to the effect that his total income is either below the taxable limit or is liable to income-tax at a lower rate, the interest on securities shall be paid without any deduction of tax or after deduction of tax at such lower rate, as the case may be.

(7) Where any income by way of interest on securities is credited to any account in the

books of account of the person liable to pay such income, such crediting is deemed to be credit of such income to the account of the payee and tax has to be deducted at source.

(8) The account to which such interest is credited may be called "Interest Payable account" or "Suspense account" or by any other name.

3.3 Dividends [Section 194]

(1) Dividends declared, distributed or paid by a domestic company are exempt in the hands of the shareholder under section 10(34). This includes deemed dividend under sections 2(22)(a) to (d). This is because such dividend attracts dividend distribution tax @ 15% in the hands of the company.

(2) The TDS provisions under this section are attracted only in respect of deemed dividend referred to in section 2(22)(e), if such dividend exceeds Rs.2,500 in a year.

(3) The rate of deduction of tax in respect of such dividend is *10%*.

(4) Individual shareholders, who are residents in India are entitled to receive their dividends from any domestic company without deduction of tax at source by the company in cases where -

(i) the amount of dividend income received from the company does not exceed Rs.2500 during the year; and

(ii) the dividend is paid by an account payee cheque.

The TDS provisions will not apply to dividend receivable by LIC, GIC, its subsidiaries or any other insurer provided the shares are owned by them, or they have full beneficial interest in such shares.

3.4 Interest other than interest on securities [Section 194A]

This section deals with the scheme of deduction of tax at source from interest other than interest on securities. The main provisions are the following:

(1) This section applies only to interest, other than "interest on securities", credited or paid by assessees other than individuals or Hindu undivided families not subject to tax audit under section 44AB in the immediately preceding financial year. In other words, individuals and HUFs subject to tax audit in the immediately preceding financial year, companies, firms, association of persons, local authorities and artificial juridical persons are under a legal obligation to deduct tax at source in respect of the interest other than "interest on securities" paid by them.

(2) These provisions apply only to interest paid or credited to residents. In respect of payments to non-residents, the provisions are contained under section 195.

(3) The deduction of tax must be made at the time of crediting such interest to the payee or at the time of its payment in cash or by any other mode, whichever is earlier.

(4) Where any such interest is credited to any account in the books of account of the person liable to pay such income, such crediting is deemed to be credit of such income to the account of the payee and the tax has to be deducted at source.

(5) The account to which such interest is credited may be called "Interest Payable account" or "Suspense account" or by any other name.

(6) The deduction of tax at source is to be made in all cases where the amount of income by way of interest or, as the case may be, the aggregate of the amounts of interest credited or paid or likely to be credited or paid during the financial year to the account of or to the payee or any other person on his behalf is more than Rs.5,000.

(7) The rate at which the deduction is to be made are given in Part II of the First Schedule to the Annual Finance Act. *The rate at which tax is to be deducted is 10% both in the case of resident non-corporate assessees and domestic companies.*

(8) No deduction of tax shall be made in the following cases:

(a) If the aggregate amount of interest paid or credited during the financial year does not exceed Rs.5,000.

This limit is increased to Rs.10,000 in respect of interest paid on–

(i) time deposits with a banking company;

(ii) time deposits with a co-operative society engaged in banking business; and

(iii) deposits with post office under notified schemes.

In all other cases, the limit would continue to be Rs.5,000.

The limit will be calculated with respect to income credited or paid by a branch of a bank or a co-operative society or a public company in case of:

(i) time deposits with a bank

(ii) time deposits with a co-operative society carrying on the business of banking; and

(iii) deposits with housing finance companies, provided:

- they are public companies formed and registered in India

- their main object is to carry on the business of providing long-term finance for construction or purchase of houses in India for residential purposes.

The above ceiling will operate:

(i) on a branch of a bank;

(ii) with reference to only time deposits.

Hence, the interest on all other types of account such as savings account, recurring deposits etc., payable by a branch will have to be excluded to determine whether the interest exceeds Rs.5,000 or not. However, in respect of time deposits, interest on all such time deposits maintained with a branch has to be aggregated.

(b) Interest paid or credited by a firm to any of its partners;

(c) Interest paid or credited by a co-operative society to a member there of or any other co-operative society;

(d) Interest paid or credited in respect of deposits under any scheme framed by the Central Government and notified by it in this behalf;

(e) Interest income credited or paid in respect of deposits (other than time deposits made on or after 1.7.1995) with

(i) a bank to which the Banking Regulation Act, 1949 applies; or

(ii) a co-operative society engaged in carrying on the business of banking.

(f) Interest credited or paid in respect of deposits with primary agricultural credit society or a primary credit society or a co-operative land mortgage bank or a co-operative land development bank.

(g) Interest income credited or paid by the Central Government under any provisions of the Income-tax Act, the Estate Duty Act, the Wealth-tax Act, the Gift-tax Act, the Companies (Profits) Surtax Act or the Interest Tax Act.

(h) Interest paid or credited to the following entities:

(1) banking companies, or co-operative societies engaged in the business of banking, including co-operative land mortgage' banks;

(2) financial corporations established under any Central, State or Provincial Act.

(3) the Life Insurance Corporation of India.

(4) companies and co-operative societies carrying on the business of insurance.

(5) the Unit Trust of India; and

(6) notified institution, association, body or class of institutions, associations or bodies.

(i) income credited or paid by way of interest on the compensation amount awarded by the Motor Accidents Claims Tribunal where the amount of such income or, as the case may be, the aggregate of the amounts of such income credited or paid during the financial year does not exceed Rs.50,000.

(j) income paid or payable by an infrastructure capital company or infrastructure capital fund or public sector company in relation to a zero coupon bond issued on or after 1.6.2005 (Refer chapter 1, Unit 2 for definitions of infrastructure capital company and infrastructure capital fund as per sections 2(26A) and 2(26B), respectively)

(9) The expression "time deposits" [for the purpose of (8)(a) above] means the deposits, excluding recurring deposits, repayable on the expiry of fixed periods.

(10) The time for making the payment of tax deducted at source would reckon from the date of credit of interest made constructively to the account of the payee.

(11) The following table shows the applicability of section 194A to various banks/co-operative societies:

Sl.No.	Entity	Nature of deposit	
		Term deposit	Other deposit
1.	Banking company to which Banking Regulation Act, 1949 applies	Applicable	N.A.
2.	Any bank or banking institution to which the Banking Regulation Act, 1949 applies	Applicable	N.A.
3.	Primary agriculture credit society	N.A.	N.A.
4.	Co-operative land mortgage bank	N.A.	N.A.
5.	Co-operative land development bank	N.A.	N.A.
6.	Any other co-operative society engaged in the business of banking.	Applicable	N.A.

3.5 Winnings from lotteries, crossword puzzles and horse races [Sections 194B and 194BB]

(1) Any income of a casual and non-recurring nature of the type of winnings from lotteries, crossword puzzles, card game and other game of any sort, races including horse races, etc. will be charged to income-tax at a flat rate of 30% [Section 115BB].

(2) According to the provisions of section 194B, every person responsible for paying to any person, whether resident or non-resident, any income by way of winnings from lottery or crossword puzzle or card came and other game of any sort, is required to deduct income-tax therefrom at the rate of 30% if the amount of payment exceeds Rs.5,000.

(3) Further, in a case where the winnings are wholly in kind or partly in cash and partly in kind but the part in cash is not sufficient to meet the liability of deduction of tax in respect of whole of the winnings, the person responsible for paying shall, before releasing the winnings, ensure that tax has been paid in respect of the winnings.

(4) Section 194BB casts responsibility on the following persons to deduct tax at source -

(i) a bookmaker; or

(ii) a person to whom a licence has been granted by the Government under any law for the time being in force -

  (a) for horse racing in any race course; or

  (b) for arranging for wagering or betting in any race course.

(5) The obligation to deduct tax at source under section 194BB arises when the abovementioned persons make payment of any income by way of winnings from any horse race in excess of Rs.2,500. The rate applicable for deduction of tax at source is 30%.

(6) Tax will have to be deducted at source from winnings from horse races even though the winnings may be paid to the person concerned in installments of less than Rs.2,500. Similarly, in cases where the book-maker or other person responsible for paying the winnings, credits such winnings and debits the losses to the individual account of the punter, the set off of the loss against the income would be treated for this purpose as a constructive payment of the income.

(7) In the context of the provisions of section 194BB, the expression 'any horse race' used therein must be taken to include, wherever the circumstances so necessitate, more than one horse race. Therefore, winnings by way of jack pot would also fall within the scope of section 194BB.

3.6 Payments to contractors and sub-contractors [Section 194C]

(1) Section 194C provides for deduction of tax at source from the payment made to resident contractors and sub-contractors.

(2) Any person responsible for paying any sum to a resident contractor for carrying out any work or supplying labour for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract between the contractor and the Central Government, a State Government, local authority, statutory corporation, a company, co-operative society, any statutory authority dealing with housing accomodation, any society registered under the Societies Registration Act, 1860, any trust or any university or any firm or any Government of a foreign State or foreign enterprise or any association or body established outside India or an individual, HUF, AOP or BOI subject to tax audit under section 44AB in the immediately preceding financial year must deduct income-tax at the prescribed rate from such sum at the time of credit or payment, whichever is earlier.

Payments made by Individuals, HUFs, AOPs and BOIs to a contractor would attract TDS if their total sales/turnover exceeds Rs.40 lakh (in case of business) and gross receipts exceed Rs.10 lakh (in case of profession) in the immediately preceding financial year. However, relief has been provided in respect of payments made by individuals/HUFs to a contractor exclusively for personal purposes.

(3) The prescribed rate is 1% in the case of advertising and 2% in any other case.

(4) A contractor, not being an individual or a Hindu undivided family, will in the following cases, be required to deduct tax at the rate of 1% at the time of credit or payment, whichever is earlier, to a resident sub-contractor -

(i) Where the contractor enters into an agreement with the sub-contractor for carrying out or for the supply of labour for carrying out the whole or any part of his work.

(ii) Where the contractor enters into an agreement with the sub-contractor for supply of labour, either wholly or partly, which the contractor has undertaken to supply.

(5) The rate of TDS under section 194C on payments to contractors has been reduced with effect from 1.10.2009 to 1%, where the payee is an individual or HUF and would remain @2% in respect of other payees. The same rates of TDS would apply for both contractors and sub-contractors. These rates would apply for advertising contracts as well.

(6) Further, in respect of payment to transport contractors and sub-contractors engaged in the business of plying, leasing and hiring goods carriages, TDS provisions would not apply if they furnish their PAN to the deductor. However, if they do not quote PAN, the

rate will be 1% for an individual/ HUF transporter and 2% for other transporters upto 31.3.2010.

(7) The following table shows a comparison of TDS rates prevalent upto 30.9.2009 vis a vis the rates applicable from 1.10.2009 –

Payee	*TDS rate applicable*	
	Up to 30.9.2009	*From 1.10.2009*
Individual / HUF contractor	*2%*	*1%*
Other than individual / HUF contractor	*2%*	*2%*
Individual / HUF sub-contractor	*1%*	*1%*
Other than individual / HUF sub-contractor	*1%*	*2%*
Individual / HUF contractor/sub-contractor for advertising	*1%*	*1%*
Other than individual / HUF contractor/sub-contractor for advertising	*1%*	*2%*
Contractor in transport business	*2%*	*Nil*
Sub-contractor in transport business	*1%*	*Nil*

(8) No deduction will be required to be made if the consideration for the contract does not exceed Rs.20,000. However, to prevent the practice of composite contracts being split up into contracts valued at less than Rs.20,000 to avoid tax deduction, it has been provided that tax will be required to be deducted at source where the amount credited or paid or likely to be credited or paid to a contractor or sub-contractor exceeds Rs.20,000 in a single payment or Rs.50,000 in the aggregate during a financial year.

(9) Work includes –

(a) advertising;

(b) broadcasting and telecasting including production of programmes for such broadcasting or telecasting;

(c) carriage of goods or passengers by any mode of transport other than by railways;

(d) catering;

(e) manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer.

However, "work" shall not include manufacturing or supplying a product according to the requirement or specification of a customer by using raw material purchased from a person, other than such customer, as such a contract is a contract for 'sale'. However, this will not be applicable to a contract which does not entail manufacture or supply of an article or thing (e.g. a construction contract).

It may be noted that the term "work" would include manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer. In such a case, tax shall be deducted on the invoice value excluding the value of material purchased from such customer if such value is mentioned separately in the invoice. Where the material component has not been separately mentioned in the invoice, tax shall be deducted on the whole of the invoice value.

(10) No deduction is required to be made from the sum credited or paid or likely to be credited or paid during the previous year to the account of a contractor, during the course of the business of plying, hiring or leasing goods carriages, if he furnishes his PAN to the deductor.

(11) However, for this purpose, it is necessary to produce a declaration within the prescribed time to the concerned person paying or crediting such sum. Such declaration should be in the prescribed form and manner.

(12) Goods carriage means -

(i) any motor vehicle constructed or adapted for use solely for the carriage of goods; or

(ii) any motor vehicle not so constructed or adapted, when used for the carriage of goods.

The term "motor vehicle" does not include vehicles having less than four wheels and with engine capacity not exceeding 25cc as well as vehicles running on rails or vehicles adapted for use in a factory or in enclosed premises.

(13) The substance of the provisions is explained hereunder:

(i) The deduction of income-tax at source from payments made to non-resident contractors will be governed by the provisions of section 195.

(ii) The deduction of income-tax will be made from sums paid for carrying out any work or for supplying labour for carrying out any work. In other words, the section will apply only in relation to 'works contracts' and 'labour contracts' and will not cover contracts for sale of

goods.

(iii) Contracts for rendering professional services by lawyers, physicians, surgeons, engineers, accountants, architects, consultants etc., can not be regarded as contracts for carrying out any "work" and, accordingly, no deduction of income-tax is to be made from payments relating to such contracts under this section. Separate provisions for fees for professional services have been made under section 194J.

(iv) The deduction of income-tax must be made at the time of credit of the sum to the account of the contractor, or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

(v) Circular No.13/2006, dated 13.12.2006 - Applicability of TDS provisions of section 194C on contract for fabrication of article or thing as per specifications given by the assessee

The CBDT has clarified the issue regarding the applicability of TDS provisions of section 194C on contract for fabrication of article or thing as per specifications given by the assessee. The CBDT observed that before taking a decision on the applicability of TDS under section 194C on a contract, it would have to be examined whether the contract in question is a contract for work or a contract for sale.

The CBDT clarified that the provisions of section 194C would apply in respect of a contract for supply of any article or thing as per prescribed specifications only if it is a contract for work and not a contract for sale as per the principles in this regard laid down in para 7(vi) of Circular No. 681, dated 8-3-1994. Para 7(vi) of Circular No.681 clarifies that where the property in the article or thing so fabricated passes from the fabricator-contractor to the assessee only after such article or thing is delivered to the assessee, such contract would be a contract of sale and would, therefore, fall outside the purview of section 194C.

3.7 Insurance commission [Section 194D]

(1) Section 194D casts responsibility on any person responsible for paying to a resident any income by way of remuneration or reward.

(2) Such income may be by way of insurance commission or other remuneration in consideration for soliciting or procuring insurance business (including the business relating to the continuance, renewal or revival of policies of insurance).

(3) Such person is required to deduct income-tax at the rate of 10%, both in the case of resident non-corporate assessees and domestic companies.

(4) The deduction is to be made at the time of the credit of the income to the account of the payee or at the time of making the payment (by whatever mode) to the payee, whichever is earlier.

(5) The tax under this section has to be deducted at source only if the amount of such income or the aggregate of the amounts of such income credited or paid during the financial year to the account of the payee exceeds Rs.5000.

3.8 Payments to non-resident sportsmen or sports association [Section 194E]

(1) This section provides for deduction of tax at source in respect of any income referred to in section 115BBA payable to a non-resident sportsman (including an athlete) who is not a citizen of India or a non-resident sports association or institution.

(2) Deduction of tax at source @10% should be made by the person responsible for making the payment.

(3) Such tax deduction should be at the time of credit of such income to the account of the payee or at the time of payment there of in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

(4) The following are the income referred to in section 115BBA -

(i) income received or receivable by a non-resident sportsman (including an athlete) by way of -

  (a) participation in any game or sport in India (However, games like crossword puzzles, horse races etc. taxable under section 115BB are not included herein); or

  (b) advertisement; or

  (c) contribution of articles relating to any game or sport in India in newspapers, magazines or journals.

(ii) Guarantee amount paid or payable to a non-resident sports association or institution in relation to any game or sport played in India. However, games like crossword puzzles, horse races etc. taxable under section 115BB are not included herein.

3.9 Payments in respect of deposits under National Savings Scheme etc. [Section 194EE]

(1) The person responsible for paying any amount from National Savings Scheme Account under section 80CCA shall deduct income-tax thereon at the rate of 20% at the time of payment.

(2) However, no such deduction shall be made where the amount of payment or the aggregate amount of payments in a financial year is less than Rs.2,500.

(3) The provisions of this section shall not apply to the payments made to the heirs of the assessee.

3.10 Repurchase of units by Mutual Fund or Unit Trust of India [Section 194F]

A person responsible for paying to any person any amount on account of repurchase of units covered under section 80CCB(2) shall deduct tax at source at the rate of 20% at the time of paym ent of such amount.

3.11 Commission etc. on the sale of lottery tickets [Section 194G]

(1) Under section 194G, the person responsible for paying any income by way of commission, remuneration or prize (by whatever name called) on lottery tickets in an amount exceeding Rs.1,000 shall deduct income-tax thereon at the rate of 10%.

(2) Such deduction should be made at the time of credit of such income to the account of the payee or at the time of payment of such income by cash, cheque, draft or any other mode, whichever is earlier.

(3) Where any such income is credited to any account, whether called "Suspense Account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section shall apply accordingly.

3.12 Commission or brokerage [Section 194H]

(1) Any person, not being an individual or a Hindu undivided family not subject to tax audit under section 44AB in the immediately preceding financial year, who is responsible for paying any income by way of commission (other than insurance commission) or brokerage to a resident shall deduct income tax at the rate of 10%.

(2) The deduction shall be made at the time such income is credited to the account of the payee or at the time of payment in cash or by issue of cheque or draft or by any other mode, whichever is earlier.

(3) Even where income is credited to some other account, whether called "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit to the account of the payee for the purposes of this section.

(4) No deduction is required if the amount of such income or the aggregate of such amount does not exceed Rs.2,500 during the financial year.

(5) "Commission or brokerage" includes any payment received or receivable, directly or indirectly, by a person acting on behalf of another person for services rendered, or for any services in the course of buying or selling of goods, or in relation to any transaction relating to any asset, valuable article or thing, other than securities.

(6) However, this section is not applicable to professional services. "Professional Services" means services rendered by a person in the course of carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or such other profession as notified by the CBDT for the purpose of compulsory maintenance of books of account under section 44AA.

(7) Further, there would be no requirement to deduct tax at source on commission or brokerage payments by BSNL or MTNL to their public call office (PCO) franchisees.

3.13 Rent [Section 194-I]

(1) Any person, other than an individual or a HUF not subject to tax audit under section 44AB in the immediately preceding year, who is responsible for paying to a resident any income by way of rent shall deduct income tax at the rate of:

(i) 15%, if the payee is an individual or HUF, and

(ii) 20% in other cases.

(2) The rate of tax deduction would be 10% in respect of rental payments for use of plant, machinery and equipment, irrespective of whether the payee is an individual/HUF, firm, company or any other person.

(3) The rate of TDS under section 194-I has been reduced from 10% to 2% in respect of rent for plant, machinery or equipment and from 15%/20% to 10% in respect of other rental payments with effect from 1st October, 2009.

(4) This deduction is to be made at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of cheque or draft or by any other mode, whichever is earlier.

(5) No deduction need be made where the amount of such income or the aggregate of the amounts of such income credited or paid or likely to be credited or paid during the financial year to the account of the payee does not exceed Rs.1,20,000.

(6) "Rent" means any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of (either separately or

together) any –

(a) land; or

(b) building (including factory building); or

(c) land appurtenant to a building (including factory building); or

(d) machinery; or

(e) plant; or

(f) equipment; or

(g) furniture; or

(h) fittings,

whether or not any or all of the above are owned by the payee.

(7) Where any such income is credited to any account, whether called "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section will apply accordingly.

Applicability of TDS provisions under section 194-I to payments made by the customers on account of cooling charges to the cold storage owners.

CBDT Circular No.1/2008 dated 10.1.2008 provides clarification regarding applicability of provisions of section 194-I to payments made by the customers on account of cooling charges to the cold storage owners.

The main function of the cold storage is to preserve perishable goods by means of a mechanical process, and storage of such goods is only incidental in nature. The customer is also not given any right to use any demarcated space/place or the machinery of the cold store and thus does not become a tenant. Therefore, the provisions of 194-I are not applicable to the cooling charges paid by the customers of the cold storage.

However, since the arrangement between the customers and cold storage owners are basically contractual in nature, the provision of section 194-C will be applicable to the amounts paid as cooling charges by the customers of the cold storage.

Applicability of TDS provisions under section 194-I to service tax component of rental income

CBDT Circular No.4/2008 dated 28.4.2008 provides clarification on deduction of tax at source (TDS) on service tax component of rental income under section 194-I.

As per the provisions of 194-I, tax is deductible at source on income by way of rent paid to any resident. Further, rent has been defined in 194-I to mean any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of (either separately or together) any, -

(a) land; or

(b) building (including factory building); or

(c) land appurtenant to a building (including factory building); or

(d) machinery; or

(e) plant; or

(f) equipment; or

(g) furniture; or

(h) fittings,

whether or not any or all of the above are owned by the payee.

Service tax paid by the tenant doesn't partake the nature of income of the landlord. The landlord only acts as a collecting agency for Government for collection of service tax. Therefore, tax deduction at source under section 194-I would be required to be made on the amount of rent paid/payable without including the service tax.

3.14 Fees for professional or technical services [Section 194J]

(1) Every person, other than an individual or Hindu undivided family not subject to tax audit under section 44AB in the immediately preceding financial year, who is responsible for paying to a resident any sum by way of fees for professional services or fees for technical services or royalty or non-compete fees referred to in section 28(va) shall deduct tax at source at the rate of 10%.

(2) The deduction is to be made at the time of credit of such sum to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

(3) No tax deduction is required if the amount of fees or the aggregate of the amounts of fees credited or paid or likely to be credited or paid during a financial year does not exceed Rs.20,000 in the case of fees for professional services, Rs.20,000 in the case of fees for technical services, Rs.20,000 in the case of royalty and Rs.20,000 in the case of non-compete fees. If A Ltd. pays Rs.17,000 towards fees for professional services,

Rs.14,000 towards fees for technical services and Rs.19,000 towards royalty to a resident individual, say Mr.X, during the P.Y.2009-10, there would be no liability to deduct tax at source under section 194J since payment for each individual service does not exceed Rs.20,000 during the year.

(4) An individual or a Hindu undivided family, whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits specified under clause (a) or clause (b) of section 44AB of the Income-tax Act during the financial year immediately preceding the financial year in which such sum by way of fees for professional or technical services is credited or paid shall be liable to deduct income-tax under this sub-section.

(5) However, such individual or Hindu Undivided family, shall not be liable deduct income-tax on the sum payable by way of fees for professional services, in case such sum is credited or paid exclusively for personal purposes.

(6) Where any fees for professional or technical services is credited to any account, whether called suspense account or by any other name, in the books of accounts of the person liable to pay such sum, such crediting shall be deemed to be credit of such sum to the account of the payee and tax has to be deducted accordingly.

(7) "Professional services" means services rendered by a person in the course of carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or advertising or such other profession as is notified by the CBDT for the purposes of section 44AA or of this section.

(8) Other professions notified for the purposes of section 44AA are as follows:

(a) Profession of "authorised representatives";

(b) Profession of "film artist";

(c) Profession of "company secretary".

(9) The CBDT has notified the services rendered by following persons in relation to the sports activities as Professional Services for the purpose of the section 194J:

(a) Sports Persons,

(b) Umpires and Referees,

(c) Coaches and Trainers,

(d) Team Physicians and Physiotherapists,

(e) Event Managers,

(f) Commentators,

(g) Anchors and

(h) Sports Columnists.

(10) Accordingly, the requirement of TDS as per section 194J would apply to all the aforesaid professions. The term "profession", as such, is of a very wide import. However, the term has been defined in this section exhaustively. For the purposes of TDS, therefore, all other professions would be outside the scope of section 194J. For example, this section will not apply to professions of teaching, sculpture, painting etc. unless they are notified.

(11) Explanation (b) to section 194J provides that the term 'fees for technical services' shall have the same meaning as in Explanation 2 to section 9(1) (vii). The term 'fees for technical services' as defined in Explanation 2 to section 9(i)(vii) means any consideration (including any lump sum consideration) for rendering of any of the following services:

(i) Managerial services;

(ii) Technical services;

(iii) Consultancy services;

(iv) Provision of services of technical or other personnel.

It is expressly provided that the term 'fees for technical services' will not include following types of consideration:

(i) Consideration for any construction, assembly, mining or like project, or

(ii) Consideration which is chargeable under the head 'Salaries'.

3.15 Payment of compensation on acquisition of certain immovable property [Section 194LA]

(1) Section 194LA provides for deduction of tax at source by a person responsible for paying to a resident any sum in the nature of –

(i) compensation or the enhanced compensation or

(ii) the consideration or the enhanced consideration

on account of compulsory acquisition, under any law for the time being in force, of any immovable property (other than agricultural land).

(2) Immovable property means any land (other than agricultural land) or any building or part of a building.

(3) The amount of tax to be deducted is 10% of such sum mentioned in (1) above.

(4) The tax should be deducted at the time of payment of such sum in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

(5) No tax is required to be deducted where the amount of such payment or, as the case may be, the aggregate amount of such payments to a resident during the financial year does not exceed Rs.1 lakh.

3.16 Other sums (payable to non-residents) [Section 195]

(1) Any person responsible for paying interest or any other sum chargeable to tax (other than salaries) to a non-resident or to a foreign company is liable to deduct tax at source at the rates prescribed by the relevant Finance Act. Such persons are also required to furnish the information relating to payment of any sum in such form and manner as may be prescribed by the CBDT.

(2) In order to subject an item of income to deduction of tax under this section the payee must be a non-resident or a foreign company.

(3) The tax is to be deducted at source at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier.

(4) Where any interest or other sum as aforesaid is credited to any account, whether called "Interest payable account" or "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee.

(5) The statutory obligation imposed under this section would apply for the purpose of deduction of tax at source from any sum being income assessable to tax (other than salary income) in the hands of the non-resident/foreign company. However, no deduction shall be made in respect of any dividends declared/distributed/paid by a domestic company, which is exempt in the hands of the shareholders under section 10(34).

(6) Payment to a non-resident by way of royalties and payments for technical services rendered in India are common examples of sums chargeable under the provisions of the Act to which the liability for deduction of tax at source would apply.

(7) In the case of interest payable by the Government or a public sector bank within the meaning of section 10(23D) or a public financial institution within the meaning of section

10(23D), deduction of tax shall be made only at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode.

3.17 TDS on income from Deep Discount Bonds

(1) The tax treatment of income from Deep Discount Bonds has been explained in the CBDT's Circular No.2/2002 dated 15.2.2002.

(2) Circular No.4/2004 dated 13.5.2004 issued by the CBDT clarifies that tax is required to be deducted at source under section 193 or 195, as the case may be, only at the time of redemption of such bonds, irrespective of whether the income from the bonds has been declared by the bond-holder on accrual basis from year to year or is declared only in the year of redemption.

(3) A person, who has declared the income from a Deep Discount Bond on annual accrual basis during the term of the bond, is entitled to make an application under section 197, requesting the Assessing Officer to issue a certificate for no deduction of tax or deduction at a lower rate. In such a case, the assessee should furnish, along with the prescribed Form No.13, details of the income offered for tax by him from year to year.

(4) In case the assessee is not the original subscriber, and has acquired the bonds from some other person, he shall furnish the relevant particulars including the name, address and PAN, of such other person.

(5) If the Assessing Officer is satisfied that the applicant assessee has declared his income from the bonds from year to year on accrual basis during the period the bond was held by him, he shall issue a certificate allowing the tax deduction at source at such reduced rate as is justified by the total income of the applicant in the year of redemption.

(6) An assessee, being a resident individual, who is the original subscriber of a Deep Discount Bond, may furnish a declaration in Form No.15H in the year of redemption in accordance with section 197A, if he has been declaring income on the bond from year to year on accrual basis, and no tax is payable on his total income, including the interest accruing during that year.

(7) However, such a declaration cannot be filed by an individual, other than a senior citizen being a resident individual of the age of 65 years or more during the relevant previous year, if the amount of accumulated interest, being paid on redemption, exceeds the maximum amount not chargeable to tax in his case.

3.18 Income payable net of tax [Section 195A]

(1) Where, under an agreement or other arrangement, the tax chargeable on any income referred to in the foregoing provisions of this Chapter is to be borne by the person by whom the income is payable, then, for the purposes of deduction of tax under those provisions such income shall be increased to such amount as would, after deduction of tax thereon, be equal to the net amount payable under such agreement or arrangement.

(2) However, no grossing up is required in the case of tax paid [under section 192(1A)] by an employer on the non-monetary perquisites provided to the employee

3.19 Interest or dividend or other sums payable to Government, Reserve Bank or certain corporations [Section 196]

(1) No deduction of tax shall be made by any person from any sums payable to -

(i) the Government; or

(ii) the Reserve Bank of India; or

(iii) a corporation established by or under a Central Act, which is, under any law for the time being in force, exempt from income-tax on its income; or

(iv) a Mutual Fund specified under section 10(23D).

(2) This provision for non-deduction is when such sum is payable to the above entities by way of -

(i) interest or dividend in respect of securities or shares -

  (a) owned by the above entities; or

  (b) in which they have full beneficial interest or

(ii) any income accruing or arising to them.

4. CERTIFICATE FOR DEDUCTION OF TAX AT A LOWER RATE [SECTION 197]

(1) This section applies where, in the case of any income of any person or sum payable to any person, income-tax is required to be deducted at the time of credit or payment, as the case may be at the rates in force as per the provisions of sections 192, 193,194,194A, 194C, 194D, 194G, 194H, 194-I, 194J 194K, 194LA and 195.

(2) In such cases, the assessee can make an application to the Assessing Officer for deduction of tax at a lower rate or for non-deduction of tax.

(3) If the Assessing Officer is satisfied that the total income of the recipient justifies the deduction of income-tax at lower rates or no deduction of income-tax, as the case may be, he may give to the assessee such certificate, as may be appropriate .

(4) Where the Assessing Officer issues such a certificate, then the person responsible for paying the income shall deduct income-tax at such lower rates specified in the certificate or deduct no tax, as the case may be, until such certificate is cancelled by the Assessing Officer.

(5) Enabling powers have been conferred upon the CBDT to make rules for prescribing the procedure in this regard.

(6) The CBDT has, in exercise of the powers conferred under section 119(1) of the Income-tax Act, 1961, directed that corporations which are established by a Central, State or Provincial Act for the welfare and economic upliftment of ex-servicemen and whose income qualifies for exemption from income-tax under section 10(26BBB) would also be exempt from tax deduction/collection at source on their receipts. This exemption shall be valid for 3 years from the date of issue of this order i.e., from 1.8.2008. However, this exemption shall not absolve such organisation from their statutory obligation of deducting TDS on all contractual payments made by them to other parties including sub-contractors etc.

5. NO DEDUCTION IN CERTAIN CASES [SECTION 197A]

(1) This section enables an individual, who is resident in India and whose estimated total income of the previous year is less than the basic exemption limit, to receive dividends and any sum out of National Savings Scheme Account, without deduction of tax at source under sections 194 and 194EE, on furnishing a declaration in duplicate in the prescribed form and verified in the prescribed manner [Sub-section (1)].

(2) The declaration in the above form is to be furnished by the declarant to the person responsible for paying any income of the nature referred to in sections 194 or 194EE. The declaration will have to be to the effect that the tax on the estimated total income of the declarant of the previous year in which such income is to be included in computing his total income will be nil [Sub-section (1)].

(3) No deduction of tax shall be made under sections 193 or 194A or 194K, where a person, who is not a company or a firm, furnishes to the person responsible for paying any income of the nature referred to in section 193 or 194A or 194K, a declaration in writing in duplicate in the prescribed form to the effect that the tax on his estimated total income of the previous year in which such income is to be included in computing his total income will be nil [Sub-section (1A)].

(4) The provisions of this section will, however, not apply where -

(i) the amount of any income from dividends,

(ii) payments in respect of deposits under National Savings Schemes, etc. or

(iii) income from interest on securities or interest other than "interest on securities" or units or

(iv) the aggregate of the amounts of such incomes in (1), (2) and (3) above credited or paid or likely to be credited or paid during the previous year in which such income is to be included exceeds the maximum amount which is not chargeable to income-tax [Sub-section (1B)].

(5) For a senior citizen, who is of the age or 65 years or more at any time during the previous year, no deduction of tax shall be made under section 193 or section 194 or section 194A or section 194EE or section 194K, if they furnish a declaration in writing to the payer, of any amount or income mentioned in the above sections [Sub-section (1C)].

(6) Such declaration should be in duplicate in the prescribed form and verified in the prescribed manner to the effect that the tax on his estimated total income of the previous year in which such income is to be included in computing his total income will be nil. The restriction contained in sub-section (1B) will not apply to senior citizens [Sub-section (1C)].

(7) No deduction of tax shall be made by an Offshore Banking Unit from the interest paid on-

(i) deposit made by a non-resident/not-ordinarily resident on or after 1.4.2005; or

(ii) borrowing from a non-resident/not-ordinarily resident on or after 1.4.2005.

This provision is contained in sub-section (1D).

(8) On receipt of the declaration referred to in sub-section (1), (1A) or (1C), the person responsible for making the payment will be required to deliver or cause to be delivered to the Chief Commissioner or Commissioner, one copy of the declaration on or before the 7th day of the month following the month in which the declaration is furnished to him [Section 197A(2)].

6. MISCELLANEOUS PROVISIONS

6.1 Tax deducted is income received [Section 198]

(1) All sums deducted in accordance with the foregoing provisions shall, for the purpose of computing the income of an assessee, be deemed to be income received.

(2) However, the tax paid by an employer under sub-section (1A) of section 192 on non-

monetary perquisites provided to the employees, shall not be deemed to be income received by the assessee.

6.2 Credit for tax deducted at source [Section 199]

(1) Tax deducted at source in accordance with the above provisions and paid to the credit of the Central Government shall be treated as payment of tax on behalf of the-

(i) person from whose income the deduction was made; or

(ii) owner of the security; or

(iii) depositor; or

(iv) owner of property; or

(v) unit-holder; or

(vi) shareholder.

(2) Any sum referred to in sub-section (1A) of section 192 and paid to the Central Government, shall be treated as the tax paid on behalf of the person in respect of whose income, such payment of tax has been made.

(3) The CBDT is empowered to frame rules for the purpose of giving credit in respect of tax deducted or tax paid under Chapter XVII. The CBDT also has the power to make rules for giving credit to a person other than the persons mentioned in (1) and (2) above. Further, the CBDT can specify the assessment year for which such credit may be given.

(4) Accordingly, Rule 37BA providing for credit for tax deducted at source for the purposes of section 199 has been inserted with effect from 1.4.2009.

Sub-rule (1) provides that credit for tax deducted at source and paid to the Central Government in accordance with the provisions of Chapter XVII, shall be given to the person to whom payment has been made or credit has been given (i.e., the deductee) on the basis of information relating to deduction of tax furnished by the deductor to the income-tax authority or the person authorised by such authority.

Sub-rule (2) provides that if the income on which tax has been deducted at source is assessable in the hands of a person other than the deductee, credit for tax deducted at source shall be given to the other person in cases where-

(a) the income of the deductee is included in the total income of another person under the provisions of section 60, section 61, section 64, section 93 or section 94;

(b) the income of a deductee being an association of persons or a trust is assessable in the hands of members of the association of persons, or in the hands of trustees, as the case may be;

(c) the income from an asset held in the name of a deductee, being a partner of a firm or a karta of a Hindu undivided family, is assessable as the income of the firm, or Hindu undivided family, as the case may be;

(d) the income from a property, deposit, security, unit or share held in the name of a deductee is owned jointly by the deductee and other persons and the income is assessable in their hands in the same proportion as their ownership of the asset:

However, in such cases, the deductee should file a declaration with the deductor. Such declaration filed by the deductee should contain the name, address, permanent account number of the person to whom credit is to be given, payment or credit in relation to which credit is to be given and reasons for giving credit to such person.

Also, the deductor should report the tax deduction in the name of the other person in the information relating to deduction of tax referred to in sub-rule (1). The deductor should issue the certificate for deduction of tax at source in the name of the person in whose name credit is shown in the information relating to deduction of tax referred to in sub-rule (1) and should keep the declaration in his safe custody.

Sub-rule (3) provides that the credit for tax deducted at source and paid to the Central Government, shall be given for the assessment year for which such income is assessable. Where tax has been deducted at source and paid to the Central Government and the income is assessable over a number of years, credit for tax deducted at source shall be allowed across those years in the same proportion in which the income is assessable to tax.

Sub-rule (4) provides that credit for tax deducted at source and paid to the account of the Central Government shall be granted on the basis of –

(i) the information relating to deduction of tax furnished by the deductor to the income-tax authority or the person authorized by such authority; and

(ii) the information in the return of income in respect of the claim for the credit,

(iii) subject to verification in accordance with the risk management strategy formulated by the Board from time to time.

6.3 Duty of person deducting tax [Section 200]

(1) The persons responsible for deducting the tax at source should deposit the sum so deducted to the credit of the Central Government within the prescribed time [Sub-section (1)].

(2) Further, an employer paying tax on non-monetary perquisites provided to employees in accordance with section 192(1A), should deposit within the prescribed time, the tax to the credit of the Central Government or as the Board directs [Sub-section (2)].

(3) Sub-section (3) casts responsibility on the following persons –

(i) any person deducting any sum on or after 1st April, 2005 in accordance with the foregoing provisions of this chapter; or,

(ii) any person being an employer referred to in section 192(1A).

(4) These persons are responsible for preparing *such statements for such periods as may be prescribed,* after paying the tax deducted to the credit of the Central Government within the prescribed time.

(5) Such statements have to be delivered or caused to be delivered to the prescribed income-tax authority or the person authorised by such authority.

(6) Such statements should be in the prescribed form and verified in the prescribed manner.

(7) It should set forth such particulars and should be delivered within such time as may be prescribed.

(8) Penalty of rupees one hundred per day of continuing default would be attracted under section 272A for failure to deliver or cause to be delivered within the prescribed time a copy of the statements as required above.

6.4 Correction of arithmetic mistakes and adjustment of incorrect claim during computerized processing of TDS statements [New Section 200A]

(i) At present, all statements of tax deducted at source are filed in an electronic mode, thereby facilitating computerised processing of these statements.

(ii) Therefore, in order to process TDS statements on computer, electronic processing on the same lines as processing of income-tax returns has been provided by insertion of new section 200A with effect from 1st April, 2010.

(iii) The following adjustments can be made during the computerized processing of

statements of tax deducted at source –

(1) any arithmetical error in the statement; or

(2) an incorrect claim, if such incorrect claim is apparent from any information in the statement.

The term "an incorrect claim apparent from any information in the statement" shall mean such claim on the basis of an entry, in the statement, –

(a) of an item, which is inconsistent with another entry of the same or some other item in such statement;

(b) in respect of rate of deduction of tax at source, where such rate is not in accordance with the provisions of the Act.

(iv) After making such adjustments, tax and interest [say, under section 201(1A)] would be calculated and sum payable by the deductor or refund due to the deductor will be determined.

(v) An intimation will be sent to the deductor, informing him of his tax liability or the refund due, within one year from the end of the financial year in which the statement is filed. The refund due shall be granted to the deductor.

(vi) For this purpose, the CBDT is empowered to make a scheme for centralized processing of statements of TDS to determine the tax payable by, or refund due to, the deductor.

6.5 Consequences of failure to deduct or pay [Section 201]

(1) The following persons shall be deemed to be an assessee in default if they do not deduct the whole or any part of the tax or after deducting fails to pay the tax -

(i) any person including the principal officer of a company, who is required to deduct any sum in accordance with the provisions of the Act; and

(ii) an employer paying tax on non-monetary perquisites under section 192(1A).

(2) However, no penalty shall be charged under section 221 from such person unless the Assessing Officer is satisfied that such person has failed to deduct and pay the tax without good and sufficient reasons.

(3) Such person shall also be liable to pay simple interest @1% for every month or part of a month. Such interest is chargeable on the amount of such tax from the date on which

such tax was deductible to the date on which such tax is actually paid.

(4) Such interest should be paid before furnishing the statements in accordance with section 200(3).

(5) Where the tax has not been paid after it is deducted, the amount of the tax together with the amount of simple interest thereon shall be a charge upon all the assets of the person or the company, as the case may be.

(6) An order under section 201(1) deeming a person to be an assessee-in-default for failure to deduct the whole or any part of the tax from a person resident in India has to be passed within two years from the end of the financial year in which the statement of TDS is filed by the deductor. Where no such statement is filed, such order can be passed up till four years from the end of the financial year in which the payment is made or credit is given.

(7) However, the time limit for passing an order deeming a person to be an assessee-in-default in respect of F.Y.2007-08 and earlier years is 31st March, 2011.

(8) Further, the exclusions from the time limit, as specified in Explanation 1 to section 153, would also apply to the above time limit for passing an order deeming a person to be an assessee-in-default. Also, the time limit would not apply to an order passed consequent to the direction contained in an order of the Commissioner under sections 263 and 264, Commissioner (Appeals) under section 250, Appellate Tribunal under section 254, Supreme Court/ National Tax Tribunal under section 260 and Supreme Court under section 262. Thus, the time limit would be extended where effect is to be given to various appellate proceedings or where proceedings are stayed.

(9) Section 201(1) deems a person to be an assessee-in-default if he –

(i) does not deduct tax; or

(ii) does not pay; or

(iii) after so deducting fails to pay

the whole or any part of the tax, as required by or under this Act.

Thus, section 201(1) contemplates three types of defaults. The default contemplated in (ii) is covered by the default contemplated in (iii). However, the time limit has been specified only for passing of orders relating to default contemplated in (i) above. There is no time limit specified in respect of the other defaults.

(10) Therefore, no time-limits have been prescribed for the order under section 201(1) where –

(i) the deductor has deducted but not deposited the tax deducted at source, as this would be a case of defalcation of government dues,

(ii) the employer has failed to pay the tax wholly or partly, under sub-section (1A) of section 192, as the employee would not have paid tax on such perquisites,

(iii) the deductee is a non-resident as it may not be administratively possible to recover the tax from the non-resident.

6.6 Deduction only one mode of recovery [Section 202]

(1) Recovery of tax through deduction at source is only one method of recovery.

(2) The Assessing Officer can use any other prescribed methods of recovery in addition to tax deducted at source.

6.7 Certificate for tax deducted [Section 203]

(1) Every person deducting tax at source shall issue a certificate to the effect that tax has been deducted and specify the amount so deducted, the rate at which tax has been deducted and such other particulars as may be prescribed.

(2) Every person, being an employer, referred to in sub-section (1A) of section 192 shall, within such period, as may be prescribed, furnish to the person in respect of whose income such payment of tax has been made, a certificate to the effect that tax has been paid to the Central Government, and specify the amount so paid, the rate at which the tax has been paid and such other particulars as may be prescribed.

(3) However, where tax has been deducted or paid in accordance with the foregoing provisions of this Chapter on or after 1.4.2010, there is no requirement to furnish a certificate for tax deducted under section 203 in respect of such tax deducted or paid on or after 1.4.2010.

6.8 Common number for TDS and TCS [Section 203A]

(1) Persons responsible for deducting tax or collecting tax at source should apply to the Assessing Officer for the allotment of a "tax-deduction and collection-account number".

(2) Section 203A(2) enlists the documents/certificates/returns/challans in which the "tax deduction account number" or "tax collection account number" or "tax deduction and collection account number" has to be compulsorily quoted. They are -

(i) challans for payment of any sum in accordance with the provisions of section 200 or section 206C(3);

(ii) certificates furnished under section 203 or section 206C(5);

(iii) statements prepared and delivered or caused to be delivered in accordance with the provisions of section 200(3) or section 206C(3).

(iv) returns delivered in accordance with the provisions of section 206 or section 206C(5A)/(5B); and

(v) in all other documents pertaining to such transactions as may be prescribed in the interests of revenue.

Note *– Provisions for tax collection at source is not relevant for the Professional Competence Course and will be dealt with at the Final level. Therefore, section 206C dealing with tax collection at source is not relevant for the Professional Competence Course.*

6.9 Furnishing of statement of tax deducted [Section 203AA]

(1) This section provides for furnishing of a statement of the tax deducted on or after 1st April, 2008 by the prescribed income-tax authority or the person authorised by such authority referred to in section 200(3)

(2) Such statement should be prepared and delivered to every person -

(a) from whose income, tax has been deducted or

(b) in respect of whose income, tax has been paid.

(3) Such statement should be in the prescribed form specifying the amount of tax deducted or paid and other prescribed particulars.

6.10 Person responsible for paying taxes deducted at source [Section 204]

For purposes of deduction of tax at source the expression "person responsible for paying" means:

	Nature of income/payment	Person responsible for paying tax
(1)	Salary (other than payment of salaries by the Central or State Government)	(i) the employer himself; or (ii) if the employer is a company, the company itself, including the principal officer thereof.
(2)	Interest on securities (other than payments by or on behalf of the Central or State Government)	the local authority, corporation or company, including the principal officer thereof.

(3)	Any sum payable to a non-resident Indian, representing consideration for the transfer by him of any foreign exchange asset, which is not a short term capital asset	the authorised dealer responsible for remitting such sum to the non-resident Indian or for crediting such sum to his Non-resident (External) Account maintained in accordance with the Foreign Exchange Regulation Act, 1973 and any rules made thereunder.
(4)	Credit/payment of any other sum chargeable under the provisions of the Act	(i) the payer himself; or (ii) if the payer is a company, the company itself including the principal officer thereof.

6.11 Bar against direct demand on assessee [Section 205]

Where tax is deductible at source under any of the aforesaid sections, the assessee shall not be called upon to pay the tax himself to the extent to which tax has been deducted from that income.

6.12 Furnishing of statements in respect of payment of interest to residents without deduction of tax [Section 206A]

(1) This section casts responsibility on every banking company or co-operative society or public company referred to in the proviso to section 194A(3)(i) to prepare *such statements for such period as may be prescribed* –

— if they are responsible for paying to a resident,

— the payment should be of any income not exceeding Rs.10,000, where the payer is a banking company or a co-operative society, and Rs.5,000 in any other case.

— such income should be by way of interest (other than interest on securities)

(2) The statements have to be delivered or caused to be delivered to the prescribed income-tax authority or the person authorised by such authority.

(3) The statements have to be in the prescribed form, verified in the prescribed manner and to be filed within the prescribed time, on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media.

(4) The Central Government may, by notification in the Official Gazette, cast responsibility on any person other than a person mentioned in (1) above.

(5) Such persons would be persons responsible for paying to a resident any income liable for deduction of tax at source.

(6) Such persons are vested with the responsibility to prepare and deliver or cause to be delivered statements within the prescribed time to the prescribed income-tax authority or the person authorized by such authority.

(7) Such statements should be in the prescribed form and verified in the prescribed manner.

(8) Such statements should be on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media.

6.13 Mandatory requirement of furnishing PAN in all TDS statements, bills, vouchers and correspondence between deductor and deductee [Section 206AA]

(i) The non-quoting of PAN by deductees in many cases have led to delay in issue of refund on account of problems in the processing of returns of income and in granting credit for tax deducted at source.

(ii) With a view to strengthening the PAN mechanism, section 206AA has been inserted, with effect from 1.4.2010, to provide that any person whose receipts are subject to deduction of tax at source i.e. the deductee, shall mandatorily furnish his PAN to the deductor failing which the deductor shall deduct tax at source at higher of the following rates –

(1) the rate prescribed in the Act;

(2) at the rate in force i.e., the rate mentioned in the Finance Act; or

(3) at the rate of 20%.

For instance, in case of rental payment for plant and machinery, where the payee does not furnish his PAN to the payer, tax would be deductible @20% instead of @2% prescribed under section 194-I. However, non-furnishing of PAN by the deductee in case of income by way of winnings from lotteries, card games etc., would result in tax being deducted at the existing rate of 30% under section 194-B. Therefore, wherever tax is deductible at a rate higher than 20%, this provision would not have any impact.

(iii) Tax would be deductible at the rates mentioned above also in cases where the taxpayer files a declaration in Form 15G or 15H (under section 197A) but does not provide his PAN.

(iv) Further, no certificate under section 197 will be granted by the Assessing Officer unless the application contains the PAN of the applicant.

(v) If the PAN provided to the deductor is invalid or it does not belong to the deductee, it shall be deemed that the deductee has not furnished his PAN to the deductor. Accordingly, tax would be deductible at the rate specified in (ii) above.

(vi) These provisions will also apply to non-residents where tax is deductible on payments or credits made to them.

(vii) Both the deductor and the deductee have to compulsorily quote the PAN of the deductee in all correspondence, bills, vouchers and other documents exchanged between them.

7. ADVANCE PAYMENT OF TAX [SECTIONS 207 TO 219]

7.1 Liability for payment of advance tax

(1) Tax shall be payable in advance during any financial year, in accordance with the provisions of sections 208 to 219, in respect of an assessee's current income i.e. the total income of the assessee which would be chargeable to tax for the assessment year immediately following that financial year [Section 207].

(2) Under section 208, obligation to pay advance tax arises in every case where the advance tax payable is *Rs.10,000 or more*.

Note - An assessee who is liable to pay advance tax of less than *Rs.10,000* will not be saddled with interest under sections 234B and 234C for defaults in payment of advance tax. However, the consequences under section 234A regarding interest for belated filing of return would be attracted.

7.2 Computation of advance tax

(1) An assessee has to estimate his current income and pay advance tax thereon. He need not submit any estimate or statement of income to the Assessing Officer, except where he has been served with notice by the Assessing Officer.

(2) Where an obligation to pay advance tax has arisen, the assessee shall himself compute the advance tax payable on his current income at the rates in force in the financial year and deposit the same, whether or not he has been earlier assessed to tax.

(3) In the case of a person who has been already assessed by way of a regular assessment in respect of the total income of any previous year, the Assessing Officer, if he is of the opinion that such person is liable to pay advance tax, can serve an order under section 210(3) requiring the assessee to pay advance tax.

(4) For this purpose, the total income of the latest previous year in respect of which the assessee has been assessed by way of regular assessment or the total income returned by the assessee in any return of income for any subsequent previous year, whichever is higher, shall be taken as the basis for computation of advance tax payable.

(5) The above order can be served by the Assessing Officer at any time during the financial year but not later than the last date of February.

(6) If, after sending the above notice, but before 1st March of the financial year, the assessee furnishes a return relating to any later previous year or an assessment is completed in respect of a later return of income, the Assessing Officer may amend the order for payment of advance tax on the basis of the computation of the income so returned or assessed.

(7) If the assessee feels that his own estimate of advance tax payable would be less than the one sent by the Assessing Officer, he can file estimate of his current income and advance tax payable thereon.

(8) Where the advance tax payable on assessee's estimation is higher than the tax computed by the Assessing Officer, then the advance tax shall be paid based upon such higher amount.

(9) In all cases, the tax calculated shall be reduced by the amount of tax deductible at source.

(10) The amount of advance tax payable by an assessee in the financial year calculated by -

(i) the assessee himself based on his estimation of current income; or

(ii) the Assessing Officer as a result of an order under section 210(3) or amended order under section 210(4)

is subject to the provisions of section 209(2), as per which the net agricultural income has to be considered for the purpose of computing advance tax.

7.3 Installments of advance tax and due dates

(1) Advance tax shall be payable by companies and other assessees as per the following schedule of installments:

Companies - Four installments

Due date of installment	Amount payable
On or before the 15th June	Not less than 15% of advance tax liability.
On or before the 15th September	Not less than 45% of advance tax liability, as reduced by the amount, if any, paid in the earlier installment.

On or before the 15th December	Not less than 75% of advance tax liability, as reduced by the amount or amounts, if any, paid in the earlier installment or installments.
On or before the 15th March	The whole amount of advance tax liability as reduced by the amount or amounts, if any, paid in the earlier installment or installments.

Non-corporate assessees - Three installments

Due date of installment	Amount payable
On or before the 15th September	Not less than 30% of advance tax liability
On or before the 15th December	Not less than 60% of advance tax liability, as reduced by the amount, if any, paid in the earlier installment.
On or before the 15th March	the whole amount of such advance tax as reduced by the amount or amounts, if any, paid in the earlier installment or installments.

(2) The last date for payment of the whole amount of advance tax is 15th March of the relevant financial year. However, any amount paid by way of advance tax on or before 31st March is also considered as advance tax paid for the financial year. Interest liability for late payment will arise in such a case.

(3) If the last day for payment of any installment of advance tax is a day on which the receiving bank is closed, the assessee can make the payment on the next immediately following working day, and in such cases, the mandatory interest leviable under sections 234B and 234C would not be charged.

(4) Where advance tax is payable by virtue of the notice of demand issued under section 156 by the Assessing Officer, the whole or the appropriate part of the advance tax specified in such notice shall be payable on or before each of such due dates as fall after the date of service of notice of demand.

(5) Where the assessee does not pay any installment by the due date, he shall be deemed to be an assessee in default in respect of such installment.

7.4 Payment of advance tax in case of capital gains/casual income [Proviso to section 234C]

(1) Advance tax is payable by an assessee on his/its total income, which includes capital gains and casual income like income from lotteries, crossword puzzles etc.

(2) Since it is not possible for the assessee to estimate his capital gains, income from lotteries, etc., it has been provided that if any such income arises after the due date for any installment, then, the entire amount of tax payable (after considering tax deducted at source) on such capital gains or casual income should be paid in the remaining installments of advance tax which are due.

(3) Where no such installment is due, the entire tax should be paid by 31st March of the relevant financial year.

(4) No interest liability would arise if the entire tax liability is so paid.

7.5 Credit for advance tax [Section 219]

Any sum, other than interest or penalty, paid by or recovered from an assessee as advance tax, is treated as a payment of tax in respect of the income of the previous year and credit thereof shall be given in the regular assessment.

7.6 Electronic payment of taxes

The CBDT has, vide Notification No.34/2008 dated 13.3.2008, inserted Rule 125 which has made electronic payment of taxes (including interest and penalty) by corporate assessees and assessees subject to tax audit mandatory on or after 1st April 2008. Electronic payment of taxes means payment of taxes by way of internet banking facility or credit or debit cards.

With a view to facilitate electronic payment of taxes by different categories of taxpayers, the CBDT has clarified the following vide its Circular No.5/2008 dated 14.7.2008:

a) an assessee can make electronic payment of taxes also from the account of any other person. However, the challan for making such payment must clearly indicate the Permanent Account Number (PAN) of the assessee on whose behalf the payment is made. It is not necessary for the assessee to make payment of taxes from his own account in an authorized bank

b) The payment of any amount by a deductor by way of Tax Deducted at Source (TDS) or Tax Collected at Source (TCS) shall fall within the meaning of 'tax' for the purpose of the rule 125 of the Income-tax Rules, 1962.

7.7 Interest for non-payment or short-payment of advance tax [Section 234B]

(1) Interest under section 234B is attracted for non-payment of advance tax or payment of advance tax of an amount less than 90% of assessed tax.

(2) The interest liability would be 1% per month or part of the month from 1st April following the financial year upto the date of determination of income under section 143(1).

(3) Such interest is calculated on the amount of difference between the assessed tax and the advance tax paid.

(4) Assessed tax is the tax calculated on total income less tax deducted at source.

7.8 Interest payable for deferment of advance tax [Section 234C]

(1) Interest under section 234C is attracted for deferment of advance tax beyond the due dates.

(2) The interest liability would be 1% per month, for a period of 3 months, for every deferment.

(3) However, for the last installment of 15th March, the interest liability under this section would be 1% for one month.

(4) The interest is to be calculated on the difference between the amount arrived at by applying the specified percentage of tax on returned income and the actual amount paid by the due date.

Self-examination questions

1. Under section 194G, any person making payment by way of commission or remuneration exceeding Rs.1000 to any person stocking, distributing, purchasing or selling lottery tickets is liable to deduct tax at the rate of -

   a) 10%

   b) 20%

   c) 30%

2. Any person responsible for paying to a resident any sum exceeding Rs.1 lakh towards compensation for compulsory acquisition of his urban industrial land under any law has to deduct income-tax at the rate of -

   a) 10%

   b) 15%

   c) 20%

3. The rate of TDS w.e.f. 1.10.2009 on rental payments of plant, machinery or equipment is -

   a) 2%

   b) 5%

   c) 10%

4. For non-payment or short payment of advance tax -

   a) interest is payable under section 234A

   b) interest is payable under section 234B

   c) interest is payable under section 234C

5. For deferment of advance tax -

   a) interest is payable under section 234A

   b) interest is payable under section 234B

   c) interest is payable under section 234C

6. Write short notes on -

   (a) Certificate for deduction of tax at lower rate

   (b) Installments of advance tax and due dates for payment of advance tax

   (c) Payment of advance tax in case of capital gains

7. Explain the meaning of the following terms in the context of section 194J -

   (a) Professional services

   (b) Fees for technical services

8. Who are the "persons responsible for paying" taxes deducted at source as per section 204?

9. Which are the payments for which individuals and HUFs, who are liable to get their accounts audited under section 44AB, are vested with the liability to deduct tax at source? Discuss.

10. What is the time-limit for passing an order under section 201(1) deeming a person to be an assessee-in-default for failure to deduct tax from a person resident in India?

Answers

1. a; **2.** a; **3.** a; **4.** b; **5.** c.

CHAPTER 10

PROVISIONS FOR FILING OF RETURN OF INCOME

Learning Objectives

After studying this chapter, you would be able to understand–

- what is a "return of income"
- who are the persons who have to compulsorily file a return of income
- what is the due date for filing return of income for different assessees
- what are the consequences of late filing of return
- whether a return of income can be revised
- what are the particulars required to be furnished with the return
- when a return of income is considered defective
- who are the persons required to apply for permanent account number
- what are the transactions in respect of which quoting of permanent account number is mandatory
- who are authorised to sign the return of income
- the forms to be used by different classes of assessees for filing their return of income.

1. RETURN OF INCOME

The Income-tax Act contains provisions for filing of return of income. Return of income is the format in which the assessee furnishes information as to his total income and tax payable. The format for filing of returns by different assessees is notified by the CBDT. The particulars of income earned under different heads, gross total income, deductions from gross total income, total income and tax payable by the assessee are generally required to be furnished in a return of income. In short, a return of income is the declaration of income by the assessee in the prescribed format.

2. COMPULSORY FILING OF RETURN OF INCOME [SECTION 139(1)]

(1) As per section 139(1), it is compulsory for companies and firms to file a return of income or loss for every previous year on or before the due date in the prescribed form.

(2) In case of a person other than a company or a firm, filing of return of income on or before the due date is mandatory, if his total income or the total income of any other person in respect of which he is assessable under this Act during the previous year exceeds the basic exemption limit.

(3) Such persons should, on or before the due date, furnish a return of his income or the income of such other person during the previous year in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed.

(4) Further, every person, being an individual or a HUF or an AOP or BOI or an artificial juridical person -

- whose total income or the total income of any other person in respect of which he is assessable under this Act during the previous year
- without giving effect to the provisions of section 10A or 10B or Chapter VI-A
- exceeded the basic exemption limit

is required to file a return of his income or income of such other person on or before the due date in the prescribed form and manner and setting forth the prescribed particulars.

For the *A.Y.2010-11*, the basic exemption limit is *Rs.1,60,000* for individuals/HUFs/AOPs/BOIs and artificial juridical persons, *Rs.1,90,000* for women assessees below the age of 65 years and *Rs.2,40,000* for assessees of the age of 65 years or more at any time during the previous year. These amounts denote the level of total income, which is arrived at after claiming the admissible deductions under sections 10A, 10B and Chapter VI-A. However, the level of total income to be considered for the purpose of filing return of income is the income before claiming the admissible deductions under sections 10A, 10B and Chapter VI-A.

(5) 'Due date' means -

(a) 30th September of the assessment year, where the assessee is -

(i) a company; or

(ii) a person (other than a company) whose accounts are required to be audited under the Income-tax Act, 1961 or any other law in force; or

(iii) a working partner of a firm whose accounts are required to be audited under the Income-tax Act, 1961 or any other law for the time being in force.

(b) 31st July of the assessment year, in the case of any other assessee.

3. INTEREST FOR DEFAULT IN FURNISHING RETURN OF INCOME [SECTION 234A]

(1) Interest under section 234A is attracted for failure to file a return of income on or before the due date mentioned above i.e. interest is payable where an assessee furnishes the return of income after the due date or does not furnish the return of income.

(2) Simple interest @1% per month or part of the month is payable for the period commencing from the date immediately following the due date and ending on the following dates -

Circumstances	Ending on the following dates
Where the return is furnished after due date	the date of furnishing of the return
Where no return is furnished	the date of completion of assessment

(3) The interest has to be calculated on the amount of tax on total income as determined under section 143(1) or on regular assessment as reduced by the advance tax paid and any tax deducted or collected at source.

Note – Section 143(1) provides that if any tax or interest is found due on the basis of a return of income after adjustment of advance tax, tax deducted at source and self-assessment tax, an intimation would be sent to the assessee and such intimation is deemed to be a notice of demand issued under section 156. If any refund is due on the basis of the return, it shall be granted to the assessee and an intimation to this effect would be sent to the assessee. Where no tax or refund is due, the acknowledgement of the return is deemed to be an intimation under section 156.

4. OPTION TO FURNISH RETURN OF INCOME TO EMPLOYER [SECTION 139(1A)]

(1) This section gives an option to a person, being an individual who is in receipt of income chargeable under the head "Salaries", to furnish a return of his income for any previous year to his employer, in accordance with such scheme as may be notified by the CBDT and subject to such conditions as may be specified therein.

(2) Such employer shall furnish all returns of income received by him on or before the due date, in such form (including on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media) and manner as may be specified in that scheme.

(3) In such a case, any employee who has filed a return of his income to his employer shall be deemed to have furnished a return of income under sub-section (1).

5. INCOME-TAX RETURN THROUGH COMPUTER READABLE MEDIA [SECTION 139(1B)]

(1) This sub-section enables the taxpayer to file his return of income in computer readable media, without interface with the department.

(2) It provides an option to a person (both corporate and non-corporate) required to furnish a return of his income.

(3) Such person may, on or before the due date, furnish a return of income in accordance with such scheme as may be notified by the CBDT, in such form (including on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media) and manner as may be specified in that scheme.

(4) Such return shall be deemed to be a return furnished under section 139(1).

6. RETURN OF LOSS [SECTION 139(3)]

(1) This section requires the assessee to file a return of loss in the same manner as in the case of return of income within the time allowed under section 139(1).

(2) Under section 80, an assessee cannot carry forward or set off his loss against income in the same or subsequent year unless he has filed a return of loss in accordance with the provisions of section 139(3).

(3) A return of loss has to be filed by the assessee in his own interest and the non-receipt of a notice from the Assessing Officer requiring him to file the return cannot be a valid excuse under any circumstances for the non-filing of such return.

(4) In particular, a return of loss must be filed by an assessee who has incurred a loss under the heads “Profits and gains from business or profession”, “Capital gains”, and income from the activity of owning and maintaining race horses taxable under the head “Income from other sources”.

(5) However, loss under the head “Income from house property” under section 71B and unabsorbed depreciation under section 32 can be carried forward for set-off even though return of loss has not been filed before the due date.

7. BELATED RETURN [SECTION 139(4)]

(1) Any person who has not furnished a return within the time allowed to him under section 139(1) or within the time allowed under a notice issued under section 142(1) may furnish the return for any previous year at any time -

(i) before the expiry of one year from the end of the relevant assessment year; or

(ii) before the completion of the assessment,

whichever is earlier.

(2) A belated return cannot be revised. It has been held in *Kumar Jagdish Chandra Sinha v. CIT [1996] 86 Taxman 122 (SC)* that only a return furnished under section 139(1) or in pursuance of a notice under section 142(1) can be revised. A belated return under section 139(4) cannot be revised.

Note – Notice under section 142(1) is served by the Assessing Officer for the purpose of making an assessment -

(i) on any person who has filed a return under section 139(1) to -

  (a) produce or cause to be produced such accounts or documents as may be required by the Assessing Officer; or

  (b) to furnish in writing information in the prescribed form on such points or matters as required by the Assessing Officer.

(ii) on a person who has not filed his return within the time allowed under section 139(1) or before the end of the relevant assessment year to -

  (a) furnish a return of his income or the income of any other person in respect of which he is assessable under the Act, in the prescribed form containing the prescribed particulars;

  (b) produce or cause to be produced such accounts or documents as may be required by the Assessing Officer; or

  (c) to furnish in writing information in the prescribed form on such points or matters as required by the Assessing Officer.

8. RETURN OF INCOME OF CHARITABLE TRUSTS AND INSTITUTIONS [SECTION 139(4A)]

(1) Every person in receipt of income -

(i) derived from property held under a trust or any other legal obligation wholly or partly for charitable or religious purpose; or

(ii) by way of voluntary contributions on behalf of such trust or institution

must furnish a return of income if the total income in respect of which he is assessable as a representative assessee (computed before allowing any exemption under sections 11 and 12) exceeds the basic exemption limit.

(2) Such persons should furnish the return in the prescribed form and verified in the prescribed manner containing all the particulars prescribed for this purpose.

(3) This return must be filed by the representative-assessee voluntarily within the time limit. Any failure on the part of the assessee would attract liability to pay interest and penalty.

9. RETURN OF INCOME OF POLITICAL PARTIES [SECTION 139(4B)]

(1) Under this section, a political party is required to file a return of income if, before claiming exemption under section 13A, the party has taxable income.

(2) The grant of exemption from income-tax to any political party under section 13A is subject to the condition that the political party submits a return of its total income within the time limit prescribed under section 139(1).

(3) The chief executive officer of the political party is statutorily required to furnish a return of income of the party for the relevant assessment year, if the amount of total income of the previous year exceeds the basic exemption limit before claiming exemption under section 13A.

(4) The return must be filed in the prescribed form and verified in the prescribed manner setting forth such other particulars as may be prescribed by the CBDT.

(5) The provisions of the Act would apply as if it were a return required to be furnished under section 139(1).

10. MANDATORY FILING OF RETURNS BY SCIENTIFIC RESEARCH ASSOCIATIONS, NEWS AGENCY, TRADE UNIONS, ETC. [SECTION 139(4C)]

(1) It will be mandatory for the following institutions/associations etc. to file the return of income if their total income without giving effect to exemption under section 10, exceeds the basic exemption limit –

	Institution/Association etc.	Applicable section
(a)	scientific research association	10(21)
(b)	news agency	10(22B)
(c)	association or institution	10(23A)
(d)	Institution	10(23B)
(e)	Fund or institution	10(23C)(iv)
(f)	Trust or institution	10(23C)(v)
(g)	University or other educational institution	10(23C)(vi)/(iiiad)
(h)	Hospital or other medical institution	10(23C)(via)/(iiiae)
(i)	Trade union	10(24)(b)

(2) Such return of income should be in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed.

(3) Then, the provisions of the Act would apply as if it were a return required to be furnished under section 139(1).

11. MANDATORY FILING OF RETURNS BY UNIVERSITIES, COLLEGES ETC. [SECTION 139(4D)]

(1) It will be mandatory for every university, college or other institution referred to in clause (ii) and clause (iii) of section 35(1), which is not required to furnish its return of income or loss under any other provision of section 139, to furnish its return in respect of its income or loss in every previous year.

(2) All the provisions of the Income-tax Act, 1961 shall apply to such return as if it were a return under section 139(1).

12. REVISED RETURN [SECTION 139(5)]

(1) If any person having furnished a return under section 139(1) or in pursuance of a notice issued under section 142(1), discovers any omission or any wrong statement therein, he may furnish a revised return at any time before the expiry of one year from the end of the relevant assessment year or before completion of assessment, whichever is earlier.

(2) It may be noted that a belated return cannot be revised. It has been held in *Kumar Jagdish Chandra Sinha v. CIT [1996] 86 Taxman 122 (SC)* that only a return furnished under section 139(1) or in pursuance of a notice under section 142(1) can be revised. A belated return furnished under section 139(4), therefore, cannot be revised.

13. PARTICULARS REQUIRED TO BE FURNISHED WITH THE RETURN [SECTION 139(6)]

The prescribed form of the return shall, in certain specified cases, require the assessee to furnish the particulars of -

(i) income exempt from tax

(ii) assets of the prescribed nature and value and belonging to him

(iii) his bank account and credit card held by him

(iv) expenditure exceeding the prescribed limits incurred by him under prescribed heads

(v) such other outgoings as may be prescribed.

14. PARTICULARS TO BE FURNISHED WITH RETURN OF INCOME IN THE CASE OF AN ASSESSEE ENGAGED IN BUSINESS OR PROFESSION [SECTION 139(6A)]

The prescribed form of the return shall, in the case of an assessee engaged in any business or profession also require him to furnish -

(i) the report of any audit referred to in section 44AB.

(ii) the particulars of the location and style of the principal place where he carries on the business or profession and all the branches thereof.

(iii) the names and addresses of his partners, if any, in such business or profession.

(iv) if he is a member of an association or body of individuals,

  (a) the names of the other members of the association or the body of individuals; and

  (b) the extent of the share of the assessee and the shares of all such partners or members, as the case may be, in the profits of the business or profession.

15. DEFECTIVE RETURN [SECTION 139(9)]

(1) Under this sub-section, the Assessing Officer has the power to call upon the assessee to rectify a defective return.

(2) Where the Assessing Officer considers that the return of income furnished by the assessee is defective, he may intimate the defect to the assessee and give him an opportunity to rectify the defect within a period of 15 days from the date of such intimation. The Assessing Officer has the discretion to extend the time period beyond 15 days, on an application made by the assessee.

(3) If the defect is not rectified within the period of 15 days or such further extended period, then the return would be treated as an invalid return. The consequential effect would be the same as if the assessee had failed to furnish the return.

(4) Where, however, the assessee rectifies the defect after the expiry of the period of 15 days or the further extended period, but before assessment is made, the Assessing Officer can condone the delay and treat the return as a valid return.

(5) A return of income shall be regarded as defective unless all the following conditions are fulfilled, namely:

(a) The annexures, statements and columns in the return of income relating to computation of income chargeable under each head of income, computations of gross total income and total income have been duly filled in.

(b) The return of income is accompanied by the following, namely:

  (i) a statement showing the computation of the tax payable on the basis of the return.

  (ii) the report of the audit obtained under section 44AB (If such report has been furnished prior to furnishing the return of income, a copy of such report and the proof of furnishing the report should be attached).

  (iii) the proof regarding the tax, if any, claimed to have been deducted or collected at source and the advance tax and tax on self-assessment, if any, claimed to have been paid. (However, the return will not be regarded as defective if (a) a certificate for tax deducted or collected was not furnished under section 203 or section 206C to the person furnishing his return of income, (b) such certificate is produced within a period of 2 years).

  (iv) the proof of the amount of compulsory deposit, if any, claimed to have been paid under the Compulsory Deposit Scheme (Income-tax Payers) Act, 1974;

(c) Where regular books of account are maintained by an assessee, the return of income is accompanied by the following -

(i) copies of manufacturing account, trading account, profit and loss account or income and expenditure account, or any other similar account and balance sheet;

(ii) the personal accounts as detailed below -

(1)	Proprietary business or profession	the personal account of the proprietor
(2)	Firm, association of persons or body of individuals	personal accounts of partners or members
(3)	Partner or member of a firm, association of persons or body of individuals	partner's personal account in firm member's personal account in the association of persons or body of individuals

(d) Where the accounts of the assessee have been audited, the return should be accompanied by copies of the audited profit and loss account and balance sheet and the auditor's report.

(e) Where the cost accounts of an assessee have been audited under section 233B of Companies Act, 1956, the return should be accompanied by such report.

(f) Where regular books of account are not maintained by the assessee, the return should be accompanied by -

(i) a statement indicating -

(1) the amount of turnover or gross receipts,

(2) gross profit,

(3) expenses and

(4) net profit

of the business or profession;

(ii) the basis on which such amounts mentioned in (1) above have been computed,

(iii) the amounts of total sundry debtors, sundry creditors, stock-in-trade and cash balance as at the end of the previous year.

16. PERMANENT ACCOUNT NUMBER (PAN) [SECTION 139A]

(1) Sub-section (1) requires the following persons, who have not been allotted a permanent account number (PAN), to apply to the Assessing Officer within the prescribed time for the allotment of a PAN -

(i) Every person whose total income or the total income of any other person in respect of which he is assessable under this Act during any previous year exceeded the basic exemption limit; or

(ii) Every person carrying on any business or profession whose total sales, turnover or gross receipts exceeds or is likely to exceed Rs.5 lakh in any previous year; or

(iii) Every person who is required to furnish a return of income under section 139(4A).

[Sub-section (1)].

(2) A person who has already been allotted a PAN under sub-clauses (i), (ii) or (iii) of sub-section (1), is not required to obtain another PAN under sub-clause (iv). The PAN already allotted to him shall be deemed to be the PAN in relation to fringe benefit tax.

(3) The Central Government is empowered to specify, by notification in the Official Gazette, any class or classes of persons by whom tax is payable under the Act or any tax or duty is payable under any other law for the time being is force. Such persons are required to apply within such time as may be mentioned in that notification to the Assessing Officer for the allotment of a PAN [Sub-section (1A)].

(4) For the purpose of collecting any information which may be useful for or relevant to the purposes of the Act, the Central Government may notify any class or classes of persons, and such persons shall within the prescribed time, apply to the Assessing Officer for allotment of a PAN [Sub-section (1B)].

(5) The Assessing Officer, having regard to the nature of transactions as may be prescribed, may also allot a PAN to any other person (whether any tax is payable by him or not) in the manner and in accordance with the procedure as may be prescribed [Sub-section (2)].

(6) Any person, other than the persons mentioned in (1) to (5) above, may apply to the Assessing Officer for the allotment of a PAN and the Assessing Officer shall allot a PAN to such person immediately.

(7) The CBDT had introduced a new scheme of allotment of computerized 10 digit PAN. Such PAN comprises of 10 alphanumeric characters and is issued in the form of a laminated card.

(8) All persons who were allotted PAN (Old PAN) earlier and all those persons who were not so allotted but were required to apply for PAN, shall apply to the Assessing Officer for a new series PAN within specified time.

(9) Once the new series PAN is allotted to any person, the old PAN shall cease to have effect. No person who has obtained the new series PAN shall apply, obtain or process another PAN.

(10) Quoting of PAN is mandatory in all documents pertaining to the following prescribed transactions :

(a) in all returns to, or correspondence with, any income-tax authority ;

(b) in all challans for the payment of any sum due under the Act;

(c) in all documents pertaining to such transactions entered into by him, as may be prescribed by the CBDT in the interests of revenue. In this connection, CBDT has notified the following transactions, namely:

(i) sale or purchase of any immovable property valued at Rs.5 lakh or more;

(ii) sale or purchase of motor vehicle or other vehicle (other than two wheeled motor vehicle) which requires registration under section 2(28) of the Motor Vehicle Act, 1988;

(iii) a time deposit exceeding Rs.50,000 with a banking company;

(iv) a deposit exceeding Rs.50,000 in any account with Post Office Savings Bank;

(v) a contract for sale or purchase of securities exceeding value of Rs.1 lakh;

(vi) opening a bank account;

However, in case the person making the application is a minor who does not have any income chargeable to tax, he is required to quote the PAN of his father or mother or guardian, as the case may be.

(vii) making an application for installation of telephone connection (including cellular telephone connection);

(viii) bill payments to hotels and restaurants exceeding Rs.25,000 at any one time;

(ix) payment in cash for purchase of bank drafts/pay orders/banker's cheque from a banking company for an amount aggregating Rs.50,000 or more during any one day;

(x) cash deposit aggregating Rs.50,000 or more with a banking company during any one day;

(xi) cash payment in excess of Rs.25,000 in connection with travel to any foreign country at any one time. Such payment includes cash payment made towards fare, or to a travel agent or a tour operator, or for the purchase of foreign currency. However, travel to any foreign country does not include travel to the neighbouring countries or to such places of pilgrimage as may be specified by the CBDT under *Explanation 3* to section 139(1);

(xii) making an application to any bank or banking institution or company or any institution for issue of a credit card;

(xiii) making an application for the following purposes involving payment of an amount exceeding Rs.50,000 -

(a) for purchase of units of a mutual fund;

(b) for acquiring shares of a company through public issue;

(c) for acquiring debentures of a company or institution;

(d) for acquiring bonds of Reserve Bank of India.

(11) Every person who receives any document relating to any transaction cited above shall ensure that the PAN is duly quoted in the document.

(12) If there is a change in the address or in the name and nature of the business of a person, on the basis of which PAN was allotted to him, he should intimate such change to the Assessing Officer.

(13) Every person who receives any amount from which tax has been deducted at source shall intimate his PAN to the person responsible for deducting such tax.

(14) Where any amount has been paid after deducting tax at source, the person deducting tax shall quote the PAN of the person to whom the amount was paid in the following documents:

(i) in the statement furnished under section 192(2C) giving particulars of perquisites or profits in lieu of salary provided to any employee;

(ii) in all certificates for tax deducted issued to the person to whom payment is made;

(iii) in all returns made to the prescribed income-tax authority under section 206;

(iv) in all statements prepared and delivered or caused to be delivered in accordance with the provisions of section 200(3)[Sub-section (5B)].

(15) The above sub-sections (5A) and (5B) shall not apply to a person who–

(i) does not have taxable income or

(ii) who is not required to obtain PAN

if such person furnishes a declaration under section 197A in the prescribed form and manner that the tax on his estimated total income for that previous year will be nil.

(16) The CBDT is empowered to make rules with regard to the following:

(a) the form and manner in which an application for PAN may be made and the particulars to be given there;

(b) the categories of transactions in relation to which PAN is required to be quoted on the related documents;

(c) the categories of documents pertaining to business or profession in which PAN shall be quoted by every person;

(d) the class or classes of persons to whom the provisions of this section shall not apply;

The following classes of persons are exempt from the provisions of section 139A:

(i) persons who have agricultural income and are not in receipt of any other taxable income;

(ii) non-residents under the Act, provided that any non-resident entering into any of the prescribed transactions shall furnish a copy of his passport.

(e) the form and manner in which a person who has not been allotted a PAN shall make a declaration;

(f) the manner in which PAN shall be quoted for transactions cited in (b) above;

(g) the time and manner in which such transactions shall be intimated to the prescribed authority.

17. SCHEME FOR SUBMISSION OF RETURNS THROUGH TAX RETURN PREPARERS [SECTION 139B]

(1) This section provides that, for the purpose of enabling any specified class or classes of persons to prepare and furnish their returns of income, the CBDT may notify a Scheme to provide that such persons may furnish their returns of income through a Tax Return Preparer authorised to act as such under the Scheme.

(2) The Tax Return Preparer shall assist the persons furnishing the return in a manner that will be specified in the Scheme, and shall also affix his signature on such return.

(3) A Tax Return Preparer can be an individual, other than

(i) any officer of a scheduled bank with which the assessee maintains a current account or has other regular dealings.

(ii) any legal practitioner who is entitled to practice in any civil court in India.

(iii) a chartered accountant.

(iv) an employee of the 'specified class or classes of persons'.

(4) The "specified class or classes of persons" for this purpose means any person other than a company or a person whose accounts are required to be audited under section 44AB (tax audit) or under any other existing law, who is required to furnish a return of income under the Act.

(5) The Scheme notified under the said section may provide for the following -

(i) the manner in which and the period for which the Tax Return Preparers shall be authorised,

(ii) the educational and other qualifications to be possessed, and the training and other conditions required to be fulfilled, by a person to act as a Tax Return Preparer,

(iii) the code of conduct for the Tax Return Preparers,

(iv) the duties and obligations of the Tax Return Preparers,

(v) the circumstances under which the authorisation given to a Tax Return Preparer may be withdrawn, and

(vi) any other relevant matter as may be specified by the Scheme.

(6) Every Scheme framed by the CBDT under this section shall be laid before each House of Parliament while it is in session to make the same effective.

(7) If both the houses decide in making any modification of Scheme, then the Scheme will have effect only in such modified form.

(8) Similarly, if both the Houses decide that any Scheme should not be framed, then such Scheme will thereafter be of no effect.

(9) However, such modification or annulment should be without prejudice to the validity of anything previously done under that scheme.

(10) Accordingly, the CBDT has, in exercise of the powers conferred by this section, framed the Tax Return Preparer Scheme, 2006, which came into force from 1.12.2006.

As per this scheme, Tax Return Preparer means any individual who has been issued a Tax Return Preparer Certificate and a unique identification number by the Partner Organisation to carry on the profession of preparing the returns of income in accordance with the provisions of this Scheme. However, the following persons are not eligible to act as a Tax Return Preparer -

(i) any person referred to in clause (ii) or clause (iii) or clause (iv) of sub-section (2) of section 288, namely, any officer of a Scheduled Bank with which the assessee maintains a current account or has other regular dealings , any legal practitioner who is entitled to practice in any civil court in India and an accountant.

(ii) any person who is in employment and income from which is chargeable to income-tax under the head salaries

Educational qualification for Tax Return Preparers

Any individual who holds a graduation degree from a recognized Indian University in the fields of Business Administration or Management or Commerce or Economics or Law or Mathematics or Statistics shall be eligible to act as Tax Return Preparer.

18. POWER OF CBDT TO DISPENSE WITH FURNISHING DOCUMENTS ETC. WITH THE RETURN AND FILING OF RETURN IN ELECTRONIC FORM [SECTIONS 139C & 139D]

(i) Section 139C provides that the CBDT may make rules providing for a class or classes of persons who may not be required to furnish documents, statements, receipts, certificate, reports of audit or any other documents, which are otherwise required to be furnished along with the return under any other provisions of this Act.

(ii) However, on demand, the said documents, statements, receipts, certificate, reports of audit or any other documents have to be produced before the Assessing Officer.

(iii) Section 139D empowers the CBDT to make rules providing for –

(a) the class or classes of persons who shall be required to furnish the return of income in electronic form;

(b) the form and the manner in which the return of income in electronic form may be furnished;

(c) the documents, statements, receipts, certificates or audited reports which may not be furnished along with the return of income in electronic form but have to be produced before the Assessing Officer on demand;

(d) the computer resource or the electronic record to which the return of income in electronic form may be transmitted.

19. AUTHORISED SIGNATORIES TO THE RETURN OF INCOME [SECTION 140]

This section specifies the persons who are authorized to sign and verify the return of income under section 139 of the Act.

	Assessee	Circumstance	Authorised signatory
1.	Individual	(i) In circumstances not covered under (ii), (iii) & (iv) below	- the individual himself
		(ii) where he is absent from India	- the individual himself; or - any person duly authorised by him in this behalf holding a valid power of attorney from the individual (Such power of attorney should be attached to the return of income)
		(iii) where he is mentally incapacitated from attending to his affairs	- his guardian; or - any other person competent to act on his behalf
		(iv) where, for any other reason, it is not possible for the individual to sign the return	- any person duly authorised by him in this behalf holding a valid power of attorney from the individual (Such power of attorney should be attached to the return of income)

2.	Hindu Undivided Family	(i) in circumstances not covered under (ii) and (iii) below	- the karta
		(ii) where the karta is absent from India	- any other adult member of the HUF
		(iii) where the karta is mentally incapacitated from attending to his affairs	- any other adult member of the HUF
3.	Company	(i) in circumstances not covered under (ii) to (v) below	- the managing director of the company
		(ii) (a) where for any unavoidable reason such managing director is not able to sign and verify the return; or (b) where there is no managing director	 - any director of the company - any director of the company
		(iii) where the company is not resident in India	- a person who holds a valid power of attorney from such company to do so (such power of attorney should be attached to the return).
		(iv) (a) Where the company is being wound up (whether under the orders of a court or otherwise); or (b) where any person has been appointed as the receiver of any assets of the company	 - Liquidator - Liquidator

		(v) Where the management of the company has been taken over by the Central Government or any State Government under any law	- the principal officer of the company
4.	Firm	(i) in circumstances not covered under (ii) below	- the managing partner of the firm
		(ii) (a) where for any unavoidable reason such managing partner is not able to sign and verify the return; or (b) where there is no managing partner.	- any partner of the firm, not being a minor - any partner of the firm, not being a minor
5.	*LLP*	*(i) in circumstances not covered under (ii) below*	*Designated partner*
		(ii) *(a) where for any unavoidable reason such designated partner is not able to sign and verify the return; or* *(b) where there is no designated partner.*	*- any partner of the LLP* *- any partner of the LLP*
6.	Local authority	-	- the principal officer
7.	Political party [referred to in section 139(4B)]	-	- the chief executive officer of such party (whether he is known as secretary or by any other designation)
8.	Any other association	-	- any member of the association or the principal officer of such association
9.	Any other person	-	- that person or some other person competent to act on his behalf.

Self-examination questions

1. Akash, who is 32 years old, has to file a return of income if his total income is in excess of -

   a) Rs.1,50,000

   b) Rs.1,60,000

   c) Rs.1,00,000

2. Entities getting exemption in respect of various items of income mentioned in clauses of section 10 need not file return of income. This statement is -

   a) correct

   b) incorrect

   c) partly correct

3. For filing returns of income in respect of various entities, the Income-tax Act has prescribed -

   a) Two due dates

   b) Three due dates

   c) Four due dates

4. Political parties -

   a) need not file their return of income

   b) should always file their return of income

   c) should file their return of income if the total income computed without giving effect to the provisions of section 13A exceeds the basic exemption limit.

5. The due date for filing of return for a company for A.Y.2010-11 is -

   a) 31st July, 2010

   b) 30th September, 2010

   c) 31st October, 2010

6. The return of a company has to be signed by -

   a) the Managing Director or Director

   b) the General Manager

   c) The Secretary

7. The Assessing Officer finds a defect in the return submitted by Kaushik and intimated the defect to him vide letter dated 12.11.09 which was received by Kaushik on 16.11.09. Assuming that Kaushik has not applied for extension of time, he would have to rectify the defect by -

   a) 1.12.2009

   b) 30.11.2009

   c) 27.11.2009

8. An assessee can file a revised return of income at any time before the completion of assessment or before expiry of the following period, whichever is earlier

   a) one year from the end of the relevant assessment year

   b) two years from the end of the relevant assessment year

   c) six months from the end of the relevant assessment year

9. As per section 139(1), filing of returns is compulsory for -

   a) companies only

   b) firms only

   c) both companies and firms

10. Write short notes on the following -

   a) Belated return

   b) Revised return

11. Filing of return of income on or before due date is necessary for carry forward of losses - Discuss the correctness of this statement.

12. Who are the persons authorised to sign the return of income in the case of -

    a) Hindu Undivided Family

    b) Company

    c) Partnership firm

13. What are the circumstances when a return of income can be treated as defective?

14. List ten transactions for which quoting of permanent account number is mandatory.

15. Mr. Bhuvan, an individual, has got his books of account for the year ending 31.3.2010 audited under section 44AB. His total income for the A.Y. 2010-11 is Rs. 2,50,000. He desires to know if he can furnish his return of income for the A.Y. 2010-11 through a Tax Return Preparer.

Answers

1. b; **2.** c; **3.** a; **4.** c; **5.** b; **6.** a; **7.** a; **8.** a; **9.** c.

PART II

SERVICE TAX AND VAT

CHAPTER 1

CONCEPTS AND GENERAL PRINCIPLES OF SERVICE TAX

Learning objectives

After reading this chapter you will be able to understand the:

- principles underlying the introduction of service tax.
- evolution of service tax to its present form.
- nature of coverage of services in India.
- constitutional background of service tax.
- components which make up the service tax law.
- administrative machinery of service tax.
- procedures governing the service tax law.
- nature of services rendered by a Chartered Accountant in his capacity as a service tax consultant.
- challenges faced by the service tax administration.
- extent, commencement and application of the service tax provisions.

1. NEED FOR A TAX ON SERVICES

In any Welfare State, it is the prime responsibility of the Government to fulfill the increasing developmental needs of the country and its people by way of public expenditure. India, being a developing economy, has been striving to fulfill the obligations of a Welfare State with its limited resources. The Government's primary sources of revenue are direct and indirect taxes. Central excise duty on the goods manufactured/produced in India and customs duties on imported goods constitute the two major sources of indirect taxes in India. However, revenue receipts from customs & excise have been declining due to World Trade Commitments and rationalization of commodity duties.

On the other hand, service sector has been growing phenomenally all over the world, though it may vary in degree and magnitude among the various countries. The growing importance of this sector can be gauged from the ever increasing contribution made by the service sector to GDP, thereby pushing back the contribution of traditional contributors like agriculture and manufacturing sectors. India is also not an exception to this changed phenomenon. In 2002, the service sector accounted for 49.2% of GDP while agriculture accounted for 25% and industry 25.8% of GDP. Continued growth in GDP accompanied by higher rate of growth in service sector promises new and wider avenues of taxation to the Government.

In the present day context, services are so widespread and encompass almost all activities like management, banking, insurance, hospitality, administration, communication, entertainment, travel, wholesale distribution, retailing, research and development activities, other professional services, etc. Service sector is now occupying the center stage of the economy so much so that in the contemporary world, development of service sector has become synonymous with the advancement of the economy. Economists believe that with the phenomenal development of the service sector, the exclusion of the service sector from indirect taxation leads not only to the loss of considerable potential revenue, but also creates distortion in the allocation of resources. The distortion arises because the consumer starts making the choice between the consumption of goods and services.

Hence, the Government's argument is that substantial revenue should come from the service sector and the tax on goods (excise duty) should be complemented with the tax on services. If the tax on services reduces the degree of intensity of taxation on manufacturing and trade without forcing the government to compromise on the revenue needs, it will enable better pricing of its products by the manufacturing sector in the global market.

With these objectives in mind, service tax was introduced in India in 1994 and today it is envisaged as the tax of the future.

2. GENESIS OF SERVICE TAX IN INDIA

The levy of service tax can be traced back to recommendations made in early 1990's by the Tax Reforms Committee headed by Professor Dr. Raja J. Chelliah. The Committee recommended imposition of tax on select services. The Committee emphasized the importance of moving towards full-fledged value added tax for making the system of indirect taxation broadly revenue neutral in relation to production and consumption and widening the tax base by covering exempted commodities. Dr. Raja J. Chelliah opined that introduction of value added tax would eliminate cascading and cost escalation effect of indirect taxation. However, the desired objectives would not be achieved to the full extent, unless services were

also taxed and the tax on services and tax on goods were integrated to form one general value added tax. It was envisaged that as the central excise duties on goods would get gradually transformed into a value added tax at the manufacturing level, service tax would get woven into that system.[1]

It was considered that in the Indian context, the taxation of services would lead to widening of the tax base which would make possible a further reduction in the general level of rates of commodity taxes. The recommendations relating to introduction of service tax made in the interim report of the Tax Reforms Committee have been reproduced here for the better understanding of the students.

"We have throughout the report emphasised the need for broadening the base of the tax system, which would make possible a lowering of rates. In respect of indirect taxes such broadening has to take the form of covering (a) almost all commodities other than raw produce of agriculture, (b) *many, if not most, services* and (c) all stages of production or transactions. This is accomplished under the ideal system of VAT. In our present context, the major steps to be taken are to extend the coverage of commodities under excise, on which we have already made recommendations, and to make a beginning with the *taxation of services*.

From the economic point of view, there is little difference between the taxation of commodities and that of services. In both cases, the principle of value added taxation can be applied to tax the final users. As an economy develops, the services sector expands relatively to the commodities sector. Multifarious services are produced for the benefit of the consumers as well as producers. Exclusion of services from indirect taxation tends to create distortions just as the exclusion of major commodity groups. There is no question therefore, that services must be brought under taxation. As pointed out earlier, the substantial broadening of the base through the taxation of services would enable the lowering of rates of commodity taxation. A general value added tax levied even at 10 per cent covering imports and domestically produced commodities and services plus a selective excise at a limited number of higher rates on a few commodities should be able to fetch sufficient revenues.

It is extremely important, however, that we do not commit the same kinds of mistakes as we have committed in respect of commodities. We must ensure that there will be a unified and rational system of taxation of services applicable to the whole country. This means that the services tax must be part of a value added tax in course of time and should be levied at the central level. A cascading type of service tax should be avoided at all costs. We envisage that

[1] Concepts relating to value added tax have been dealt in Chapter 4 of this study material.

as the Union excise on commodities gets gradually transformed into a value added tax at the manufacturing level, the service tax will get woven into that system and therefore tax could be levied also on services that enter into the productive processes.

Towards the end of our discussion of the reform of the Union excises earlier in this chapter we had indicated the manner in which the Modvat system should be gradually converted into the comprehensive value added tax at the manufacturing stage. Once this is done it would be possible to introduce a fairly comprehensive system of taxation of services also on the basis of the value added principle so that the entire system of indirect taxation at the Central level would be devoid of cascading and would cause no distortion in costs or in the allocation of resources.

The power to levy a tax on services in general is not mentioned either in the Union List or in the State List in the VII Schedule of the Constitution. However, by virtue of Entry 97 in the Union List which gives power to the Centre for levy and collection of "any tax not mentioned in either of those Lists" (that is, the State List or the Concurrent List), it is clear that the Union Legislature is competent to levy indirect tax on services.

For the time being only a few selected services should be subjected to tax; and the services to be selected for the purpose must be those which do not enter into productive processes in any substantial way. We recommend that a tax be levied on the following services:

a. Advertising services;

b. Services of stock brokers;

c. Service of automobile insurance;

d. Service of insurance of residential property, personal effects and jewellery; and

e. Residential telephone services.

In all the cases above except for telephone services, the tax will be levied at 10 per cent of the value of the transaction, i.e., the value of the turnover in the case of advertising and brokerage services and the value of the insurance policy in the case of insurance services. The same basis could be applied also to the taxation of the residential telephone services. However, in order to limit the incidence and because of the difficulty of separating out business and non-business telephone calls made from residences. It is recommended that an annual telephone service tax, on every residential telephone connection, of Rs. 1,000 be levied on those in whose names telephones are installed in residential premises. For purposes of this tax, connections in places other than the non-residential premises of public limited companies, non profit organisations and government offices will be treated as residential telephones.

The telephones department should be asked to collect the tax alongwith the telephone charges in bound equal instalments. It is common in India for employers to provide their senior employees with one or more telephone connections in their residences. Although they are meant to be used for official purposes, they are also generally being used for calls on personal account often without any restriction as to the number of calls. Such telephone connections should also be made subject to the telephone service tax. In their case, the tax can be collected only from the employers because the telephone connections would be in their names. However, in case such connections are in the name of the employer-the Government, public sector company, private sector company or non-profit organisation, as the case maybe-the tax will be collected from the employer. It is for the employer to recover the whole or part of the tax from the employee concerned".

Based on the above recommendations (though with certain modifications), Dr. Manmohan Singh, the then Union Finance Minister, in his Budget speech for the year 1994-95 introduced the new concept of service tax and stated that "There is no sound reason for exempting services from taxation, when goods are taxed and many countries treat goods and services alike for tax purposes. The Tax Reforms Committee has also recommended imposition of tax on services as a measure for broadening the base of indirect taxes. I, therefore, propose to make a modest effort in this direction by imposing a tax on services of telephones, non-life insurance and stock brokers." Thus, service tax was imposed on 3 services.

The baton then passed on to successive Finance Ministers who widened the service tax net in their budgets. The modest beginning that was made in the year 1994 by levying tax on three services has reached an ambitious level today. At present, *106* services are in the net of service tax. In the years to come, it is expected that all services would be in the service tax net except a few exempted services. During this period of *sixteen years (1994-2009*) not only the number of taxable services has increased from 3 to *106,* the rate of service tax, which was 5% in the year 1994, has also taken a leap to 8% in the year 2003, to 10% in the year 2004 and to 12% in 2006. In 2009, the rate of service tax has again been reduced to 10%.

3. SELECTIVE VS. COMPREHENSIVE COVERAGE

Depending on the socio-economic compulsions, each country evolved a taxation system on services adopting either a comprehensive approach or a selective approach. In comprehensive approach all services are made taxable and a negative list is given in case some services are to be exempted. In selective approach, selective services are subjected to service tax. While most of the developed countries tax all the services with very few and limited exemptions, most of the developing countries have opted for taxation of select services

only. India has adopted a selective approach to taxation of services.

In India, service tax has been levied on specified taxable services and the responsibility of payment of the tax is cast on the service provider (barring few exceptional cases). The service tax is leviable on the gross amount charged by the service provider from the client. System of self assessment of service tax by the assesses has been introduced. Tax returns are expected to be filed half yearly. Central Board of Excise & Customs is the central authority to regulate service tax matters. Directorate of Service Tax at Mumbai oversees the activities at the field level for technical and policy level coordination.

4. VITAL STATISTICS OF SERVICE TAX

The service tax collections have shown a steady rise since its inception in 1994. The tax collections have grown manifolds since 1994-95 i.e, from Rs. 410 crores in 1994-95 to Rs. 14196 crores in 2004-05. Service tax collection is primarily from metro areas and bigger towns.

Service tax revenue collection target for the year 2004-05 was fixed at Rs. 14150 crores, however, the actual service tax revenue collection stands at Rs. 14196.19 crores. It indicates a growth of 79.93% against the actual realization Rs. 7889.97 crores during the last financial year 2003-04.

There is a substantial growth in the assessee base from 403856 nos. in 2003-04 to 7,74,988 nos. in 2004-05. It indicates a growth of almost 91%, which is significantly robust ever after 1994-95. The revenue and assessee statistics from the year 1994-95 to 2004-05 is shown in the Table below:

Year	*No. of assessees*	*Gross Collections (Rs. Crores)*	*Percentage(%) of growth*	*No. of Services*
1994-1995	3943	410	Base Year	3
1995-1996	4866	846	101	3
1996-1997	13982	1022	24	6
1997-1998	45991	1515	49	18
1998-1999	107479	1787	18	30
1999-2000	115495	2072	16	27
2000-2001	122326	2540	23	26

2001-2002	187577	3305	26	41
2002-2003	232048	4125	25	51
2003-2004	403856	7890	91	58
2004-2005	774988	14196	79.93	71

Trends of revenue indicate that the service tax collection is growing at fast rate since its inception.

5. NATURE OF SERVICE TAX

Service tax is a tax on services. This is not a tax on profession, trade, calling or employment but is in respect of service rendered. If there is no service, there is no tax. As per Webster's Concise Dictionary, 'service' means a useful result or product of labour, which is not a tangible commodity. Thus, basically, service is a value addition that can be perceived but cannot be seen, as it is intangible. However, usage of some goods during the course of rendering the service would not mean that there is no 'service'. It is the predominant factor in each case, which is to be studied to arrive at a conclusion.

6. CONSTITUTIONAL AUTHORITY

The Government derives its power to levy taxes from the Constitution of India. Elaborate provisions have been made in the Constitution of India to regulate the power of taxation of both the Central Government and the State Governments. Article 265 of the Constitution of India prohibits arbitrary collection of tax. It reads as:

"No tax shall be levied or collected except by authority of law."

Thus the Government may levy a tax on the citizens only under the authority of the Constitution of India. The Constitution, in its Schedule VII, has enumerated the matters on which the Central Government and the State Government can make laws. Such matters are divided into three categories--

(a) List – I : Union List (It contains the matters in respect of which only the Central Government has the power of legislation)

(b) List – II : State List (It contains the matters in respect of which only the State Government has the power of legislation)

(c) List – III : Concurrent List (It contains the matters in respect of which both the Central and the State Governments have power of legislation).

Entries 82 to 92C of List I enumerate the subjects where the Central Government has power to levy taxes. Entries 45 to 63 of List II enumerate the subjects where the State Governments have power to levy taxes.

Entry 92C of the Union List of the Seventh Schedule to the Constitution of India enables the Union to levy "Taxes on Services". Initially there was no specific entry in the Union List for levying service tax. Service tax was levied by the Central Government by drawing power from entry 97 of the Union List. Entry 97 is a 'residuary entry' in List-I, which has been reproduced below:

"97 - Any other matter not enumerated in List II or List III including any tax not mentioned in either of those Lists."

The 'residuary entry' provides wide powers to the Central Government in respect of taxation of the subjects not mentioned in the Lists given by the constitution.

However, as a result of deliberations between the States and the Centre and as per the recommendations of the various expert committees, entry 92C was introduced in the VII Schedule in the Union List vide Constitution (92nd Amendment) Act, 2003 with effect from 07.01.2004. Entry 92C reads as under:

"92C - Taxes on services."

A new Article 268A was inserted in the Constitution which reads as follows:

"268 (1) Taxes on services shall be levied by the Government of India and such tax shall be collected and appropriated by the Government of India and the State in the manner provided in clause (2).

(2) The proceeds in any financial year of any such tax levied in accordance with the provisions of clause (1) shall be--

(a) Collected by the Government of India and the States;

(b) Appropriated by the Government of India and the States,

in accordance with such principles of collection and appropriation as may be formulated by the Parliament by law."

A consequential amendment to Article 270 of the Constitution was also made to enable Parliament to formulate by law, principles for determining the modalities of levying the service tax by the Central Government and collection of the proceeds thereof by the Central Government and the State Government.

With this amendment in the Constitution, the Central Government has become competent to enact a separate legislation on service tax.

7. SERVICE TAX LAW

Service tax was introduced in 1994 but there is no independent statute on service tax as yet. However, following sources provide statutory provisions relating to service tax and can be broadly grouped under the following categories:

7.1 Finance Act, 1994: The statutory provisions relating to service tax were first promulgated through Chapter V of the Finance Act, 1994. Since then, Chapter V of the Finance Act, 1994 is working as the Act for the service tax provisions. Later, in the year 2003, the Finance Act 2003 inserted Chapter VA relating to advance rulings on service tax in the Finance Act, 1994. In the year 2004, the provisions relating to charging of 'education cess' on the amount of service tax were made applicable through Chapter VI of the Finance (No.2) Act, 2004.

7.2 Rules on service tax: Section 94 of Chapter V and section 96 -I of Chapter VA of the Finance Act, 1994 grants power to the Central Government to make rules for carrying out the provisions of these Chapters. Using these powers, the Central Government has issued Services Tax Rules 1994, Service Tax (Advance Rulings) Rules, 2003, CENVAT Credit Rules, 2004, Export of Service Rules, 2005, Service Tax (Registration of Special Category of Persons) Rules, 2005, Service Tax (Determination of Value) Rules, 2006 and Taxation of Services (Provided from Outside India and Received in India) Rules, 2006 which are amended from time to time.

Rules should be read with the statutory provisions contained in the Act. Rules are made for carrying out the provisions of the Act. The rules can never override the Act and cannot be in conflict with the same.

7.3 Notifications on service tax: Sections 93 and 94 of Chapter V, and section 96-I of Chapter VA of the Finance Act, 1994 empower the Central Government to issue notifications to exempt any service from service tax and to make rules to implement service tax provisions. Accordingly, notifications on service tax have been issued by the Central Government from time to time. These notifications usually declare date of enforceability of service tax provisions, provide rules relating to service tax, make amendments therein, provide or withdraw exemptions from service tax or deal with any other matter which the Central Government may think would facilitate the governance of service tax matters.

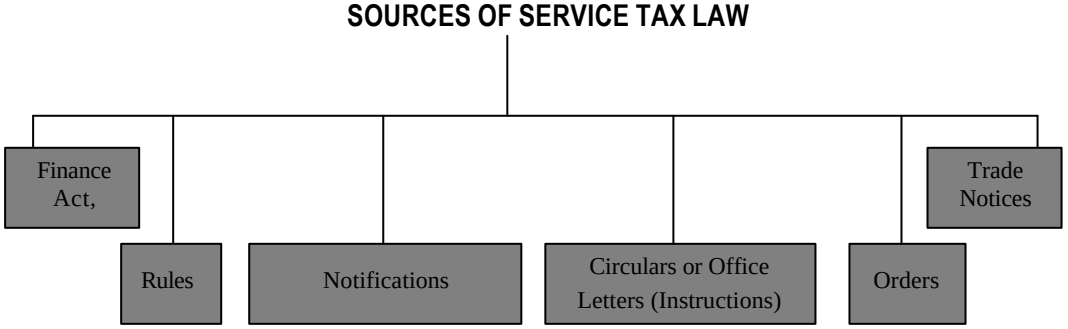
7.4 Circulars or Office Letters (Instructions) on service tax: The Central Board of Excise and Customs (CBEC) issues departmental circulars or instruction letters from time to time to explain the scope of taxable services and the scheme of service tax administration etc. These circulars/instructions have to be read with the statutory provisions and notifications on service tax.

The circulars clarify the provisions of the Act and thus, bring out the real intention of the legislature. However, the provisions of any Act of the Parliament cannot be altered or contradicted or changed by the departmental circulars.

7.5 Orders on service tax: Orders on service tax may be issued either by the CBEC or by the Central Government. Rule 3 of the Service Tax Rules, 1994, empowers the CBEC to appoint such Central Excise Officers as it thinks fit for exercising the powers under Chapter V of the Finance Act, 1994. Accordingly, orders have been issued by the CBEC, from time to time, to define jurisdiction of Central Excise Officers for the purposes of service tax.

7.6 Trade Notices on service tax: Trade Notices are issued by the Central Excise/Service Tax Commissionerates. These Commissionerates receive various instructions from the Ministry of Finance or Central Board of Excise & Customs for effective implementation and administration of the various provisions of service tax law. The same are circulated among the field officers and the instructions which pertain to trade are communicated to them in the form of trade notices. Trade Associations are supplied with the copies of these trade notices. Individual assesses may also apply for copies of trade notices. The trade notice disseminate the contents of the notifications and circulars/letters/orders, define their jurisdiction; identify the banks in which service tax can be deposited; give clarifications regarding service tax matters, etc.

The various components making service tax law have been represented in the following diagram:



8. ADMINISTRATION OF SERVICE TAX

The Department of Revenue of the Ministry of Finance exercises control in respect of matters relating to all the direct and indirect taxes through two statutory Boards, namely, the Central Board of Direct Taxes (CBDT) and the Central Board of Excise and Customs (CBEC). Matters relating to the levy and collection of all the direct taxes (income tax, wealth tax etc.) are looked after by CBDT, whereas those relating to levy and collection of indirect taxes (customs duties, central excise duties etc.) fall within the purview of CBEC. The two Boards were constituted under the Central Board of Revenue Act, 1963.

The responsibility of administration and collection of service tax has also been vested upon the CBEC ('Board'). The Board administers service tax matters through the Central Excise Zones and each Zone, in turn works through Central Excise Commissionerate falling under its territory. Each zone is headed by a Chief Commissioner of Central Excise, while each Commissionerate is headed by a Commissioner of Central Excise.

The Chief Commissioner of Zone exercises supervision and control over the working of the Commissionerates in the Zone and is mainly responsible for monitoring revenue collection, disposal of pendencies, redressal of grievances of trade, etc. He also ensures coordination among the Commissionerates within the Zone.

8.1 Director General (Service Tax): Considering the increasing workload due to the expanding coverage of service tax, it was decided to centralise all the work and entrust the same to a separate unit supervised by a very senior official. Accordingly, the office of Director General (Service Tax) was formed in the year 1997. It is headed by the Director General (Service Tax). The functions and powers of Director General (Service Tax) are as follows:

(1) To ensure that proper establishment and infrastructure has been created under different Central Excise Commissionerates to monitor the collection and assessment of service tax.

(2) To study the staff requirement at field level for proper and effective implementation of service tax.

(3) To study as to how the service tax is being implemented in the field and to suggest measures as may be necessary to increase revenue collection or to streamline procedures.

(4) To undertake study of law and procedures in relation to service tax with a view to simplify the service tax collection and assessment and make suggestions thereon.

(5) To form a data base regarding the collection of service tax from the date of its inception in 1994 and to monitor the revenue collection from service tax.

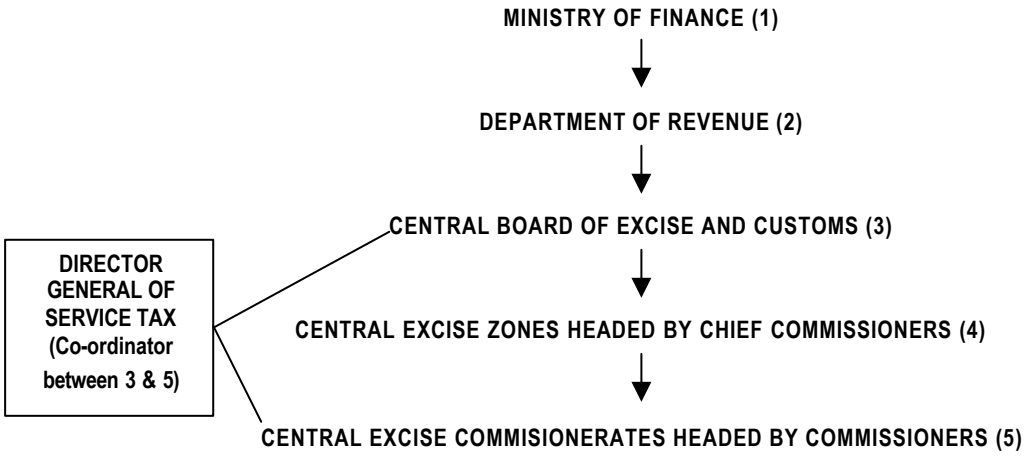
(6) To inspect the service tax cells in the Commissionerate to ensure that they are functioning effectively.

(7) To undertake any other functions as assigned by the Board from time to time.

The Directorate of Service Tax coordinates between the CBEC and Central Excise Commissionerates. It also monitors the collection and the assessment of service tax. It compiles the service tax revenue reports received from various Central Excise Commissionerates and monitors the performances of the Commissionerates. It scrutinises the correspondences received from field formations and service providers and replies to the clarifications sought for, wherever possible. In cases where the doubts/clarification sought involves policy matter, the Directorate apprises the Board for issuing clarification/instruction.

The administrative machinery of the service tax law can be understood with the help of the following diagram:

ADMINISTRATION OF SERVICE TAX



9. SERVICE TAX PROCEDURES

Service tax procedures include registration, maintenance of books and records, payment of service tax, availment and utilization of CENVAT credit, filing of service tax returns, self assessment, provisional assessment and recovery of service tax, interest and penalties, rectification of mistakes, revision of assessment order, appeals, search and seizure, advance rulings, refund etc.[2]

10. ROLE OF A CHARTERED ACCOUNTANT

As the gamut of service tax is expanding there is a great need for professionals to advice and assist the assessees. A chartered accountant with his training and experience is well-equipped to position himself in the new role as an advisor and facilitator for due compliance of service tax law. The nature of services are:

10.1 Advisory services : With the selective coverage of service tax on certain specified services a great deal of professional acumen is required to interpret and understand the law and advise the applicability of service tax *qua* an activity or service. A chartered accountant is able to fill this void.

10.2 Procedural compliance: The service tax law envisages registration, payment of tax, filing returns and assessments involving interface with the excise department. A chartered accountant with his experience and expertise is the best person to assist the assessee in all the above functions and ensure compliance.

10.3 Personal representation: As per the service tax law read with the Central Excise Act and Rules, a chartered accountant is allowed to appear before the assessment authority, Commissioner (Appeals) (first appeal) and Tribunal (second appeal). Here, too with his experience and expertise a chartered accountant is well positioned to represent his clients in these fora.

10.4 Certification and audit: With the widening of tax base there has been a phenomenal growth in the number of service tax assessees. In the ensuing years, the department would have to evolve a mechanism where there is management by exception i.e. generally accept all the returns as correct and pick and choose those returns which need detailed scrutiny. In this

[2] The procedure relating to availment and utilisation of credit is spelt out in CENVAT Credit Rules, 2004 which will be discussed at the Final level. Provisions relating to payment of service tax and filing of returns have been dealt in Chapter 3, while rest of the procedures shall be taken up at the Final level.

mechanism, a chartered accountant could be of great assistance. Service tax returns and financial statements could be certified by the Chartered Accountant from the perspective of service tax similar to an audit under section 44AB of the Income-tax Act.

10.5 Onerous task to keep pace : The service tax like excise is administered more by way of trade notices issued by various commissionerates. A Chartered Accountant will have to keep himself abreast of the latest notifications and trade notices in addition to the changes in law so as to meet the client expectations. Thus, in order to render good value added services in the area of service tax, a chartered accountant has an onerous task to keep pace with the latest in the legal front.

11. CHALLENGES BEFORE THE SERVICE TAX ADMINISTRATION IN INDIA

Although the spread and quantum of service tax levy has shown a tremendous rise over the past twelve years and there are fair chances of its further rise in the forthcoming years, at administrative front, service tax is still at a nascent stage. Service tax administration in India has to face multi-dimensional challenges. Few of them are related to the very nature and growth of service sector in the economy and others relate to procedural aspects of the service tax collection.

The growth of service sector at higher rate offers opportunities as well as challenges to bring under the tax net, hitherto uncovered services. This offers tremendous revenue potential to the Government. It is expected that in due course service tax would reduce the tax burden on international trade (customs duty) and domestic manufacturing sector (excise duty). So, a planned growth of service tax would be commensurate with the goals of economic liberalization and globalization. This process requires levy of taxes on new services without substantial rise in the rate or cost of collection.

The basic objective of service tax is broadening the tax base, augmentation of revenue and larger participation of citizens in the economic development of the nation. Bringing services under taxation is not simple as the services are intangible and are provided by large groups of organized as well as unorganized service providers including retailers who are scattered across the country. Further, there are several services, which are of intermediate nature. The low level of education of service providers also poses difficulties to both -tax administration and assessees.

The administration of service tax requires a separate comprehensive legislation along with distinct administrative machinery exclusively devoted to the collection of service tax. That alone would bring in greater clarity, streamlined procedures, greater taxpayer assistance and

a new tax culture of voluntary compliance. The twin goal of revenue maximization and introduction of the culture of voluntary tax compliance also throw up major challenge before the service tax administration in the country.

12. EXTENT, COMMENCEMENT AND APPLICATION [SECTION 64]

The Finance Act, 1994 came into force from 1.7.1994. By section 64(1), the Act extends to the whole of India except the state of Jammu and Kashmir, and by section 64(3), the levy applies to "taxable services provided". Thus, services provided in the State of Jammu and Kashmir are not liable to service tax.

As per Article 370 of the Constitution, any Act of Parliament applies to Jammu & Kashmir only with concurrence of State Government. Since, no such concurrence has been obtained in respect of Finance Act, 1994; service tax provisions are not applicable in Jammu and Kashmir.

Service tax will not be payable only if service is provided in Jammu & Kashmir. However, if a person from Jammu & Kashmir provides the service outside Jammu & Kashmir in any other part of India, the service will be liable to service tax, as the location where service is provided is relevant. Merely because the office of the service provider is situated in Jammu & Kashmir, it does not mean that service is provided in Jammu & Kashmir.

Levy of service tax extends to services rendered in designated areas in the continental shelf and exclusive economic zone. The 'exclusive economic zone' extends upto 200 nautical miles inside the sea from base line.

Service provided within the territorial waters will be liable to service tax as levy of service tax extends to whole of India except Jammu and Kashmir and 'India includes territorial waters. Indian territorial waters extend upto 12 nautical miles from the Indian land mass.

13. DEFINITIONS [SECTION 65]

This section contains definitions of various important terms used in the Finance Act, 1994. The adoption of selective coverage necessitates the definition of various service categories/service providers. These definitions are contained in section 65 of the Act. The Act defines the categories of services to which the Act applies by defining the term "taxable service" which is contained in section 65(105) of the Act. Further, various service providers like "stock brokers", "advertisement agencies", "courier agency", etc. are also defined in this section.

13.1 Services provided by unincorporated association or body of persons to its members subject to tax: The explanation after clause (121) of section 65 clarifies that taxable services include any service provided or to be provided by any unincorporated association or body of persons to a member thereof, for cash, deferred payment or any other valuable consideration. Thus, service tax shall be payable if a taxable service is provided by such an organisation to any of its members.

Self-examination questions

1. Service tax was introduced in India in the year:
   (a) 1994
   (b) 1996
   (c) 1995
   (d) 1991
2. Which entry of the Union List of the Constitution provides for levy of service tax?
   (a) 92C
   (b) 97
   (c) 84
   (d) none of the above
3. The provisions relating to service tax are contained in:
   (a) Service tax Act, 1992
   (b) Finance Act, 1994
   (c) Finance Act, 1992
   (d) Income-tax Act, 1961
4. Which of the following statement is true?
   (a) Rules can override the provisions of the Act.
   (b) Only in certain exceptional circumstances can the rules override the provisions of the Act.

(c) Rules can never override the provisions of the Act.

(d) none of the above

5. Director General (Service tax) coordinates between _____ and _____.

(a) CBEC and CBDT

(b) Chief Commissioner of Central Excise and Commissioner of Central Excise

(c) Department of Revenue and CBEC

(d) CBEC and Central Excise Commissionerates

6. Sections _____ and _____ of the Finance Act, 1994 empower the Central Government to make rules.

(a) 64 and 65

(b) 94 and 96-I

(c) 93 and 94

(d) none of the above

7. Indian Territorial Waters extend up to _____ nautical miles from the Indian land mass.

(a) 200

(b) 24

(c) 12

(d) none of the above

8. In which of the following cases service tax will not be attracted?

(a) a person from Jammu provides service at New Delhi

(b) a person having office at Srinagar provides service at New Delhi

(c) a person from New Delhi provides service at Jammu

(d) all of the above

9. Which committee recommended the introduction of service tax?

10. Which were the first three services to be brought under the service tax net?

11. What is the extent and application of the provisions of Finance Act, 1994 relating to service tax?

12. Write a note on administration of service tax.

13. What do you mean by selective and comprehensive coverage of services for the purpose of service tax? Which system is being adopted in India?

14. Write briefly about the role of a chartered accountant in the field of service tax consultancy.

Answers

1.(a); **2.**(a); **3.**(b); **4**.(c); **5.**(d); **6.**(b); **7.**(c); **8.**(c); **9.** Tax Reforms Committee headed by Dr. Raja J. Chelliah; **10.** Telephones, General insurance and Stock brokers

CHAPTER 2

CHARGE OF SERVICE TAX, TAXABLE SERVICES AND VALUATION

UNIT – 1 : CHARGE OF SERVICE TAX

Learning objectives

After reading this unit you will be able to understand the:

- concept of charging service tax on services.
- principles of education cess and secondary and higher education cess.
- general exemptions available in respect of all services.

1.1 CHARGE OF SERVICE TAX [SECTION 66]

Section 66 is the charging section of the Act which deals with the levy and collection of service tax. It prescribes the applicable rate of service tax which is to be levied on the value of various taxable services. For collection of service tax, it provides that the 'prescribed manner' needs to be followed. Applicable rate is provided in the section itself whereas the prescribed manner for collection and payment of tax is provided in the Service Tax Rules, 1994. With effect from 18.04.2006, the rate of service tax prescribed by section 66 is 12% of the value of taxable services referred to in section 65(105) of the Act. Section 65(105) provides that taxable service shall not only includes service provided but also the "service to be provided". Thus,

(a) the charge is on the services provided or to be provided;

(b) the services provided or to be provided must be the one which is covered in section 65(105);

(c) the rate of tax is 12%;

(d) the measure of tax is on "value of taxable services" provided which is defined in section 67[1].

[1] Section 67 is discussed in Unit - 3 of this Chapter.

However, Notification No. 8/2009 ST dated 24.02.2009 exempted all the taxable services specified in sub-section (105) of section 65 of the Finance Act from so much of service tax leviable thereon under section 66 of the Finance Act, as is in excess of the rate of 10% of the value of taxable services. Therefore, the effective rate of service tax shall be 10%.

1.1.1 Education Cess: With effect from 10.09.2004, an education cess has been levied @ 2%, calculated on the service tax on all taxable services.

The education cess on taxable services is in addition to the tax chargeable on such taxable services. The education cess so collected is utilized for providing and financing universalised quality basic education.

The provisions of Chapter V of the Finance Act, 1994 and the rules including those relating to refunds and exemptions from tax and imposition of penalty shall apply in relation to the levy and collection of the education cess on taxable services, as they apply in relation to the levy and collection of service tax on such taxable services.

Fully exempted taxable services are not subject to education cess. In case of a partial exemption, say by way of abatement, the cess is calculated on the net tax paid and not on the entire amount of tax that would have been payable, but for the exemption.

1.1.2 Secondary and Higher Education Cess: With effect from 11.05.2007, a secondary and higher education cess @ 1% has been imposed on services liable to service tax. It is levied on the service tax payable on such services. The secondary and higher education cess is in addition to the education cess of 2%. Thus, the effective rate of service tax works out to be 10.30% [10% + 3% (2 + 1) of 10%].

The provisions of the Chapter V of the Finance Act, 1994 and the rules including those relating to refunds and exemptions from service tax and imposition of penalty shall apply in relation to the levy and collection of the secondary and higher education cess on taxable services, as they apply in relation to the levy and collection of service tax on such taxable services.

Service tax, education cess and secondary and higher education cess should be shown separately in the invoice.

1.2 EXEMPTIONS FROM SERVICE TAX FOR ALL SERVICES

Section 93 of the Finance Act, 1994 empowers the Central Government to exempt taxable services either generally or subject to the specified conditions from levy of whole of the service tax or any part thereof. This power is exercised by issuing notifications or special orders. The following exemptions from payment of whole of the amount of service tax are available to the service providers:

1.2.1 Exemption to all services provided to United Nations or International Organisation - *Notification No. 16/2002 ST, dated 02.08.2002*

Central Government has exempted all the taxable services specified in section 65 of the Act provided by any person to the United Nations or an International Organisation, from whole of the service tax leviable thereon under section 66 of the Act.

International Organisation means an International Organisation declared by the Central Government in pursuance of section 3 of the United Nations (Privileges and Immunities) Act, 1947 to which the provisions of the schedule to the said Act apply.

1.2.2 Exemption to services provided to a developer or units of Special Economic Zone - Notification No.9/2009-ST dated 03.03.2009

Notification No.9/2009-ST dated 03.03.2009 *has exempted service tax paid on the services provided in relation to the authorized operations in a Special Economic Zone, and received by a developer or units of a Special Economic Zone, whether or not the said taxable services are provided inside the Special Economic Zone.*

Provided that

(a) Approval of list of services

The developer or units of Special Economic Zone shall get the services required in relation to the authorised operations in the Special Economic Zone approved from the Approval Committee (hereinafter referred to as the specified services);

(b) Actual use of specified services

The developer or units of Special Economic Zone claiming the exemption actually uses the specified services in relation to the authorised operations in the Special Economic Zone;

(c) Exemption in the form of refund

The exemption claimed by the developer or units of Special Economic Zone shall be provided by way of refund of service tax paid on the specified services used in relation to the authorised operations in the Special Economic Zone;

(d) Actual payment of service tax

The developer or units of Special Economic Zone claiming the exemption has actually paid the service tax on the specified services;

(e) No CENVAT credit of service tax paid on specified services

No CENVAT credit of service tax paid on the specified services used in relation to the authorized operations in the Special Economic Zone has been taken under the CENVAT Credit Rules, 2004;

(f) Exemption under no other notification claimed

Exemption or refund of service tax paid on the specified services used in relation to the authorised operations in the Special Economic Zone shall not be claimed except under this notification.

Conditions to be satisfied:-

(a) the person liable to pay service tax under sub-section (1) or sub-section (2) of section 68 of the said Finance Act shall pay service tax as applicable on the specified services provided to the developer or units of Special Economic Zone and used in relation to the authorised operations in the Special Economic Zone, and such person shall not be eligible to claim exemption for the specified services:

Provided that where the developer or units of Special Economic Zone and the person liable to pay service tax under sub-section (2) of section 68 for the said services are the same person, then in such cases exemption for the specified services shall be claimed by that person;

(b) the developer or units of Special Economic Zone shall claim the exemption by filing a claim for refund of service tax paid on specified services;

(c) the developer or units of Special Economic Zone shall file the claim for refund to the jurisdictional Assistant Commissioner/Deputy Commissioner of Central Excise, as the case may be;

(d) the developer or units of Special Economic Zone who is not registered as an assessee under the Central Excise Act, 1944 or the rules made thereunder, or the said Finance Act or the rules made thereunder, shall, prior to filing a claim for refund of service tax under this notification, file a declaration in the Form annexed hereto with the respective jurisdictional Assistant Commissioner/Deputy Commissioner of Central Excise, as the case may be;

(e) the jurisdictional Assistant Commissioner/Deputy Commissioner of Central Excise, as the case may be, shall, after due verification, allot a service tax code (STC) number to the developer or units of Special Economic Zone within seven days from the date of receipt of the said Form;

(f) the claim for refund shall be filed, within six months or such extended period as the Assistant Commissioner/Deputy Commissioner of Central Excise, as the case may be, shall permit, from the date of actual payment of service tax by such developer or unit to service provider;

(g) the refund claim shall be accompanied by the following documents, namely:-

(i) a copy of the list of specified services required in relation to the authorised operations in the Special Economic Zone, as approved by the Approval Committee;

(ii) documents for having paid service tax;

(iii) a declaration by the Special Economic Zone developer or unit, claiming such exemption, to the effect that such service is received by him in relation to authorised operation in Special Economic Zone.

(h) the Assistant Commissioner/Deputy Commissioner of Central Excise, as the case may be, shall, after satisfying himself that the said services have been actually used in relation to the authorised operations in the Special Economic Zone, refund the service tax paid on the specified services used in relation to the authorised operations in the Special Economic Zone;

(i) where any refund of service tax paid on specified services is erroneously refunded for any reasons whatsoever, such service tax refunded shall be recoverable under the provisions of the said Finance Act and the rules made thereunder, as if it is a recovery of service tax erroneously refunded

1.2.3 Exemption to goods and materials sold by service provider to recipient of service - *Notification No. 12/2003 ST, dated 20.6.2003*

So much of the value of all the taxable services, as is equal to the value of goods and materials sold by the service provider to the recipient of service is exempt from the service tax leviable thereon subject to the condition that there is documentary proof specifically indicating the value of the said goods and materials.

However, the said exemption shall apply only in such cases where:

(i) no credit of duty paid on such goods and materials sold, has been taken under the provisions of the CENVAT Credit Rules, 2004; or

(ii) where such credit has been taken by the service provider on such goods and materials, such service provider has paid the amount equal to such credit availed before the sale of such goods and materials.

1.2.4 Exemption to services provided by or to the Reserve Bank of India – *Notification No. 22/2006 ST dated 31.05.2006*

Following taxable services are exempted from the whole of the service tax leviable thereon:

(i) taxable services provided or to be provided to any person, by the Reserve Bank of India;

(ii) taxable services provided or to be provided by any person, to the Reserve Bank of India when the service tax for such services is liable to be paid by the Reserve Bank of India under sub-section (2) of section 68 of the said Finance Act read with rule 2 of the Service Tax Rules, 1994;

(iii) taxable services received in India from outside India by the Reserve Bank of India under section 66A of the Finance Act, 1994.

1.2.5 Exemption to services provided by Technology Business Incubator / Science and Technology Entrepreneurship Park – *Notification No. 9/2007 ST dated 01.03.2007*

With effect from 01.04.2007, all taxable services provided or to be provided by Technology Business Incubators (TBI)/Science and Technology Entrepreneurship Parks (STEP) recognized by National Science and Technology Entrepreneurship Board (NSTEBD) of the Department of Science & Technology have been exempted from the whole of service tax leviable thereon. The exemption contained in this notification shall be subject to the following conditions:

(i) the STEP or the TBI, who intends to avail the exemption, shall furnish the requisite information containing the details of the incubator along with the information received from each incubatee to the concerned Assistant/Deputy Commissioner of Central Excise before availing the exemption; and

(ii) the STEP or the TBI shall thereafter furnish the information in the formats mentioned above in the same manner before the 30th day of June of each financial year.

1.2.6 Exemption to services provided by an incubatee located within the premises of a Technology Business Incubator / Science and Technology Entrepreneurship Park – *Notification No. 10/2007 ST dated 01.03.2007*

With effect from 01.04.2007, taxable services provided or to be provided by an (incubatee) entrepreneur located within the premises of a Technology Business Incubator (TBI)/Science and Technology Entrepreneurship Park (STEP) recognized by National Science and Technology Entrepreneurship Board (NSTEBD) of the Department of Science and Technology Government of India have been exempted from the whole of the service tax leviable thereon subject to the following conditions:-

(i) the entrepreneur enters into an agreement with the TBI or the STEP as an incubatee, to enable himself to develop and produce hi-tech and innovative products; and

(ii) the total business turnover of such entrepreneur does not exceed Rs.50 lakh during the previous financial year.

Further, the exemption contained in this notification shall apply for a period of 3 years from the date on which such entrepreneur enters into an agreement with the TBI or the STEP.

The exemption for taxable services under this notification shall not be available for any taxable services provided or to be provided immediately after the total business turnover of the entrepreneur exceeds Rs.50 lakh during a given financial year.

1.2.7 Exemption to services provided in relation to delivery of contents of a cinema in digitized encrypted form - *Notification No. 12/2007 ST dated 01.03.2007*

Taxable services provided or to be provided, under an agreement, by any person to other person who has the right to authorise any person to exhibit cinematograph film are exempt from the whole of the service tax leviable thereon subject to the following conditions:

(i) that the service provided or to be provided is in relation to the delivery of the content of the cinematograph film; and

(ii) that the content of such film, being in digitized form, after its encryption, is transmitted directly to a cinema theatre for exhibition through the use of satellite, microwave or terrestrial communication line and not by any physical means including CD and DVD.

For the purposes of this notification,-

(a) "cinematograph film" means a film certified under section 5A of the Cinematograph Act, 1952;

(b) "cinema theatre" means a place which is licenced under Part III of the Cinematograph Act, 1952, or under any other law for the time being in force in a state for the exhibition of a cinematograph film.

1.2.8 Exemption to services provided for the official use of a foreign diplomatic mission or consular post in India - *Notification No. 33/2007 ST dated 23.05.2007*

All taxable services provided by any person, for the official use of a foreign diplomatic mission or consular post in India are exempt from whole of the service tax leviable thereon. The Notification also prescribes a procedure for availing the said exemption.

1.2.9 Exemption to services provided for the personal use or the use of the family members of diplomatic agents or career consular officers posted in a foreign diplomatic mission or consular post in India – *Notification No. 34/2007 ST dated 23.05.2007*

All taxable services provided by any person, for the personal use or for the use of the family members of diplomatic agents or career consular officers posted in a foreign diplomatic mission or consular post in India are exempt from whole of the service tax leviable thereon. The Notification also prescribes a procedure for availing the said exemption.

1.2.10 Exemption for small service providers – *Notification No.6/2005 ST dated 01.03.2005*

Service tax is fully exempt in respect of the taxable services of aggregate value not exceeding *Rs.10,00,000* in any financial year. The exemption is however, subject to certain conditions. This exemption was introduced with effect from 01.04.2005[2].

1.2.11 Service tax not leviable on fee collected by public authorities while performing statutory functions/duties under the provisions of a law - *Circular No. 96/7/2007 ST dated 23.08.2007*

It has been clarified that service tax shall not be leviable on fee collected by public authorities while performing statutory functions/duties under the provisions of a law. However, if such authority performs a service, which is not in the nature of statutory activity and the same is undertaken for a consideration not in the nature of statutory fee/levy, then in such cases, service tax would be leviable, if the activity undertaken falls within the ambit of taxable services.

A number of sovereign/public authorities (i.e. an agency constituted/set up by government) perform certain functions/duties, which are statutory in nature. These functions are performed in terms of specific responsibility assigned to them under the law in force. For example, the Regional Reference Standards Laboratories (RRSL) undertake verification, approval and calibration of weighing and measuring instruments; the Regional Transport Officer (RTO) issues fitness certificate to the vehicles; the Directorate of Boilers inspects and issues certificate for boilers; or Explosive Department inspects and issues certificate for petroleum storage tank, LPG/CNG tank in terms of provisions of the relevant laws. Fee as prescribed is charged and the same is ultimately deposited into the Government Treasury.

[2] Exemption for small service providers has been dealt in detail at the Final level.

The Circular explains that the activities performed by the sovereign/public authorities under the provision of law are in the nature of statutory obligations which are to be fulfilled in accordance with law. The fee collected by them for performing such activities is in the nature of compulsory levy as per the provisions of the relevant statute, and it is deposited into the Government treasury. Such activity is purely in public interest and it is undertaken as mandatory and statutory function. These are not in the nature of service to any particular individual for any consideration. Therefore, such an activity performed by a sovereign/public authority under the provisions of law does not constitute provision of taxable service to a person and, therefore, no service tax is leviable on such activities.

1.3 EXEMPTION FROM SERVICE TAX FOR SPECIFIC SERVICES

While the exemptions discussed in point no. 1.2 are available in respect of all taxable services, there are certain exemptions which are available only in respect of specific services. They are discussed below:

1.3.1 Exemption to specified services received by an exporter (refund of service tax paid) by an exporter and used for export of goods - Notification No. 17/2009 dated 07.07.2009

The said notification exempts the taxable services specified in column (3) of the Schedule below (hereinafter referred to as specified services) received by an exporter and used for export of goods (hereinafter referred to as said goods), from the whole of the service tax leviable thereon under section 66 and section 66A subject to the conditions specified in the corresponding entry in column (4) of the Schedule.

Sr. No.	*Classification of sub-clauses of clause (105) of section 65 of the Finance Act, 1994*	*Taxable Services*	*Conditions*
(1)	*(2)*	*(3)*	*(4)*
1.	*(d)*	*Service provided to an exporter by an insurer, including a reinsurer carrying on general insurance business in*	*Exporter shall submit document issued by the insurer, including re-insurer, for payment of insurance premium and the document shall be specific to export goods and*

		relation to insurance of said goods.	*shall be in the name of the exporter.*
2.	*(zn)*	*Service provided by a port or any person authorised by the port in respect of the export of said goods.*	
3.	*(zzh)*	*Service provided by a technical testing and analysis agency, in relation to technical testing and analysis of said goods.*	
4.	*(zzi)*	*Service provided by a technical inspection and certification agency in relation to inspection and certification of export goods.*	
5.	*(zzl)*	*Service provided by other port or any person authorised by that port in respect for export of said goods.*	
6.	*(zzp)*	*(i) Service provided for transport of said goods from the inland container depot to the port of export;*	*(i) Exporter shall certify that the benefit of exemption provided vide notification number 18/2009-S.T. has not been claimed; and*
		(ii) Service provided to an exporter in relation to transport of export goods directly from the place of removal, to inland	*(ii) details, those are specified in the invoice of exporter relating to export goods, are specifically mentioned in the lorry receipt and the*

		container depot or port or airport, as the case may be, from where the goods are exported.	*corresponding shipping bill.*
7.	*(zzzp)*	*(i) Service provided for transport of said goods from the inland container depot to the port of export, and* *(ii) services provided to an exporter in relation to transport of export goods directly from the place of removal to inland container depot or port or airport, as the case may be, from where the goods are exported.*	*Invoice issued by the exporter in relation to export goods shall indicate the inland container depot or port or airport from where the goods are exported.*
8.	*(zzzd)*	*Specialised cleaning services namely disinfecting, exterminating, sterilising or fumigating of containers used for export of said goods provided to an exporter.*	
9.	*(zza)*	*Service provided for storage and warehousing of said goods.*	
10.	*(f)*	*Service provided by a courier agency to an exporter in relation to transportation of time-sensitive documents, goods or articles relating*	*(i) The receipt issued by the courier agency shall specify the importer-exporter code (IEC) number of the exporter, export invoice number, nature of courier, destination of the*

		to export, to a destination outside India.	*courier including name and address of the recipient of the courier; and* *(ii) exporter produces documents relating to the use of courier service to export goods.*
11.	*(h)*	*Service provided by a custom house agent in relation to export goods exported by the exporter.*	*Exporter shall produce,-* *(i) invoice issued by custom house agent for providing services specified in column (3) specifying,-* *(a) number and date of shipping bill;* *(b) number and date of the invoice issued by the exporter relating to export goods;* *(c) details of all the charges, whether or not reimbursable, collected by the custom house agent from the exporter in relation to export goods;* *(ii) details of other taxable services provided by the said custom house agent and received by the exporter, whether or not relatable to export goods.*
12.	*(zm)*	*(i) Service provided in relation to collection of export bills;* *(ii) Service provided in relation to advising*	

		export letters of credit such as advising commission,confirmation charges; amendment, *(iii) Service of purchase or sale of foreign currency, including money changing provided to an exporter in relation to export goods.*	
13.	*(zzk)*	*Service of purchase or sale of foreign currency including money changing provided to an exporter in relation to export goods.*	
14.	*(zzzzj)*	*Service of supply of tangible goods for use, without transferring right of possession and effective control of tangible goods, provided to an exporter in relation to goods exported by the exporter.*	
15.	*(j)*	*Service provided by a clearing and forwarding agent in relation to export goods exported by the exporter.*	*Exporter shall produce,- (i) invoice issued by clearing and forwarding agent for providing services specified in column (3) specifying,-* *(a) number and date of shipping bill;* *(b) description of export*

			goods; *(c) number and date of the invoice issued by the exporter relating to export goods;* *(d) details of all the charges, whether or not reimbursable, collected by the clearing and forwarding agent from the exporter in relation to export goods;* *(ii) details of other taxable services provided by the said clearing and forwarding agent and received by the exporter, whether or not relatable to export goods.*
16.	*classified under any sub-clause of clause (105) of section 65.*	*Payment of service tax paid on services commonly known as terminal handling charges.*	

A. Points to be noted in this regard:-

1. *The exemption shall be claimed by the exporter for the specified service received and used by him for export of the said goods.*
2. *The exemption claimed by the exporter shall be provided by way of refund of service tax paid.*
3. *The exporter claiming the exemption has actually paid the service tax on the specified service to its provider.*
4. *No CENVAT credit of service tax paid has been taken under the CENVAT Credit Rules, 2004.*
5. *The person liable to pay service tax under section 68 of the Finance Act, 1994 shall not be eligible to claim exemption for the specified service.*
6. *The manufacturer-exporter, who is registered as an assessee under the Central Excise Act, 1944 or the rules made thereunder, shall claim the*

exemption by filing a claim for refund of service tax paid on specified service to the Assistant Commissioner/Deputy Commissioner of Central Excise, as the case may be, having jurisdiction over the factory of manufacture, in Form A-I.

7. *The exporter who is not so registered under the provisions referred to in point (6) above, shall before filing a claim for refund of service tax, file a declaration in Form A-2 with the Assistant Commissioner/Deputy Commissioner of Central Excise, as the case may be, having the jurisdiction over the registered office or the head office, as the case may be, of such exporter.*

8. *The Assistant Commissioner/Deputy Commissioner of Central Excise, as the case may be, shall, after due verification, allot a service tax code (STC) number to the exporter [referred to in point (7) above] within seven days from the date of receipt of the said Form A-2.*

9. *The exporter, referred to in point (6) or (7) , shall file the claim for refund of service tax to the Assistant Commissioner/Deputy Commissioner of Central Excise, as the case may be, having jurisdiction over the factory of manufacture, registered office or the head office, as the case may be, of such exporter in Form A-I.*

10. *The claim for refund shall be filed within one year from* ***the date of export*** *of the said goods.*

    Explanation.- For the purposes of this clause, ***the date of export*** *shall be the date on which the proper officer of Customs makes an order permitting clearance and loading of the said goods for exportation under section 51 of the Customs Act, 1962 (52 of 1962);*

11. *For each taxable service specified in column(3) of the Schedule above, the exporter shall enclose all the documents specified in corresponding entry in column (4) of the said Schedule and the Form A-I with the claim of refund.*

12. *No refund claim shall be allowed if the same is for an amount less than rupees five hundred.*

13. *Where -*

    (a) *the total amount of refund sought under a claim is upto 0.25% of the total declared free on board value of export;*

    (b) *the exporter is registered with Export Promotion Council sponsored by the Ministry of Commerce or the Ministry of Textiles;*

    (c) *subject to the provisions of (a) and (b) above, each document specified in clause (b) and in column (4) of the said Table shall be enclosed with the claim;*

(d) *invoice, bill or challan, or any other document issued in the name of the exporter, showing payment for such service availed and the service tax payable shall be submitted in original after being certified in the manner specified in sub-clauses (e) and (f);*

(e) *the exporter is a proprietorship concern or partnership firm, the documents enclosed with the claim shall be certified by the exporter himself and where the exporter is a limited company, the documents enclosed with the claim shall be certified by the person authorised by the Board of Directors;*

(f) *the documents enclosed with the claim shall contain a certificate from the exporter or the authorised person to the effect that specified service, to which the document pertains, has been received, the service tax payable thereon has been paid and the specified service has been used for export of goods under the shipping bill number;*

14. *Where the amount of refund sought under a claim is more than 0.25% of the declared free on board value of export, such certification, shall be done by the Chartered Accountant who audits the annual accounts of the exporter for the purposes of the Companies Act, 1956 or the Income Tax Act, 1961, as the case may be.*

B. *Refund of service tax by Assistant Commissioner/Deputy Commissioner of Central Excise*

The Assistant Commissioner/Deputy Commissioner of Central Excise, as the case may be, shall, after satisfying himself, -

(i) *that the claim filed is complete in every respect;*

(ii) *that all the documents requiring certification have been filed after due certification; and*

(iii) *about the arithmetical accuracy of the claim,*

shall refund the service tax paid on the specified service within a period of one month from the receipt of said claim.

However, where the Assistant Commissioner of Central Excise or the Deputy Commissioner of Central Excise has reason to believe that the claim, or the enclosed documents are not in order or that there is a reason to deny such refund,

he may, after recording the reasons in writing, take action, in accordance with the provisions of the said Act and the rules made there under.

C. Recovery of service tax erroneously refunded

Where any refund of service tax paid on specified service utilised for export of said goods has been paid to an exporter but the sale proceeds in respect of the said goods have not been realised by or on behalf of the exporter in India within the period allowed under the Foreign Exchange Management Act, 1999 (42 of 1999), including any extension of such period, such service tax refunded shall be recoverable under the provisions of the said Act and the rules made thereunder, as if it is a recovery of service tax erroneously refunded.

1.3.2 Notification No. 18/2009 – ST dated 07.07.2009 – Services in relation to 'transport of goods by road' and 'commission paid to foreign agents' exempted from service tax subject to certain conditions

The aforesaid notification exempts the taxable services specified in column (3) of the Schedule below (hereinafter referred to as specified services) received by an exporter and used for export of goods (hereinafter referred to as said goods), from the whole of the service tax leviable thereon under section 66 and section 66A subject to the conditions specified in the corresponding entry in column (4) of the Schedule.

Serial No.	*Classification of sub-clauses of clause (105) of section 65 of the Finance Act, 1994*	*Description of the taxable service*	Conditions
(1)	*(2)*	*(3)*	(4)
1.	*(zzp)*	*Service provided to an exporter for transport of the said goods by road from any container freight station or inland container depot to the port or airport, as the case may be, from*	The exporter shall have to produce the consignment note, by whatever name called, issued in his name.

		where the goods are exported; or *Service provided to an exporter in relation to transport of said goods by road directly from their place of removal, to an inland container depot, a container freight station, a port or airport, as the case may be, from where the goods are exported.*	
2.	*(zzb)*	*Service provided by a commission agent located outside India and engaged under a contract or agreement or any other document by the exporter in India, to act on behalf of the exporter, to cause sale of goods exported by him.*	*(1) The exporter shall declare the amount of commission paid or payable to the commission agent in the shipping bill or bill of export, as the case may be.* *(2) The exemption shall be limited to one per cent of the free on board value of export goods for which the said service has been used.-* *(3) The exemption shall not be available on the export of canalised item, project export, or export financed under lines of credit extended by Government of India or EXIM Bank, or export made by Indian partner in a company with equity participation in an overseas joint venture or wholly owned subsidiary.* *(4) The exporter shall submit with the half yearly return after certification of the same as specified*

in clause (g) of the proviso -

(i) the original documents showing actual payment of commission to the commission agent; and

(ii) a copy of the agreement or contract entered into between the commission agent located outside India and the exporter in relation to sale of export goods, outside India :

General conditions to be satisfied:-

(a) the exemption shall be available to an exporter who,-

(i) informs the Assistant Commissioner/Deputy Commissioner of Central Excise, as the case may be, having jurisdiction over the factory or the regional office or the head office, as the case may be, in Form EXP1, before availing the said exemption;

(ii) is registered with an export promotion council sponsored by the Ministry of Commerce or the Ministry of Textiles, as the case may be;

(iii) is a holder of Import-Export Code Number;

(iv) is registered under section 69 of the said Act;

(v) is liable to pay service tax under sub-section (2) of section 68 of said Act, read with sub-clause (iv) or sub-clause (v) of clause (d) of sub-rule (1) of rule 2 of the Service Tax Rules, 1994, for the specified service;

(b) the invoice, bill or challan, or any other document issued by the service provider to the exporter, on which the exporter intend to avail exemption, shall be issued in the name of the exporter, showing that the exporter is liable to pay the service tax in terms of item (v) of clause (a);

(c) the exporter availing the exemption shall file the return in Form EXP2 every six months of the financial year, within fifteen days of the completion of the said six months;

(d) the exporter shall submit with the half yearly return, after certification, the documents in original specified in clause (b) and the certified copies of the documents specified in column (4) of the said Schedule;

(e) *the documents enclosed with the return shall contain a certification from the exporter or the authorised person, to the effect that taxable service to which the document pertains, has been received and used for export of goods by mentioning the specific shipping bill number on the said document.*

(f) *where the exporter is a proprietorship concern or partnership firm, the documents enclosed with the return shall be certified by the exporter himself and where the exporter is a limited company, the documents enclosed with the return shall be certified by the person authorised by the Board of Directors;*

(g) *where the amount of service tax in respect of the service specified against serial No. 2 of the Schedule exceeds one per cent of the free on board value of the export then, the amount in excess of the said one per cent shall be paid within the period specified under rule 6 of the Service Tax Rules, 1994.*

1.3.3 Abatements for specified services – *Notification No. 1/2006 ST dated 01.03.06*

Notification No. 1/2006 ST dated 01.03.06 provides for abatements from gross value in case of certain specified services. Service tax is payable at lower rate if the service provider does not avail CENVAT credit of duty/tax on inputs/input services and capital goods. Such abatement has been discussed in Unit - 2 : Taxable Services under the relevant taxable service.

1.3.4 Exemption to services provided by a person located outside India in relation to booking of accommodation for a customer located outside India in a hotel in India – *Notification No. 14/2008 ST dated 01.03.2008*

The taxable services provided by a person, having his place of business, fixed establishment, permanent address or usual place of residence, in a country other than India, and which is received by a hotel located in India, in relation to booking of an accommodation in the said hotel, for a customer, who has his place of business, fixed establishment, permanent address or usual place of residence, in a country other than India are exempt from whole of the service tax leviable thereon.

Hotel has been defined to mean a place that provides boarding and lodging facilities to public on commercial basis.

Self-examination questions

1. The value of a taxable service is Rs.10,000. Service tax payable on it is:
   (a) Rs.1030
   (b) Rs.1200
   (c) Rs.1224
   (d) Rs.1020
2. The charge of service tax is on the:
   (a) service provided
   (b) service provided or to be provided
   (c) service to be provided
   (d) none of the above
3. All the taxable services specified in section 65 of the Act provided by any person to certain organisations are exempt from whole of the service tax. The said organisations are:
   (a) only the United Nations
   (b) only an International Organisation
   (c) the United Nations or an International Organisation
   (d) none of the above
4. What is education cess? Why is it being levied? What is the source of levy of education cess?
5. Does service tax law provide for any exemption to small service providers? If yes, then what is the quantum of such exemption?

Answers

1.(a)**; 2.**(b); **3.**(c)

UNIT – 2 : TAXABLE SERVICES

Learning objectives

After reading this unit you will be able to understand the:

- List of services covered in the gamut of service tax
- different definitions relating to certain taxable services
- scope of these taxable services and the specific provisions governing such services

2.1 LIST OF SERVICES COVERED IN THE GAMUT OF SERVICE TAX

1. Stock broking services
2. General insurance services
3. Advertising agency services
4. Courier services
5. Consulting engineer's services
6. Custom house agent's services
7. Steamer agent' s services
8. Clearing & forwarding agent's services
9. Manpower recruitment agent's services
10. Air travel agent's services
11. Mandap keeper's services
12. Tour operator's services
13. Rent-a-cab scheme operator's services
14. Architect's services
15. Interior decorator's services
16. Management or business consultant's services
17. Practising chartered accountant's services
18. Practising cost accountant's services

19. Practising company secretary's services
20. Real estate agent's services
21. Security agency's services
22. Credit rating agency's services
23. Market research agency's services
24. Underwriter's services
25. Scientific or technical consultancy services
26. Photography services
27. Convention services
28. On-line information and database access and/or retrieval services
29. Video tape production services
30. Sound recording services
31. Broadcasting (radio and television) services
32. Insurance auxiliary services
33. Banking and other financial services
34. Port services by major ports and other ports
35. Authorised service station's services
36. Beauty parlour's services
37. Cargo handling services
38. Cable operator's services
39. Dry cleaning services
40. Event management services
41. Fashion designer's services
42. Health club and fitness centre services
43. Life insurance services
44. Rail travel agent's services

45. Storage and warehousing services
46. Business auxiliary services
47. Commercial training or coaching services
48. Erection, commissioning and installation services
49. Franchise services
50. Internet café's services
51. Management, maintenance or repair services
52. Technical testing and analysis services
53. Technical inspection and certification services
54. Airport services
55. Transport of goods by air services
56. Business exhibition services
57. Transport of goods by road (by a goods transport agency)
58. Construction services in respect of commercial or industrial buildings or civil structures
59. Intellectual property service other than copyrights
60. Opinion poll services
61. Outdoor catering
62. TV or radio programme production services
63. Survey and exploration of mineral services
64. Pandal or shamiana services
65. Travel agent's services (other than air/rail travel agents)
66. Forward contract services
67. Transport of goods through pipeline or other conduit
68. Site preparation and clearance, excavation, earth moving and demolition services
69. Dredging services of rivers, ports, harbours, backwaters and estuaries
70. Survey and map-making services other than by Government departments

71. Cleaning services other than in relation to agriculture,horticulture, animal husbandry or dairying
72. Services in respect of membership of clubs or associations
73. Packaging services
74. Mailing list compilation and mailing services
75. Construction services in respect of residential complexes
76. Registrar to an issue's services
77. Share transfer agent's services
78. Automated teller machine operations, maintenance or management services
79. Recovery agent's services
80. Sale of space or time for advertisement, other than in print media
81. Sponsorship services provided to any body corporate or firm, other than sponsorship of sports events
82. Transport of passengers embarking on international journey by air, other than economy class passengers
83. Transport of goods in containers by rail by any person, other than government railway
84. Business support services
85. Auctioneers' services, other than auction of property under directions or orders of a court of law or auction by the Central Government
86. Public relations services
87. Ship management services
88. Internet telecommunication services
89. Transport of persons by cruise ship
90. Credit card, debit card, charge card or other payment card related services
91. Telecommunication services
92. Mining services
93. Services of renting of immovable property

94. Services involved in the execution of a works contract
95. Development and supply of content services
96. Asset management including portfolio management and all forms of fund management services
97. Design services
98. Information technology software services
99. Investment management services provided under ULIP
100. Stock exchange services in relation to securities
101. Commodity exchange services
102. Processing and clearing house services
103. Supply of tangible goods services

Following three new services have been brought under the service tax net by the Finance (No.2) Act, 2009:-

104. Transport of coastal goods and goods transported through inland water including National Waterways
105. Cosmetic surgery or plastic surgery
106. Legal consultancy services

Five such services have been discussed in details as follows:-

2.2 LEGAL CONSULTANCY SERVICES

Effective date: *1st September, 2009*

Scope of taxable service *shall include any service provided or to be provided to a business entity, by any other business entity, in relation to advice, consultancy or assistance in any branch of law [Section 65(105) (zzzzm)].*

Exemptions:

In the following cases, the legal consultancy services provided shall not be liable to service tax:-

(a) Any service provided by way of appearance before any court, tribunal or authority.

(b) The service provider and/or service recipient is an individual.

Explanation -

For the purpose of this sub-clause clause, "business entity" includes an association of persons, body of individuals, company or firm, but does not include an individual.

2.3 COMMERCIAL TRAINING OR COACHING SERVICES

Effective date 1st July 2003.

Definitions:

"Commercial training or Coaching" means any training or coaching provided by a commercial training or coaching center [Section 65(26)].

"Commercial training or Coaching Centre" means any institute or establishment providing commercial training or coaching for imparting skill or knowledge or lessons on any subject or field other than the sports, with or without issuance of a certificate and includes coaching or tutorial classes but does not include preschool coaching and training centre or any institute or establishment which issues any certificate or diploma or degree or any educational qualification recognised by law for the time being in force [Section 65(27)].

Scope of taxable service shall include any service provided or to be provided to any person, by a commercial training or coaching centre in relation to commercial training or coaching [Section 65(105)(zzc)].

Exemptions:

(i) Taxable services, provided in relation to commercial training or coaching by, -

(a) a vocational training institute;

(b) a recreational training institute;

to any person are exempt from the whole of the service tax leviable thereon. However, this exemption is not available to the taxable services provided in relation to commercial training or coaching by a computer training institute.

Explanation - For the purposes of this notification, -

(i) a vocational training institute" means a commercial training or coaching centre which provides vocational coaching or training that impart skills to enable the trainee to seek employment or undertake self-employment, directly after such training or coaching;

(ii) "recreational training institute" means a commercial training or coaching centre which provides coaching or training relating to recreational activities such as dance, singing, martial arts, hobbies.

(iii) "computer training institute" means a commercial training or coaching centre which provides coaching or training relating to computer software or hardware *[Notification No. 24/2004 ST dated 10.09.2004].*

(ii) The taxable services provided by a commercial training or coaching centre, in relation to commercial training or coaching, which form an essential part of a course or curriculum of any other institute or establishment, leading to issuance of any certificate or degree or educational qualification recognised by law for the time being in force, to any person, are also exempt from the whole of the service tax leviable thereon. However, this exemption shall not be applicable if the charges for such services are paid by the person undergoing such course or curriculum directly to the commercial or coaching centre *[Notification No. 10/2003 ST dated 20.06.2003]*

Clarifications:

Circular No. 107/01/2009 – ST dated 28.01.2009

The aforesaid circular clarifies on the following mentioned issues:-

A. Commercial nature of the institute

The commercial training or coaching does not mean that such institute must have 'commercial' (i.e. profit making) intent or motive. It has to be interpreted in a wider sense.

B. Vocational Training Institutes - whether institutes offering general course on improving communication skills, how to be effective in group discussions or personal interviews, personality development, general grooming and finishing etc are covered

The circular clarifies that such institutes ***are not covered*** *under the definition of vocational training institute because they only improve the chances of success for a candidate possessing required skill and do not impart training to enable the trainee to seek employment or self-employment.*

C. Post school education

(a) Institutes falling under the category of institutes/establishments which issue diploma or certificate recognized by the law for the time being in force-hence

not taxable under the category of "commercial coaching and training services"

Following institutes not taxable under the category of "commercial coaching and training services":-

1. *University as defined under section 2(f) of the UGC Act, 1956*
2. *Deemed University as defined under section 3 of the UGC Act, 1956*
3. *A college or institution, recognized by UGC, run by a trust/registered society/body corporate/body incorporated under Central or State Act as an institution affiliated to or form as constituent member with a university, providing education up to a bachelors degree, masters degree or diploma of a duration of minimum one academic year.*

   Autonomous colleges as per National Policy on Education, 1986.

(b) Institutes not falling under the category of institutes/establishments which issue diploma or certificate recognized by the law for the time being in force-hence taxable under the category of "commercial coaching and training services"

An institution or establishment which is derecognized by the professional councils (such as All India Council for Technical Education-AICTE, Medical Council of India-MCI, Indian Council for Agricultural Research-ICAR, Bar Council of India-BCI) created through independent Union Acts is taxable under the category of "commercial coaching and training services".

(c) Deemed to be University not required to obtain the approval of AICTE to start any programme in technical or management education leading to an award, including degrees in disciplines covered under the AICTE Act, 1987

From the year 2005 onwards, a technical institution or establishment (which is otherwise recognized being a university, or affiliate college) has to obtain AICTE approval to fall under the category of institutes/establishments which issue diploma or certificate recognized by the law for the time being in force. However 'Deemed to be University' have been exempt from this requirement.

(d) Taxability of the courses conducted

In India, due to change in legal provisions, an institute/establishment may be recognized by the law at one time and not recognized at other. However, the

taxability of the courses conducted would depend on the legal status of such institute or establishment ***at the point of time when such service is provided*** *(i.e. course is conducted).*

2.4 MANDAP KEEPER'S SERVICES

Effective date: 1st July 1997

Definitions:

"Mandap" means any immovable property as defined in section 3 of the Transfer of Property Act, 1882 and includes any furniture, fixtures, light fittings and floor coverings therein let out for consideration for organising any official, social or business function. Here, social function includes marriage [Section 65(66)].

"Immovable property" does not include standing timber, growing crops or grass — (Section 3 of the Transfer of Property Act, 1882).

"Mandap keeper" means a person who allows temporary occupation of a mandap for consideration for organising any official, social or business function. Here, social function includes marriage [Section 65(67)].

"Caterer" means any person who supplies, either directly or indirectly, any food, edible preparations, alcoholic or non-alcoholic beverages or crockery and similar articles or accoutrements for any purpose or occasion [Section 65(24)].

Scope of taxable service shall include any service provided or to be provided to any person, by a mandap keeper in relation to the use of a mandap in any manner including the facilities provided or to be provided to such person in relation to such use and also the services, if any, provided or to be provided as a caterer [Section 65(105)(m)].

Exemptions:

(i) The taxable services provided to any person by a mandap keeper for the use of the precincts of a religious place as a mandap are exempt from service tax leviable thereon. Here, religious place means a place which is meant for conduct of prayers or worship pertaining to a religion *[Notification No. 14/2003 ST dated 20.06.2003].*

(ii) In case of services provided by a hotel as mandap keeper, where services provided include catering services (i.e. supply of food alongwith any service in relation to use of a mandap), an abatement of 40% of the gross amount charged is granted if the bill issued for this purpose indicates that it is inclusive of charges for catering services. Accordingly, in such cases, service tax is payable on 60% of the gross amount charged for the above services. However,

the exemption is not available in cases where:

(i) the CENVAT credit of duty paid on inputs or capital goods or the CENVAT credit of service tax on input services, used for providing such taxable service, has been taken under the provisions of Cenvat Credit Rules, 2004; or

(ii) the service provider has availed the benefit under the Notification No. 12/2003 ST, dated 20.06.2003.

Here, 'food' means a substantial and satisfying meal. 'Hotel' means a place that provides boarding and lodging facilities to public on commercial basis *[Notification No. 1/2006 ST dated 01.03.2006].*

(iii) An abatement of 40% of the gross amount charged is granted in case of services in relation to use of mandap, including the facilities provided to any person in relation to such use and also for the catering charges. Accordingly, in such cases, service tax is payable on 60% of the gross amount charged for the above services. This exemption shall apply only in such cases where the mandap keeper also provides catering services, that is, supply of food and the invoice, bill or challan issued indicates that it is inclusive of the charges for catering service. However, the exemption is not available in cases where:

(i) the CENVAT credit of duty paid on inputs or capital goods or the CENVAT credit of service tax on input services, used for providing such taxable service, has been taken under the provisions of Cenvat Credit Rules, 2004; or

(ii) the service provider has availed the benefit under the Notification No. 12/2003 ST, dated 20.06.2003.

Here, 'food' means a substantial and satisfying meal *[Notification No. 1/2006 ST dated 01.03.2006].*

Clarifications:

Master Circular No. 96/7/2007 ST dated 23.08.2007

(i) Mandap keeper [Section (105)(m)]	23.08.07	"Mandap" is defined as any immovable property as defined in section 3 of the Transfer of Property Act, 1882 and includes any furniture, fixtures, light fittings and floor coverings therein let out for a consideration for organizing	Halls, rooms etc. let out by hotels / restaurants for a consideration for organising social, official or business functions are covered within the scope of "mandap" [section 65(66)], and such hotels and restaurants are

		any official, social or business function. [section 65(66)] "Mandap keeper" is defined as a person who allows temporary occupation of a mandap for a consideration for organising any official, social or business function [section 65(67)]. Whether hotels / restaurants letting out their halls, rooms etc. for social, official or business functions fall within the definition of "mandap" and allowing temporary occupation of halls, rooms etc by such hotels / restaurants for organizing any official, social or business function is liable to service tax under "mandap keeper service" [section 65(105)(m)]?	covered within the scope of "mandap keeper" [section 65(67)]. Accordingly, service tax is leviable on services provided by hotels and restaurants in relation to letting out of halls, rooms, etc. for organizing any official, social or business function under mandap keeper service [section 65(105)(m)].
(ii) Mandap keeper [Section (105)(m)]	23.08.07	Whether allowing temporary occupation of a hall for the purpose of holding dance, drama or music programme or competitions is liable to service tax under Mandap Keeper Service?	Dance, drama or music programme or competitions are social functions and allowing temporary occupation of a hall for a consideration for organizing such functions are liable to service tax under Mandap Keeper Service [section 65(105)(m)].

2.5 INFORMATION TECHNOLOGY SOFTWARE SERVICES

Effective date: 16th May 2008

Definition:

"Information technology software" means any representation of instructions, data, sound or image, including source code and object code, recorded in a machine readable form, and capable of being manipulated or providing interactivity to a user, by means of a computer or an automatic data processing machine or any other device or equipment [Section 65(53a)].

Scope of taxable service shall include service provided or to be provided to any person, by any other person in relation to information technology software for use in the course, or furtherance, of business or commerce, including,—

(i) development of information technology software,
(ii) study, analysis, design and programming of information technology software,
(iii) adaptation, upgradation, enhancement, implementation and other similar services related to information technology software,
(iv) providing advice, consultancy and assistance on matters related to information technology software, including conducting feasibility studies on implementation of a system, specifications for a database design, guidance and assistance during the start-up phase of a new system, specifications to secure a database, advice on proprietary information technology software,
(v) providing the right to use information technology software for commercial exploitation including right to reproduce, distribute and sell information technology software and right to use software components for the creation of and inclusion in other information technology software products,
(vi) providing the right to use information technology software supplied electronically [Section 65(105)(zzzze)].

2.6 SERVICES IN RESPECT OF MEMBERSHIP OF CLUBS OR ASSOCIATIONS

Effective date: 16th June 2005

Definition:

"Club or association" means any person or body of persons providing services, facilities or advantages, for a subscription or any other amount, to its members, but does not include—

(i) any body established or constituted by or under any law for the time being in force; or
(ii) any person or body of persons engaged in the activities of trade unions, promotion of agriculture, horticulture or animal husbandry; or
(iii) any person or body of persons engaged in any activity having objectives which are in the nature of public service and are of a charitable, religious or political nature; or
(iv) any person or body of persons associated with press or media [Section 65(25)(a)].

Scope of taxable service shall include any service provided or to be provided to its members, by any club or association in relation to provision of services, facilities or advantages for a subscription or any other amount [Section 65(105)(zzze)].

Exemptions:

(i) The taxable services provided or to be provided by a resident welfare association to its members have been exempted from whole of the service tax leviable thereon. However, the exemption is subject to the condition that the total consideration received from an individual member by the said association for providing the said services does not exceed Rs.3,000 per month. This service would otherwise be taxable under the category of membership of clubs or association [Notification No.8 /2007 ST dated 01.03.2007].

(ii) *Services provided by following twenty two export promotion councils, which were earlier taxable under the category of club or association services, have been exempted from the levy of service tax under the said category of service:-*

1. *Federation of Indian Export Organizations*
2. *Engineering Export Promotion Council*
3. *Project Exports Promotion Council of India*

   Basic Chemicals, Pharmaceuticals and Cosmetics Export Promotion Council
5. *Chemicals and Allied Products Export Promotion Council, World Trade Centre*
6. *Council for Leather Exports*
7. *Sports Goods Export Promotion Council*
8. *Gem and Jewellery Export Promotion Council*
9. *Shellac Export Promotion Council*
10. *Cashew Export Promotion Council*
11. *The Plastics Export Promotion Council*
12. *Export Promotion Council for Export Oriented Units and Special Economic Zones Units*
13. *Pharmaceutical Export Promotion Council*
14. *Apparel Export Promotion Council*
15. *Carpet Export Promotion Council*
16. *Cotton Textile Export Promotion Council*
17. *Export Promotion Council for Handicrafts*
18. *Handloom Export Promotion Council*

19. *Indian Silk Export Promotion Council*
20. *Powerloom Development Export Promotion Council*
21. *Synthetic and Rayon Textile Export Promotion Council*
22 *Wool and Woollens Export Promotion Council*

The exemption shall remain in force till 31.03.2010.

[Notification No. 16/2009-ST dated 07.07.2009]

Clarifications:

Master Circular No. 96/7/2007 ST dated 23.08.2007

(i) Club or association [Section (105)(zzze)]	23.08.07	"Club or association" is defined as any person or body of persons providing services, facilities or advantages, for a subscription or any other amount, to its members, but does not include such person or body of persons engaged in any activity having objectives which are of a charitable nature. Whether a club or association enjoying exemption under the provisions of Income Tax Act as a public charitable institution gets automatically excluded from levy of service tax under section 65(105)(zzze) read with section 65(25a) of the Finance Act, 1994?	Exemption under the Income Tax Act on the ground of being a public charitable institution is of no consequence or relevance for service tax purposes. Levy of service tax is entirely governed by the provisions contained in the Finance Act, 1994 and the rules made thereunder. "Charity" is defined as "aid given to the poor, the suffering or the general community for religious, educational, economic, public safety, or medical purposes", and "charitable" is defined as "dedicated to a general public purpose, usually for the benefit of needy people who cannot pay for the benefits received" [Black's Law Dictionary].

			Whether a club or association is engaged in activity having objectives which are of a charitable nature or not is to be determined purely on the basis of the facts and circumstances of the case.
(ii) Club or association [Section (105)(zzze)]	23.08.07	Services provided by a resident welfare association to its members under club or association service [section 65(105) (zzze)] is exempted from service tax vide notification No.8/2007-Service Tax, dated 01.03.07, subject to the condition that the total consideration received from an individual member by the said association for providing the said services does not exceed three thousand rupees per month. Whether a resident welfare association registered as a co-operative society with the Registrar of Co-operative Societies is entitled for the benefit of service tax exemption under notification No.8/2007-Service Tax, dated 01.03.2007 or not?	A resident welfare association, even if it is registered as a co-operative society with the Registrar of Co-operative Societies, is eligible to avail of exemption from levy of service tax vide notification No.8/2007-Service Tax, dated 01.03.2007 provided the following conditions are satisfied, namely:- (i) The exemption is available for the services specified under section 65(105)(zzze) of the Finance Act, 1994 and provided or to be provided by the association to its members. (ii) The sole criterion for membership of the resident welfare association is the residential status of a person in a residential complex or locality i.e., membership of the association is restricted to the residents of the complex or

			locality. (iii) The value of total consideration received from an individual member by the association for providing the services does not exceed Rs.3,000/- per month.

UNIT – 3 : VALUATION OF TAXABLE SERVICES

Learning objectives

After reading this unit you will be able to understand the:

- provisions relating to valuation of taxable services.
- concept of gross amount charged and consideration for taxable services.

3.1 VALUATION OF TAXABLE SERVICES FOR CHARGING SERVICE TAX [SECTION 67]

After identifying the taxable service, one has to determine their value to pay service tax as section 66, the charging section, provides that service tax is chargeable on the value of taxable service. Section 67 provides for the valuation of taxable services. Prior to 18.02006, section 67 only provided that service tax shall be payable on gross amount charged by the service provider for the taxable services provided or to be provided.

However, with effect from 18.02006 Finance Act, 2006 has introduced detailed provisions for valuation. New section 67 enables valuation in cases where the consideration for the service provided is not in terms of money. Further, Service Tax (Determination of Value) Rules, 2006 have also been notified with effect from 19.02006.[3]

The provisions of section 67 are discussed below:

(1) If the consideration for a taxable service is in terms of money, the value of such service shall be the gross amount charged by the service provider for such service provided or to be provided by him.

Example : If a chartered accountant charges Rs.50,000 as audit fee from its client, the value of the taxable service rendered by the chartered accountant will be Rs.50,000 and service tax shall be payable on this amount.

(2) If the consideration for a taxable service is not wholly or partly in terms of money, then the value of such service shall be such amount in money, with the addition of service tax charged, is equivalent to the consideration.

In other words, where the service rendered is for a consideration not wholly or partly consisting of money, the value of the taxable service is equivalent to the total value of the

[3] Service Tax (Determination of Value) Rules, 2006 shall be taken up at the Final level.

consideration. However, the total of such money and non-money value of the consideration has to be treated as inclusive the service tax payable thereon.

Example : Mr. X, a company secretary provides taxable professional services to one of its clients. In lieu of rendering such services, Mr. X charges Rs.10,000 in lumpsum from its client and also asks its client to give him a Law book worth Rs.1,030. The total consideration in this case will be Rs.11,030 and the value of the taxable service shall be Rs.10,000 $\left(\frac{11{,}030}{100+10.30}\times 100\right)$ and Rs.1,030 shall be the service tax payable.

(3) If the consideration for a taxable service is not ascertainable, the value of such service shall be the amount as may be determined in the prescribed manner.

(4) Consideration includes any amount that is payable for the taxable services provided or to be provided. Thus, an advance received for providing any taxable service shall also form part of the consideration.

Example : Mr. A, an architect receives an advance of Rs.1,000 for providing architectural services. He gets Rs.6,000 on completion of provision of such services. The consideration in this case would be Rs.7000, i.e. it would include the amount that is payable for the taxable service to be provided and taxable service provided.

(5) Where the gross amount charged by a service provider, for the service provided or to be provided is inclusive of service tax payable, the value of such taxable service shall be such amount as, with the addition of tax payable, is equal to the gross amount charged.

Example : Mr. B, a management consultant charges a lump sum amount of Rs.11,030 as professional fee for rendering taxable services (i.e., he does not charge service tax separately). The value of taxable service in this case would not be Rs.11,030 but Rs.10,000 i.e. $\left(\frac{11{,}030}{100+10.30}\times 100\right)$ and Rs.1,030 shall be the service tax payable.

(6) The gross amount charged for the taxable service shall include any amount received towards the taxable service before, during or after the provision of such service. Thus, not even advance but any other amount recovered after the completion of provision of service shall form part of the gross amount charged for the taxable service.

For example, ABC Co., a security agency receives Rs.10,000 as advance while signing a contact for providing taxable service. It receives Rs.50,000 while providing the service and another Rs.20,000 after completion of service. Thus, value of taxable service shall be Rs.80,000 and service tax shall be payable on it.

(7) Subject to the provisions mentioned in points (1), (2), (3), (5) and (6) above, the value of a taxable service shall be determined in such manner as may be prescribed.

(8) Money includes any currency, cheque, promissory note, letter of credit, draft, pay order, travellers cheque, money order, postal remittance and other similar instruments but does not include currency that is held for its numismatic value.

(9) "Gross amount charged" includes payment by cheque, credit card, deduction from account and any form of payment by issue of credit notes or debit notes and book adjustment, and any amount credited or debited, as the case may be, to any account, whether called "suspense account" or by any other name, in the books of account of a person liable to pay service tax, where the transaction of taxable service is with any associated enterprise.

"Associated enterprise" has the meaning assigned to it in section 92A of the Income tax Act, 1961."

Self-examination questions

1. Which section governs the valuation of taxable services?
   (a) section 65 of the Finance Act, 1994
   (b) section 67 of the Service Tax Act, 1994
   (c) section 67 of the Finance Act, 1994
   (d) none of the above
2. Money for the purpose of valuation of taxable service includes:
   (a) promissory note
   (b) cheque
   (c) postal remittance
   (d) all of the above
3. Gross amount charged for the taxable service includes:
   (a) only the amount received before the provision of taxable service
   (b) any amount received before, during or after the provision of taxable service
   (c) only the amount received during the provision of taxable service
   (d) only the amount received after the provision of taxable service

How will a taxable service be valued when the consideration thereof is not in wholly or partly in terms of money?

5. How will a taxable service be valued when the gross amount charged for it includes service tax payable?

Answers

1.(c); **2.**(d); **3.**(b)

CHAPTER 3

PAYMENT OF SERVICE TAX AND FILING OF RETURNS

UNIT – 1 : PAYMENT OF SERVICE TAX

Learning objectives

After reading this unit, you will be able to:

- identify persons liable to pay service tax.
- get an insight of the basic principles underlying the procedures relating to payment of service tax.
- know the time period for paying service tax.
- comprehend the manner of payment of service tax.

1.1 PERSON LIABLE TO PAY SERVICE TAX

By now you have understood the basic concepts of service tax and the provisions relating to taxable services. In this unit, the procedures relating to payment of service tax have been discussed. The service provider rendering taxable services is liable to pay service tax (with some exceptions) to the Central Government at regular intervals of time.

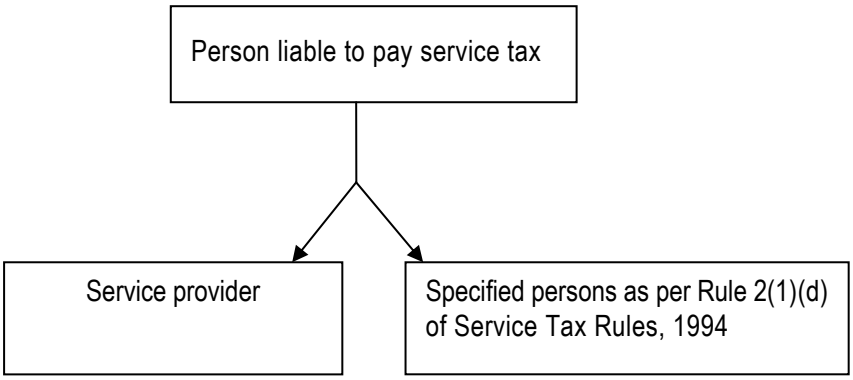
Section 68 of the Finance Act, 1994 is the principal section which fixes responsibility to pay service tax. The powers to decide time and manner of payment of service tax have been granted to the Central Government vide Rule 6 of the Service Tax Rules, 1994.

As per section 68, every person providing taxable service to any person, pays service tax at the rate specified in section 66 in the prescribed manner and within the prescribed period. The period and the manner is prescribed in Rule 6 of the Service Tax Rules, 1994 which have been discussed in paras 1.9 and 1.11 respectively.

However, in respect of certain services notified by the Central Government, the service tax

thereon is paid by certain specified persons in the prescribed manner. In pursuance of this power, the Central Government in Rule 2(1)(d) of Service Tax Rules, 1994 has notified specific class of persons who are liable to pay service tax.

Thus, as a general rule a service provider is liable to pay service tax, but in the cases and circumstances mentioned in Rule 2(1)(d), service receiver or the specified persons are liable to pay service tax. The above mentioned principle can be understood by the following diagram:



Following list provides the notified taxable services and the specified persons/class of persons who are liable to pay service tax thereon as per rule 2(1)(d) of Service Tax Rules,1994:

(i) in relation to general insurance business, the person liable to pay service tax is the insurer or re-insurer, as the case may be, providing such service.

(ii) in relation to insurance auxiliary service provided by an insurance agent, the person liable to pay service tax is the person carrying on general insurance business or the life insurance business as the case may be, in India.

(iii) in relation to any taxable service provided or to be provided by any person from a country other than India and received by any person in India, the person liable to pay service tax is the recipient of such service.

(iv) in relation to taxable service provided by a goods transport agency, where the consignor or consignee of goods is,-

(a) any factory registered under or governed by the Factories Act, 1948;

(b) any company formed or registered under the Companies Act, 1956;

(c) any corporation established by or under any law;

(d) any society registered under the Societies Registration Act, 1860 or under any law corresponding to that Act in force in any part of India;

(e) any co-operative society established by or under any law;

(f) any dealer of excisable goods, who is registered under the Central Excise Act, 1944 or the rules made thereunder; or

(g) any body corporate established, or a partnership firm registered, by or under any law,

the person liable for paying service tax is any person who pays or is liable to pay freight either himself or through his agent for the transportation of such goods by road in a goods carriage.

(v) in relation to business auxiliary service of distribution of mutual fund by a mutual fund distributor or an agent, as the case be, the person liable for paying service tax is the mutual fund or asset management company, as the case may be, receiving such service.

(vi) in relation to sponsorship service provided to any body corporate or firm located in India, the person liable to pay service tax is the body corporate or firm, as the case may be, who receives such sponsorship service.

1.1.1 Sub-contractors liable to service tax: A taxable service provider outsources a part of the work by engaging another service provider, generally known as sub-contractor. Service tax is paid by the service provider for the total work. A question arises as to whether service tax is liable to be paid by the service provider known as sub-contractor who undertakes only part of the whole work.

A sub-contractor is essentially a taxable service provider. The fact that services provided by such sub-contractors are used by the main service provider for completion of his work does not in any way alter the fact of provision of taxable service by the sub-contractor.

Services provided by sub-contractors are in the nature of input services[1] (Input services are services which are used by a service provider for providing the output service). Service tax

[1] The concept of input services and output services shall be dealt in detail in Paper 8 : Indirect Tax Laws at the Final level under CENVAT Credit Rules, 2004.

is, therefore, leviable on any taxable services provided, whether or not the services are provided by a person in his capacity as a sub-contractor and whether or not such services are used as input services. The fact that a given taxable service is intended for use as an input service by another service provider does not alter the taxability of the service provided.

1.2 PAYMENT ONLY ON RECEIPT

It is to be noted that though the service provider charges service tax in his bill raised on his client as and when the service is provided, the service tax is payable to the Government only when the value of taxable services is 'received'. Thus, if a chartered accountant raises a bill for auditing services say, on 15th December, 20098 for Rs.1,10,300/- (including service tax of Rs.10,300/-) and the client pays his bill only in February 2010, the liability to pay service tax to the Government would arise only in February 2010. This alleviates the major grievance of the service providers who otherwise would be required to pay service tax on amounts not received or not likely to be received.

Thus, *situs* of taxation is on service provided but the payment of service tax to the Government is deferred till the receipt of the value of the taxable service.

1.3 SERVICE TAX NOT PAYABLE ON FREE SERVICES

Section 67(1)(iii) and Service Tax (Determination of Value) Rules, 2006 (as inserted w.e.f. 19.04.2006) make provisions for valuation even when consideration is not ascertainable. However, these provisions apply only when there is consideration. If there is no consideration i.e., in case of free service, section 67 and Service Tax (Determination of Value) Rules, 2006 cannot apply.

Thus, no service tax is payable when value of service is zero as the charging section 66 provides that service tax is chargeable on the value of taxable service. Hence, if the value is zero the tax will also be zero even though the service may be taxable. However, this principle applies only when there is really a 'free service' and not when its cost is recovered through different means.

1.4 SERVICE TAX LIABLE TO BE PAID EVEN IF NOT COLLECTED FROM THE CLIENT

Section 68 casts the liability to pay service tax upon the service provider or upon the person liable to pay service tax as per Rule 2(1)(d). This liability is not contingent upon the service provider realizing or charging the service tax at the prevailing rate. The statutory liability does not get extinguished if the service provider fails to realize or charge the service tax

from the service receiver.

However, sometimes it may happen that the assessee is not able to charge service tax because of the nature of service or he fails to recover the service tax from the client/customer as he is not aware that his services are taxable. Hence, in these cases the amount recovered from the client in lieu of having rendered the service will be taken to be inclusive of service tax and accordingly tax payable will be calculated by making back calculations.

For example, if bill amount is Rs.5,000 and service tax is not shown separately in invoice, then service tax payable shall be computed as follows:

5000/110.30 x 10.30 = Rs.467

It may be noted that service tax payable is not Rs.515 computed by applying 10.30% to Rs.5000. The value of the taxable service in this case is Rs.4533.

The example given above can be solved by using the following formulae:

Value of taxable service = [Gross amount charged/(100 + rate of tax)] x 100

Service tax = [Gross amount charged/(100 + rate of tax)] x rate of tax

1.5 SERVICES PERFORMED PRIOR TO THE DATE OF LEVY NOT LIABLE FOR PAYMENT OF SERVICE TAX

No service tax is payable for the part or whole of the value of services, which is attributable to services provided during the period when such services were not taxable. The time of receipt of payment towards the value of services will not be relevant for this purpose. For instance, no service tax shall be payable in case of newly introduced legal consultancy service which is rendered prior to 01.09.2009. (Legal consultancy service has become effective from 01.09.2009).

1.6 SERVICE TAX PAYABLE ON ADVANCE RECEIVED

Service tax is payable as soon as any advance is received as:

(i) the taxable service includes “service to be provided”, and

(ii) the payments received before, during, or after the provision of taxable service, form part of the gross amount charged for the taxable services.

For example, a security agency takes a contract to provide security services to a client for the month of October for a consideration of Rs.50,000. It receives an advance of Rs.25,000

from the client in the month of September. In this case service tax shall be payable by the security agency on the amount of Rs.25,000 received as an advance even though the service has not been provided at that time.

When advance payment is received for a service which is non-taxable at the time of receipt of payment but becomes taxable during the course of provision of service, such payments would have to be apportioned appropriately between the two periods and that part of service provided on or after the service becomes taxable service, is only liable for service tax.

When payment is received in advance for services to be provided but subsequently the services are not actually provided, then in such cases service tax paid is liable to be refunded.

1.7 SERVICE TAX COLLECTED FROM THE RECIPIENT OF SERVICE MUST BE PAID TO THE CENTRAL GOVERNMENT [SECTION 73A]

Every person, who is liable to pay service tax and has collected any amount in excess of the service tax assessed or determined and paid on any taxable service from the recipient of taxable service in any manner as representing service tax, must pay the amount so collected immediately to the credit of the Central Government. This provision ensures that the service provider does not collect excess amount from the recipient of the service in the name of service tax.

Further, where any person who has collected any amount, which is not required to be collected, from any other person, in any manner as representing service tax, such person should also immediately pay the amount so collected to the credit of the Central Government.

1.8 INTEREST ON AMOUNT COLLECTED IN EXCESS [SECTION 73B]

Where an amount has been collected, in excess of the tax assessed or determined and paid, for any taxable service from the recipient of such service, the person who is liable to pay such amount shall, in addition to the amount, be liable to pay interest. The interest shall also be payable by the person who has collected any amount, which is not required to be collected as service tax.

The interest shall be payable at the rate of 13% per annum from the first day of the month succeeding the month in which the amount should have been paid till the date of payment of such amount.

Where such amount is reduced or increased in appeal, the interest payable thereon shall be

on such reduced or increased amount.

1.9 DUE DATE FOR PAYMENT OF SERVICE TAX

Rule 6(1) *inter alia* provides that service tax on the value of taxable services received:

(i) by an individual or a proprietary firm or a partnership firm during any quarter is payable by the **5th day of the month immediately following the said quarter; and**

(ii) in other cases (company and HUF) during any calendar month is payable by the **5th day of the month immediately following the said calendar month.**

However, the month of March is an exception to this general rule. The service tax on the value of taxable services received during the month of March, or the quarter ending in March, as the case may be, shall be paid to the credit of the Central Government by the 31st day of March of the calendar year. For the month of March there is no distinction between the assessees.

It is to be noted here that service tax is not payable on the amounts charged in the bills/invoice, but on the amounts actually received.

The due dates for payment of service tax in case of different assessees are tabulated below:

I. Individuals, proprietary concerns and partnership firms	
Quarters	**Due dates**
1st April to 30th June	5th July
1st July to 30th September	5th October
1st October to 31st December	5th January
1st January to 31st March	31st March

II. Persons other than individuals, proprietary concerns and partnership firms	
Months	**Due dates**
April	5th May
May	5th June
June	5th July
July	5th August

August	5th September
September	5th October
October	5th November
November	5th December
December	5th January
January	5th February
February	5th March
March	31st March

If the last day of payment of service tax is a public holiday, tax can be paid on next working day.

1.9.1 Due date for payment in case of e-payment of service tax: As per rule 6(1), where service tax is paid electronically through internet banking the service tax on the value of taxable services received:

(i) by an individual or a proprietary firm or a partnership firm during any quarter is payable by the **6th day of the month immediately following the said quarter; and**

(ii) in other cases (company and HUF) during any calendar month is payable by the **6th day of the month immediately following the said calendar month.**

The due date for the month of March will remain the same i.e., 31st March.

1.10 TRANSACTIONS WITH ASSOCIATED ENTERPRISE

In case of transactions of taxable services involving any associated enterprise, any payment received towards the value of taxable service includes any amount credited or debited, as the case may be, to any account, whether called "Suspense account" or by any other name, in the books of account of a person liable to pay service tax. Thus, service tax would be payable on such receipts as well.

Here, "associated enterprise" has the meaning assigned to it in section 92A of the Income tax Act, 1961."

1.11 MANNER OF PAYMENT

Service tax has to be paid to the credit of the Central Government in Form TR-6 challan (yellow colour) in the specified branches of the designated bank. The list of such Banks and Branches is available in every Commissionerate of Central Excise. Different heads of

accounts have been specified for different taxable service by the Government under which payment has to be made. While making the payment of service tax to the credit of Central Government, head of account should be correctly and properly indicated under major and minor heads and sub-heads to avoid misclassification. In the TR-6 challan, account head of education cess should be shown separately.

TR-6 challan is to be filled in quadruplicate and tendered to the designated bank alongwith the payment of service tax. The bank returns two sets of TR-6 challans duly acknowledging payment, one for the assessee's record and the other to be submitted with the return.

1.11.1 Payment in case of multiple service provider : A multiple service provider (a service provider rendering more than one taxable service) can use single TR-6 challan for payment of service tax on different services. However, amounts attributable to each such service along with concerned accounting codes should be mentioned clearly in the column provided for this purpose in the TR-6 challan. Alternatively, separate TR-6 challans may be used for payment of service tax for each service provided by the service provider.

1.11.2 E-payment of service tax : With effect from 01.10.2006, the assessee who has paid service tax of Rs.50,00,000 or above in the preceding financial year or has already paid service tax of Rs.50,00,000 in the current financial year has to compulsorily deposit the service tax liable to be paid by him electronically, through internet banking.

1.12 ADVANCE PAYMENT OF SERVICE TAX

The assessee has been provided with a facility to make advance payment of service tax on his own volition and adjust the amount so paid against the service tax which he is liable to pay for the subsequent period. Such facility shall be available when the assessee:

(i) intimates the details of the amount of service tax paid in advance, to the Jurisdictional Superintendent of Central Excise within a period of 15 days from the date of such payment, and

(ii) indicates the details of the advance payment made, and its adjustment, if any in the subsequent return to be filed under section 70.

1.13 POINTS TO BE REMEMBERED WHILE PAYING SERVICE TAX

The following important points should be kept in mind while paying service tax:

- Service tax is to be paid on the value of taxable services which is charged by an assessee. Any income tax deducted at source is included in the charged amount.

Therefore, service tax is to be paid on the amount of income tax deducted at source also.

- Where the amount of service tax is paid in cash, the date of payment is the date on which cash is tendered to the designated bank.
- Payment of service tax into non-designated banks does not amount to payment of service tax.
- In case the amount of service tax is paid by cheque, the date of presentation of cheque to the bank designated by Central Board of Excise and Customs shall be considered as the date of payment, subject to realization of cheque.
- Payment should be rounded off in multiple of rupees.

1.14 ADJUSTMENT OF SERVICE TAX PAID WHEN SERVICE IS NOT PROVIDED EITHER WHOLLY OR PARTIALLY

An assessee may adjust excess payment of service tax against his liability of service tax for subsequent periods. Where an assessee has deposited service tax in respect of a taxable service which is not so provided by him either wholly or partially for any reason, he may adjust the excess service tax so paid by him (calculated on a pro rata basis) against his service tax liability for the subsequent period.

For example, if the assessee, who is an individual or partnership firm, has paid Rs.6,000 in excess of service tax liability during the previous half year ending period, the assessee can adjust Rs.3,000 only per quarter in his subsequent tax liability and not at a stretch.

Similarly, if the assessee is a company and has paid Rs.6,000 in excess of service tax liability during the previous half year ending period, the assessee can adjust Rs.1000 only per month in his subsequent tax liability and not at a stretch.

However, for carrying out such adjustment, the assessee must have refunded the value of taxable service and the service tax thereon to the person from whom it was received.

In such cases of adjustment, the assessee is required to file the details in respect of such *suo motu* adjustments done by him at the time of filing the service tax returns. The return Form ST-3 also provides for enclosure of documentary evidence for adjustment of such excess service tax paid.

It is to be noted that adjustment of excess payment of service tax is not allowed *per se*, say due to clerical mistake etc. In such cases, the assessee has to claim the refund of excess tax paid.

1.15 ADJUSTMENT OF EXCESS AMOUNT PAID TOWARDS SERVICE TAX LIABILITY

Where an assessee has paid to the credit of Central Government any amount in excess of the amount required to be paid towards service tax liability for a month or quarter, as the case may be, the assessee may adjust such excess amount paid by him against his service tax liability for the succeeding month or quarter, as the case may be. However, such an adjustment is subject to the following conditions:

(i) Self-adjustment of excess credit would not be allowed in case of reasons involving interpretation of law, taxability, classification, valuation or applicability of any exemption notification.

(ii) Excess amount paid and proposed to be adjusted should not exceed *Rs.1,00,000* for the relevant month or quarter. However, in case of assessees opting for centralized registration excess amount can be adjusted without any monetary limit provided the excess amount paid is on account of delayed receipt of details of payments from branch offices. (Centralized registration can be obtained when an assessee provides taxable service from more than one premises on fulfillment of certain specified conditions[2]).

(iii) Adjustment can be made only in the succeeding month or quarter.

(iv) The details of self-adjustment should be intimated to the Superintendent of Central Excise within a period of 15 days from the date of such adjustment.

1.15.1 Adjustment of excess amount paid as service tax in case of renting of immovable property service: In case of renting of immovable property service, a deduction of property taxes paid in respect of the immovable property is allowed from the gross amount charged for renting of the said immovable property vide Notification No.24/2007 ST dated 22.05.2007. However, where any amount in excess of the amount required to be paid towards service tax liability has been paid on account of non-availment of such deduction, such excess amount may be adjusted against the service tax liability within 1 year from the date of payment of such property tax. The details of such adjustment shall be intimated to the Superintendent of Central Excise having jurisdiction over the service provider within a period of 15 days from the date of such adjustment.

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[2] Concepts relating to registration and centralized registration shall be dealt in detail in Paper 8 : Indirect Tax Laws at the Final level.

1.16 PROVISIONAL PAYMENT OF SERVICE TAX

In case the assessee is unable to correctly estimate, at the time of the deposit, the actual amount of service tax for any month or quarter, he may make a written request to Assistant/Deputy Commissioner of Central Excise for making payment of service tax on provisional basis. The concerned officer may allow payment of service tax on provisional basis on such value of taxable service as may be specified by him.

For the purpose of provisional assessment at the time of filling the return, the assessee is required to file a statement in form ST-3A giving detail of difference between service tax deposited and the service tax liable to be paid for each month. The quarterly or half yearly statements should also accompany.

The Assistant/Deputy Commissioner of Central Excise, on the basis of memorandum in form ST-3A may complete the assessment after calling for necessary documents or records, if need be.

1.17 SPECIAL PROVISION FOR PAYMENT OF SERVICE TAX IN CASE OF AIR TRAVEL AGENT

The person liable for paying service tax in relation to the services provided by an air travel agent has an option to pay an amount calculated at the rate of:

(i) 0.6% of the basic fare in the case of domestic bookings, and

(ii) 1.2% of the basic fare in the case of international bookings,

of passage for travel by air, during any calendar month or quarter, as the case may be, towards the discharge of his service tax liability instead of paying service tax @ 10%.

The option once exercised applies uniformly in respect of all the bookings of passage for travel by air made by him and cannot be changed during a financial year under any circumstances.

The expression "basic fare" means that part of the air fare on which commission is normally paid to the air travel agent by the airline.

1.18 SPECIAL PROVISION FOR PAYMENT OF SERVICE TAX IN CASE OF LIFE INSURER CARRYING ON LIFE INSURANCE BUSINESS

An insurer carrying on life insurance business who is liable for paying service tax has the option to pay an amount calculated @ 1% of the gross amount of premium charged by him towards the discharge of his service tax liability instead of paying service tax @ 10%.

However, such option is not available in cases where:

(a) the entire premium paid by the policy holder is only towards risk cover in life insurance; or

(b) the part of the premium payable towards risk cover in life insurance is shown separately in any of the documents issued by the insurer to the policy holder.

1.19 SPECIAL PROVISION FOR PAYMENT OF SERVICE TAX IN CASE OF SERVICES PROVIDED IN RELATION TO PURCHASE OR SALE OF FOREIGN CURRENCY INCLUDING MONEY CHANGING

The person liable to pay service tax in relation to purchase or sale of foreign currency, including money changing, provided by a foreign exchange broker, including an authorised dealer in foreign exchange or an authorized money changer, referred to in sub-clauses (zm) and (zzk) of clause (105) of section 65 of the Finance Act, 1994 as amended shall have the option to pay an amount calculated at the rate of 0.25% of the gross amount of currency exchanged towards discharge of his service tax liability instead of paying service tax @10%.

However, such option shall not be available in cases where the consideration for the service provided or to be provided is shown separately in the invoice, bill or, as the case may be, challan issued by the service provider.

Illustration

Buying rate $US 1 = Rs.38, selling rate $US 1 = Rs.40

(i) Person exchanged $100 for equivalent rupees

Transaction value = Rs.3800 (Rs.38 x 100)

Service tax payable = Rs.9.5 (0.25% x 3800)

(ii) Person exchanged equivalent rupees for $100

Transaction value = Rs.4000 (40 x 100)

Service tax payable = Rs.10 (0.25% x 4000).

1.20 INTEREST ON DELAYED PAYMENT OF SERVICE TAX [SECTION 75]

In case payment of service tax is made after its due date, interest is leviable on the amount of tax liable to be paid for the period of delay. Payment of interest is mandatory in all circumstances. There is no provision to waive this interest on delayed payment of service tax.

Every person who fails to deposit the service tax or any part thereof to the account of Central Government within the prescribed period has to pay simple interest at a rate not below 10% p.a. but not exceeding 36% p.a. as may be notified by the Central Government. Currently, the notified rate of interest is 13%.

For computing the period of delay in payment of service tax, the month is counted from the next day from the date on which the payment of service tax was due. For example, if service tax is payable by 5th of a month, one month period for computation of interest would be from 6th of that month to 5th of the next month.

Self-examination Questions

1. Which of the following statement is false?
   (a) In case of insurance auxiliary service provided by an insurance agent, the person liable to pay service tax is the person carrying on the insurance business in India.
   (b) In case of business auxiliary service of distribution of mutual fund by a mutual fund distributor, the person liable to pay service tax is the mutual fund or asset management company receiving such service.
   (c) In case of accounting services rendered by a chartered accountant, the person liable to pay service tax is the chartered accountant.
   (d) none of the above
2. What is the due date for payment of service tax in case of a partnership firm?
   (a) 5th day of the month immediately following every month
   (b) 25th day of the month immediately following every quarter
   (c) 5th day of the month immediately following every quarter
   (d) 25th day of the month immediately following every month
3. 'A Ltd.' enters in to an advertising contract with 'B Ltd.' for a sum of Rs.15,000.00 on 05.06.2009. 'A Ltd.' receives an advance of Rs.10,000.00 on 06.06.2009 and the balance amount on the completion of services on 12.07.2009. The service tax payable by 'A Ltd.' is:
   (a) Rs.1545 by 25.08.2009
   (b) Rs.1020 by 25.07.2009 and Rs.510 by 25.08.2009
   (c) Rs.1545 by 05.08.2009
   (d) Rs.1030 by 05.07.2009 and Rs.515 by 05.08.2009

4. 'X Ltd.' provides management consultancy service to 'Y' for a consideration of Rs.20,000. 'X Ltd.' raises the bill on 'Y' on 05.06.2009. 'X Ltd.' receives the payment from 'Y' on 15.07.2009. When should 'X Ltd.' pay the service tax?
   (a) on or before 05.08.2009
   (b) on or before 05.07.2009
   (c) on or before 31.07.2009
   (d) on or before 30.06.2009
5. Service tax is payable to the credit of the Central Government in:
   (a) Form ST-3
   (b) TR-6 challan
   (c) Form F
   (d) none of the above
6. 'A' charges Rs.10,000 from 'B' towards the taxable services provided by him. He does not charge service tax from 'B'. In this context, which of the following statement is true?
   (a) No service tax is payable by 'A'.
   (b) Rs.934 is payable by 'A' as service tax.
   (c) Rs.926 is payable by 'A' as service tax.
   (d) Rs.909 is payable by 'A' as service tax.
7. (i) What is the due date for payment of service tax in case of a company for the month of February and March?
   (ii) Who is responsible to make the payment of service tax in case of service rendered by a Goods Transport Agency?
8. (i) A payment of Rs.11,000 is made by a client/ customer to an assessee after deducting income -tax of Rs.1,000 at source. In such a case, is service tax leviable only on the amount actually received by the assessee from his client/customer or does it also extend to the amount of income tax deducted at source?
   (ii) In case of payment of service tax by cheque, which date is considered as date of payment of service tax? Is it the date on which the cheque for the same is deposited/tendered in the designated Bank or the date on which the amount is credited?
9. (i) What is the special provision regarding payment of tax in respect of an air travel agent?

(ii) Does payment of service tax in a branch of the Bank other than the nominated Bank for the Central Excise Commissionerate amount to non-payment of service tax?

10. Write a brief note on provisional payment of service tax.

Answers

1.(d); **2.**(c); **3.**(d); **4.**(a); **5.**(b); **6.**(b);

UNIT – 2 : FILING OF RETURNS

Learning objectives

After reading this unit you will be able to:

- understand the procedure relating to filing of service tax returns.
- know the frequency of filing returns.
- be aware of the due date for filing returns.

2.1 PERSONS LIABLE TO FILE RETURNS

After understanding the concept of payment of service tax let us now delve with the scheme of filing of service tax returns.

Section 70 of the Finance Act, 1994 is the principal section which fixes the responsibility of filing of returns. It *inter alia* provides that every person liable to pay service tax shall himself assess the tax due on the services provided by him and shall furnish a return to the Superintendent of Central Excise. The return shall be furnished in such manner and at such frequency as may be prescribed. Rule 7 of the Service Tax Rules, 1994 prescribes the form, manner and frequency of furnishing the return.

Sub section (2) of section 70 stipulates that certain notified person or class of persons shall also furnish to the Superintendent of the Central Excise, a return in such form and in such manner and at such frequency as may be prescribed.

2.2 PERIODICITY AND FORM FOR RETURN

The prescribed form for the service tax returns is 'Form ST-3'. This form is applicable in case of all assessees. In case of provisional payment of service tax, the assessee has to file a statement giving details of the difference between the service tax deposited and the service tax liable to be paid for each month in a memorandum in Form 'ST-3A' which should accompany the return in 'Form ST-3'.

The return is to be furnished **half yearly**. In other words, the return should cover the periods of 1st April to 30th September (first half-year) and 1st October to 31st March (second half-year) of a financial year.

2.3 DUE DATES FOR FILING OF SERVICE TAX RETURNS

The service tax return, in Form ST-3 should be filed on half yearly basis by the 25th of the month following the particular half year. The due dates on this basis are tabulated as under:

Half year	Due date
1st April to 30th September	25th October
1st October to 31st March	25th April

2.3.1 When the due date falls on public holiday: In case the due date of the filing of return i.e., either 25th October or 25th April falls on a public holiday, the assessee can file the return on the immediately succeeding working day.

2.4 DELAYED RETURN

Section 70(1) *inter alia* provides for filing of periodical return after the due date with the prescribed late fee of not more than Rs.2,000. Thus, a delayed return can be furnished by paying the prescribed late fee.

2.4.1 Late fee for delay in furnishing return: The prescribed late fee for furnishing a delayed return is given in the following table:

S. No.	Period of delay	Late fee
(a)	15 days from the date prescribed for submission of the return	Rs.500
(b)	Beyond 15 days but not later than 30 days from the date prescribed for submission of the return	Rs.1,000
(c)	Beyond 30 days from the date prescribed for submission of the return	An amount of Rs.1,000 plus Rs.100 for every day from the 31st day till the date of furnishing the said return

However, the total late fee for delayed submission of return shall not exceed Rs.2,000. Further, where the assessee has paid the prescribed late fee for delayed submission of return, the proceedings, if any, in respect of such delayed submission of return shall be deemed to be concluded.

2.4.2 Late fee may be reduced/waived where service tax payable is nil: Where the gross amount of service tax payable is nil, the Central Excise Officer may, on being satisfied that there is sufficient reason for not filling the return, reduce or waive the penalty (late fee).

2.5 REVISED RETURN

An assessee can submit a revised return, in Form ST-3, in triplicate, to correct a mistake or omission, within a period of 90 days from the date of submission of the original return.

2.6 CONTENTS OF THE RETURN

Apart from the general details, like financial year, half year period (April-September or October-March), name of the assessee, registration number of the premises for which return is being filed, category of taxable services, the contents of the return *inter alia*, also include month-wise details of:

(i) amount received towards taxable service

(ii) amount received in advance towards taxable service to be provided

(iii) amount billed for exempted services and services exported without payment of tax

(iv) amount billed for services on which tax is to be paid

(v) abatement claimed - value

(vi) notification number of abatement and exemption

(vii) service tax payable

(viii) education cess payable

(ix) TR-6 challan date and number

(x) credit details for service tax provider/recipient

Further, half yearly details of other payments like interest, arrears and excess amount paid and adjusted subsequently and details of amount payable but not paid as on the last day of the period for which the return is filed are also to be provided in the return.

2.7 DOCUMENTS TO BE SUBMITTED ALONG WITH THE RETURN

Along with ST-3 return following documents should be attached:

(i) copies of TR-6 challans which indicate the payment of service tax for the months/quarter covered in the half-yearly return

(ii) a memorandum in form ST-3A giving full details of the difference between the amount of provisional amount of tax deposited and the actual amount payable for each month. Form-ST-3A is to be attached only when the assessee opts for provisional payment of service tax.

2.7.1 First return: Every assessee shall furnish to the Superintendent of Central Excise at the time of filing of return for the first time or the 31st day of January, 2008, whichever is later, a list in duplicate, of-

(i) all the records prepared or maintained by the assessee for accounting of transactions in regard to,-

  (a) providing of any service, whether taxable or exempted;

  (b) receipt or procurement of input services and payment for such input services;

  (c) receipt, purchase, manufacture, storage, sale, or delivery, as the case may be, in regard of inputs and capital goods;

  (d) other activities, such as manufacture and sale of goods, if any.

(ii) all other financial records maintained by him in the normal course of business.

2.8 MANNER OF FILING RETURNS

The service tax return in Form ST-3 should be filed in triplicate along with the copies of TR-6 challans for the quarters (in case of individual, proprietary concerns and partnership firms) or months (in other cases) covered in the half-yearly return. The return should be furnished to the Superintendent of Central Excise.

The assessee may also file the return with the concerned Divisional Office by registered post if he finds it difficult to file the return in person. However, the assesses should stick on to the due date and ensure that the return reaches the Divisional Office on or before the due date.

2.8.1 Return in case of multiple service providers: For an assesee who provides more than one taxable service, filing of a single return is sufficient. However, the details in each

of the columns of the Form ST-3 have to be furnished separately for each of the taxable service rendered by him. Thus, instead of showing a lump sum figure for all the services together, service-wise details should be provided in the return.

2.9 E-FILING OF RETURNS

E-filing is a facility for the electronic filing of service tax returns by the assesse from his office, residence or any other place of choice, through the Internet, by using a computer. The assesse can go to the e-filing site 'Home Page' by typing the address http://servicetaxefiling.nic.in in the address bar of the browser.

E filing of returns is an assesse facilitation measure of the department in continuation of its modernization and simplification program. It is an alternative to the manual filing of returns. This facility is available to all service providers.

2.10 NIL RETURN

Even if no service has been provided during a half year and no service tax is payable; the assessee has to file a Nil return within the prescribed time limit.

2.11 SCHEME FOR SUBMISSION OF RETURNS THROUGH SERVICE TAX RETURN PREPARERS [SECTION 71]

The Finance Act, 2008 has inserted a new section 71 to provide for the scheme for submission of returns through service tax returns prepares. Section 71 provides that the Central Board of Excise and Customs (Board) may frame a Scheme for the purposes of enabling any person or class of persons to prepare and furnish a return under section 70 and authorise a Service Tax Return Preparer to act as such under the Scheme.

A Service Tax Return Preparer shall assist the person or class of persons to prepare and furnish the return in such manner as may be specified in the Scheme framed under this section.

"Service Tax Return Preparer" means any individual, who has been authorised to act as a Service Tax Return Preparer under the Scheme framed under this section. "Person or class of persons" means such person, as may be specified in the Scheme, who is required to furnish a return required to be filed under section 70.

The Scheme framed by the Board may provide for the following, namely:—

(a) the manner in which and the period for which the Service Tax Return Preparer shall be

authorised under sub-section (1);

(b) the educational and other qualifications to be possessed, and the training and other conditions required to be fulfilled, by a person to act as a Service Tax Return Preparer;

(c) the code of conduct for the Service Tax Return Preparer;

(d) the duties and obligations of the Service Tax Return Preparer;

(e) the circumstances under which the authorisation given to a Service Tax Return Preparer may be withdrawn;

(f) any other matter which is required to be, or may be, specified by the Scheme for the purposes of this section.

In this regard, it may be noted that Service Tax Return Preparers Scheme, 2009 has been notified. Further, Form No. ST-3 in Service Tax Rules, 1994 has also been amended to furnish the details of name and identification of Service Tax Return Preparers in case the return has been prepared by them.

Self-examination questions

1. Which of the following statement is true with regards to service tax return?
   (a) A half yearly return is to be filed by each assessee.
   (b) A quarterly return is to be filed by each assessee.
   (c) A monthly return is to be filed by each assessee.
   (d) An annual return is to be filed by each assessee.
2. What is the due date for filing returns?
   (a) 5th of the month following the particular quarter
   (b) 25th of the month following the particular month
   (c) 25th of the month following the particular half year
   (d) 5th of April each year.
3. The prescribed form for service tax return is:
   (a) Form 3CD
   (b) Form 2E
   (c) Form ST-3
   (d) Form TR-6

4. The contents of the service tax return do not include:
   (a) amount billed for exempted services and services exported without payment of tax
   (b) amount received towards taxable service
   (c) amount received in advance towards taxable service to be provided
   (d) the income or loss of the service provider
5. For an assesee who provides 3 taxable services:
   (a) filing of return is not compulsory at all
   (b) filing of a single return is sufficient
   (c) filing of separate returns for all 3 services is necessary
6. Which documents are to be submitted along with the first return?
7. When should the return be filed if the due date happens to be a public holiday?
8. 'X', an individual, has not provided any services in the half year period of April to September. Should he file any return for this period? Give your opinion.
9. Write a note on the manner of payment of service tax.
10. What do you mean by e-filing of returns? Is there any facility of e-filing of service tax returns? If yes, then which of the services are eligible for this facility?

Answers

1.(a); **2.**(c); **3.**(c); **4.**(d); **5.**(b)

CHAPTER 4

VAT - CONCEPTS AND GENERAL PRINCIPLES

Learning objectives

After reading this chapter you will be able to understand:

- the basic concepts of VAT in relation to manufacture of and trading in goods and services.
- a brief historical background of VAT.
- calculation of VAT liability.
- merits and demerits of VAT.
- development of VAT in the Indian context.
- a brief overview of State-Level VAT in India.

1. INTRODUCTION

A really progressive and welfare oriented country should balance the requirements of direct and indirect taxes in a fair manner. Too much dependence on direct taxes will be repressive but at the same time passing heavy burdens to the general public by way of indirect taxes will constitute hardships to the common citizen. Therefore, economic administrators throughout the world have been constantly engaged in the exercise of lightening the burden of indirect taxes on the ultimate consumers.

Suppose, for manufacturing a product A, the manufacturer has to purchase four types of commodities B, C, D and E on which he pays excise duty[1]. When ultimately he sells his manufactured product A on which he has to discharge his liability towards excise, the excise duty leviable on such product will be on a tax base which will include excise duties paid by the manufacturer on products B, C, D and E. Thus, the final excise duty is a duty on duty, which will increase the cost of production as well as the price of the final product.

Suppose, we find a method by which the excise duties paid on commodities B, C, D and E

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[1] Excise duty is levied on the manufacture of goods. The concepts relating to excise duty shall be taken up in Paper – 8: Indirect Tax Laws at the Final level.

are allowed to be set-off from the final duty liability on product A, it is obvious that the manufacturer will not only be able to avoid payment of duty on duty but the cost of the product will also be reduced leading to a benefit to the consumer. This is the origin of Value added tax (VAT).

In simple words, the tax will be levied and collected at each stage of manufacture only on the value added by the manufacturer represented by the purchase value and the value of the work performed on such purchased commodities. This will not only result in cost reduction but will also ensure equity. What we have talked about is a value added tax on manufacture. In the same way, there can be a value added tax in respect of trading in commodities also.

In other words, the various taxes paid on inputs purchased will be allowed as a credit and will be allowed to be set off against the tax liability on the value of sales of the commodity. Thus, there can be a system of VAT in respect of manufacture and in respect of sales. In the same way, one can think of a system of VAT in dealing with input and output services. When the individual systems of manufacturing, sales and services VAT are ultimately combined to form a grand system of VAT on goods and services, such a VAT system will be applicable throughout the country as a common market.

2. HISTORICAL BACKGROUND

Ever since 1954, when the tax on value added was introduced in France it has spread to a large number of countries. This tax was proposed for the first time by Dr. Wilhelm Von Siemens for Germany in 1919 as an improved turnover tax. In 1921, VAT was suggested by Professor Thomas S. Adams for the United States of America who recommended "sales-tax with a credit or refund for taxes paid by the producer or dealer (as purchaser) on goods bought for resale or for necessary use in the production of goods for sales." VAT was also recommended by the Shoup Mission for the reconstruction of the Japanese Economy in 1949. However, the tax was not introduced by any country till 1953. France led the way in 1954 by adopting a VAT that covered the industrial sector alone and the tax was limited up to the wholesale level. The tax was limited to the boundaries of France until the fifties.

VAT has, however, been spreading rapidly since the sixties. The Ivory Coast followed France by adopting VAT in 1960. The tax was introduced by Senegal in 1961 and by Brazil and Denmark in 1967. The tax has gathered further momentum as it was made a standard form of sales-tax required for the countries of the European Union (then European Economic Community). In 1968, France extended VAT to the retail level while the Federal Republic of Germany introduced it in its tax system. The Netherlands and Sweden imposed this tax in 1969 while Luxembourg adopted it in 1970, Belgium in 1971,

Ireland in 1972, and Italy, the United Kingdom, and Austria in 1973. Of the other members of the European Union, Portugal and Spain introduced VAT in 1986, Greece in 1987, while this tax was adopted by Finland in 1994. Many other European countries have adopted VAT. Similarly, many countries in the North and South America, Africa and Oceania have introduced VAT.

VAT has been spreading in the Asian region as well. The Republic of Vietnam adopted VAT briefly in 1973. (VAT was abolished soon but it was reintroduced in 1999 in Vietnam.) South Korea introduced VAT in 1977, China in 1984, Indonesia in 1985, Taiwan in 1986, Philippines in 1988, Japan in 1989, Thailand in 1992, and Singapore in 1994 while Mongolia has been implementing this tax since 1998.

In the South Asian Association for Regional Cooperation (SMRC) region, VAT has been considered in great depth in India. In 1986, India introduced VAT in a different way under the name of Modified Value Added Tax (MODVAT). Unlike the VAT system of other countries, the Indian MODVAT system was designed to cover manufacturing of goods by giving credit of excise duty paid on inputs. The scope of MODVAT has been extended over the years and has since been renamed as Central Value Added Tax (CENVAT), which covers services also.

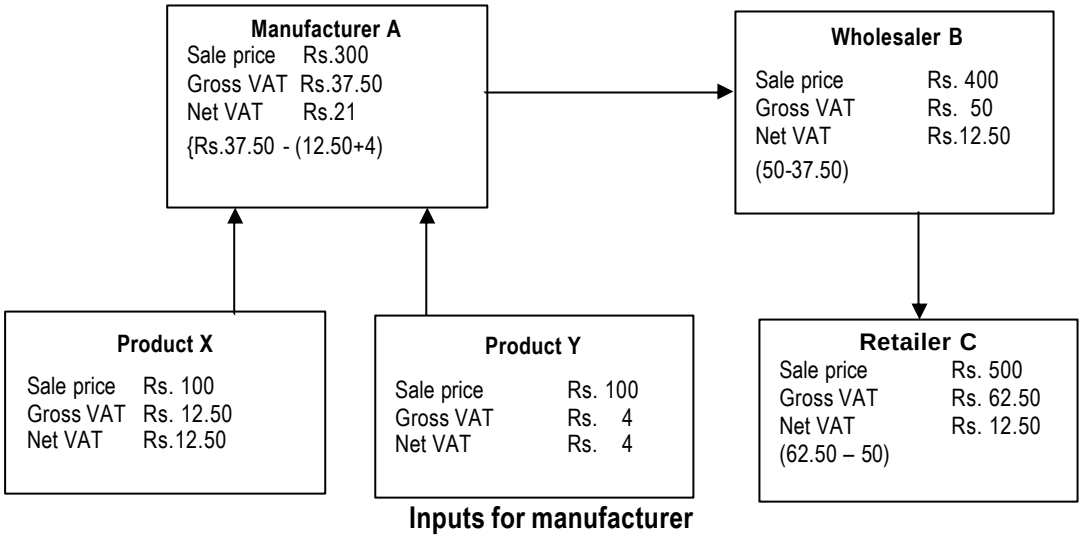
Pakistan adopted VAT in 1990, Bangladesh in 1991, and Nepal in 1997 while Sri Lanka introduced VAT in 1998.

As VAT is less distortive and more revenue-productive, it has been spreading all over the world. As on today, about 130 countries have adopted the same.

3. CALCULATION OF VAT LIABILITY

3.1 Different stages of VAT

The Value Added Tax (VAT) is a multistage tax levied as a proportion of the value added (i.e. sales minus purchase) which is equivalent to wages plus interest, other costs and profits. To illustrate, a chart of transactions is given below:



Inputs for manufacturer

Note: The rate of tax is assumed to be 12.5% on the transactions relating to goods manufactured by A.

For a manufacturer A, inputs are product X and product Y which are purchased from a primary producer. In practice, even these producers use inputs. For example, a farmer would use seeds, feeds, fertilizer, pesticides, etc. However, for this example their VAT impact is not considered. B is a wholesaler and C is a retailer.

The inputs X and Y are purchased at Rs. 100 each on which tax is paid @12.5 % and 4% respectively. The manufacturer A would, therefore, take the credit for tax paid by him for the use of such inputs. The input price of Rs.200 plus tax would include wages, salaries and other manufacturing expenses. To all this, he would also add his own profit. Assuming that after the addition of all these costs his sale price is Rs.300, the gross tax (at the rate of 12.5 per cent) would be Rs.37.50. As manufacturer A has already paid tax on Rs.200, he would get credit for this tax (i.e. 12.50+4=16.50). Therefore, his net VAT liability would be Rs.37.50 minus Rs.16.50. Thus, manufacturer A would pay Rs.21 only (because of this he would take the cost of his inputs to be only R s.200)

Similarly, the sale price of Rs.400 fixed by wholesaler B would have net VAT liability of Rs.12.50 (Rs.50-37.50= Rs.12.50) and the sales price of Rs.500 by Retailer C would also have net VAT liability of Rs.12.50 (Rs. 62.50 - 50 = Rs.12.50). Thus, VAT is collected at each stage of production and distribution process, and in principle, its entire burden falls on the final consumer, who does not get any tax credit. Thus, VAT is a broad-based tax covering the value added to each commodity by parties during the various stages of

production and distribution.

3.2 How VAT operates

The operation of VAT can be further appreciated from the following illustrations:

Illustration

A is a trader selling raw materials to a manufacturer of finished products. He imports his stock-in-trade as well as purchases the same in the local markets. If the rate of VAT is assumed to be 12.50 per cent ad valorem, he will pay VAT as under:

		(Rs.)
(i)	A's cost of imported materials (from other State)	10,000
	(A will deposit Rs.1250 duty on the above. Since, this is not a State VAT it will form a cost of input)	1,250
(ii)	A's cost of local materials	20,000
	(VAT charged by local suppliers Rs.2,500. Since the credit of this would be available it will not be included in cost of input)	
(iii)	Other expenditure (such as for storage, transport, interest, etc.) incurred and profit earned by A	8,750
(iv)	Sales price of goods	40,000
(v)	VAT on the above @ 12.50% (Approx.)	5,000
(vi)	Invoice value charged by A to the manufacturer, B	45,000

I.	**A's liability for VAT**		Rs.
	Tax on the sales price		5,000
	Less: Set-off of VAT paid on purchases		
	On imported goods	Nil	
	On local goods	2,500	2,500
	Net Tax Payable		**2,500**

In the above illustration (as well as in illustrations that follows) it is assumed that set off of VAT paid on imported goods from outside countries or other States is not allowed.

Now B manufactures finished products from the raw materials purchased from A and other materials purchased from other suppliers. His liability would be as under:

			(Rs.)
(i)	B's cost of raw materials		40,000
	(VAT recovered by *A* Rs.5,000)		
(ii)	B's cost of other materials		
	Local Purchases		20,000
	(VAT charged on the above Rs.2,500)		
	Inter- State Purchases*		10,400
	(CST paid Rs.400)		
(iii)	Manufacturing and other expenses incurred and profit earned by B		29,600
(iv)	Sale price of finished product		1,00,000
(v)	VAT on the above		12,500
(vi)	Invoice value charged by B to the wholesaler, C		1,12,500

II. B's liability for VAT

Tax on the sales price		12,500
Less: Set-off of VAT on Purchases		
To A	5,000	
To other suppliers	2,500	7,500
Net Tax Payable		**5,000**

*Credit / set off for tax paid on inter-State purchases (inputs) is not allowed.

When C, after repacking the goods into other packing, sells the finished product to a retailer. The following would be the position:

		(*Rs.*)
(i)	C*'s* cost of goods	1,00,000
	(VAT recovered by B Rs.12, 500)	
(ii)	Cost of packing material	2,000
	(VAT charged on the above Rs. 250)	
(iii)	Expenses incurred and profit earned by C	18,000

(iv)	Sale price of goods	1,20,000
(v)	VAT on the above	15,000
(vi)	Invoice value charged by C to D, a retailer	1,35,000

III. C's liability for VAT

	Tax on the sales price	15,000
	Less: set-off of VAT paid	
	To B 12,500	
	To other suppliers 250	12,750
	Net Tax payable	**2,250**

When D sells the goods to the consumers, the position would be as under:

		Rs.
(i)	D's cost of goods	1,20,000
	(VAT recovered by C Rs.15,000)	
(iii)	Expenses incurred and profit earned by D	20,000
(iv)	Sale price of goods	1,40,000
(v)	VAT on the above	17,500
(vi)	Invoice value charged by D to the consumers	1,57,500

IV. D's liability for VAT

	Tax on the sale price	17,500
	Less: Set-off of VAT paid to C	15,000
	Net Tax Payable	**2,500**

Total recovery

It would be seen that in the above illustrations, at the successive stages which the raw materials and other goods pass till they are sold to the ultimate consumers, VAT would be collected as under:

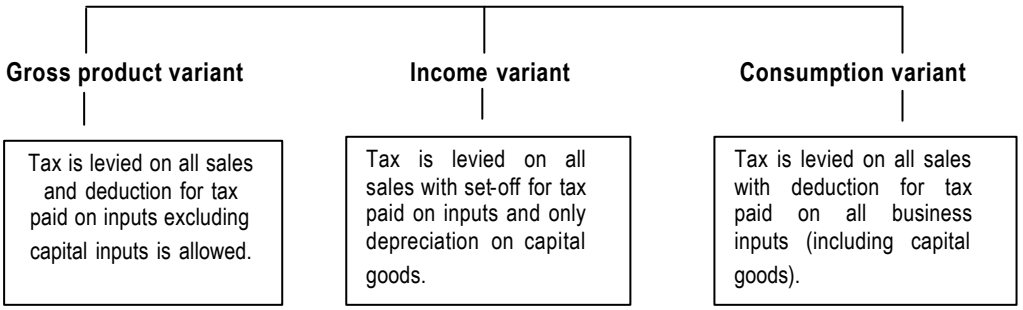
		(Rs.)
(i)	Paid by suppliers selling raw materials to A	2,500
(ii)	Net tax paid by A on his sales to B	2,500
(iii)	Paid by suppliers selling other materials to B	2,500
(iv)	Net tax paid by B	5,000
(v)	Paid by suppliers selling packing materials to C	250
(vii)	Net tax paid by C	2,250
(viii)	Net tax paid by D	2,500
	Total recovery of revenue	17,500

Now, if tax was leviable under a sales-tax law at the last stage in a series of successive sales (when the finished product is sold to consumers) the authorities in the above case would have recovered the entire tax of Rs.17, 500 from D at 12.50 per cent on his sale price of Rs.1,40,000 and all earlier stages are to be exempted.

4. VARIANTS OF VAT

VAT has three variants, viz., (a) gross product variant, (b) income variant, and (c) consumption variant. These variants are presented in a schematic diagram given below:

Different variants of VAT



The gross product variant allows deductions for taxes on all purchases of raw materials and components, but no deduction is allowed for taxes on capital inputs. That is, taxes on capital goods such as plant and machinery are not deductible from the tax base in the

year of purchase and tax on the depreciated part of the plant and machinery is not deductible in the subsequent years. Capital goods carry a heavier tax burden as they are taxed twice. Modernization and upgrading of plant and machinery is delayed due to this double tax treatment.

The income variant of VAT on the other hand allows for deductions on purchases of raw materials and components as well as depreciation on capital goods. This method provides incentives to classify purchases as current expenditure to claim set-off. In practice, however, there are many difficulties connected with the specification of any method of measuring depreciation, which basically depends on the life of an asset as well as on the rate of inflation.

Consumption variant of VAT allows for deduction on all business purchases including capital assets. Thus, gross investment is deductible in calculating value added. It neither distinguishes between capital and current expenditures nor specifies the life of assets or depreciation allowances for different assets. This form is neutral between the methods of production; there will be no effect on tax liability due to the method of production (i.e. substituting capital for labour or vice versa). The tax is also neutral between the decision to save or consume.

Among the three variants of VAT, the consumption variant is widely used. Several countries of Europe and other continents have adopted this variant. The reasons for preference of this variant are:

Firstly, it does not affect decisions regarding investment because the tax on capital goods is also set-off against the VAT liability. Hence, the system is tax neutral in respect of techniques of production (labour or capital-intensive).

Secondly, the consumption variant is convenient from the point of administrative expediency as it simplifies tax administration by obviating the need to distinguish between purchases of intermediate and capital goods on the one hand and consumption goods on the other hand.

In practice, therefore, most countries use the consumption variant. Also, most VAT countries include many services in the tax base. Since the business gets set-off for the tax on services, it does not cause any cascading effect.

5. METHODS FOR COMPUTATION OF TAX

There are several methods to calculate the 'value added' to the goods for levy of tax. The three commonly used methods are:

(a) addition method,

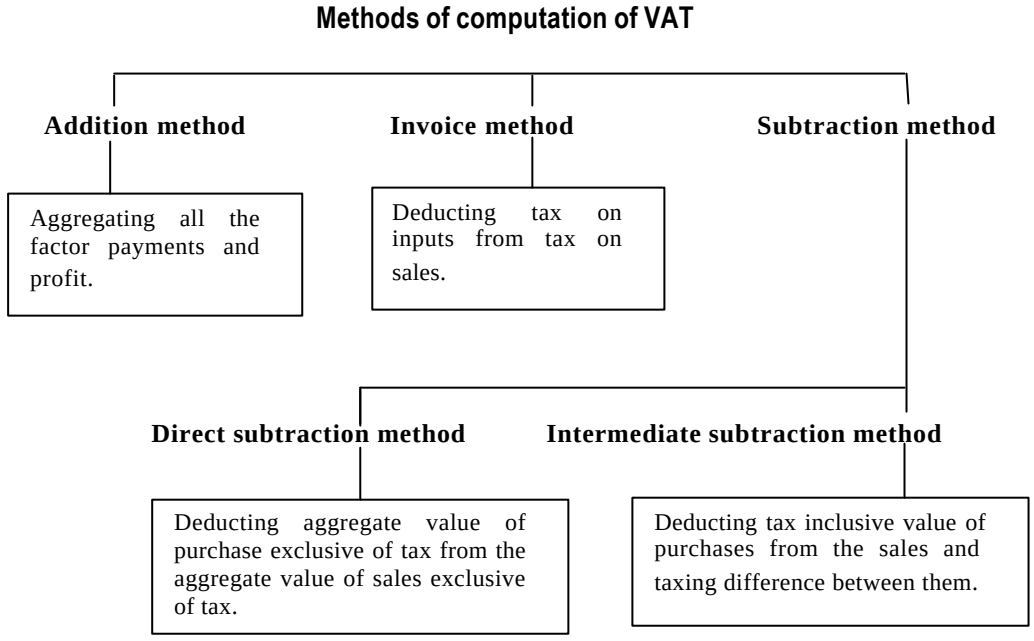
(b) invoice method and

(c) subtraction method.

The subtraction method can be further divided into:

(a) direct subtraction method

(b) intermediate subtraction method



5.1 Addition Method

This method aggregates all the factor payments including profits to arrive at the total value addition on which the rate is applied to calculate the tax. This type of calculation is mainly used with income variant of VAT. Addition method does not easily accommodate exemptions of intermediate dealers. A drawback of this method is that it does not facilitate matching of invoices for detecting evasion.

5.2 Invoice Method

This is the most common and popular method for computing the tax liability under 'VAT' system. Under this method, tax is imposed at each stage of sales on the entire sale value

and the tax paid at the earlier stage is allowed as set-off. In other words, out of tax so calculated, tax paid at the earlier stage i.e., at the stage of purchases is set-off, and at every stage the differential tax is being paid. The most important aspect of this method is that at each stage, tax is to be charged separately in the invoice. This method is very popular in western countries. In India also, under the VAT law as introduced in several States and under the Central Excise Law this method is followed. This method is also called the 'Tax Credit Method' or 'Voucher Method'. From the following illustration, the mode of calculation of tax under this method will become clear:

Stage	Particulars	VAT Liability	Less VAT Credit	Tax to Government
1.	Manufacturer/first seller in the State sells the goods to distributor for Rs.1000. Rate of tax is 12.50%. Therefore, his tax liability will be Rs.125. He will not get any VAT credit, being the first seller.	125	-	125
2.	Distributor sells the goods to a wholesale dealer for say Rs. 1200 @ 12.50% and will get set-off of tax paid at earlier stage at Rs. 125. His tax liability will be Rs. 25.	150	125	25
3.	Wholesale dealer sells the goods to a retailer at say Rs. 1500. Here again he will have to pay the tax on Rs. 1500. He will get credit of tax paid at earlier stage of Rs. 150. His tax liability will be Rs. 37.50.	187.50	150	37.50
4.	Retailer sells the goods to consumers at say Rs. 2000. Here again he will have to pay tax on Rs. 2000. He will get credit for tax paid earlier at. Rs. 187.50. His tax liability will be Rs.62.50.	250	187.50	62.50
	Total	712.50	462.50	250

Thus, the Government will get tax on the final retail sale price of Rs. 2,000. However, the tax will be paid in instalments at different stages. At each stage, tax liability is worked out on the sale price and credit is also given on the basis of tax charged in the purchase invoice. If the first seller is a manufacturer, he gets the credit of tax paid on raw materials, etc. which are used in the manufacturing. From the above illustration, it is clear that under this method, tax credit cannot be claimed unless and until the purchase invoice is produced. As a result, in a chain, if at any stage the transaction is kept out of the books, still there is no loss of revenue. The department will be in a position to recover the full tax at the next stage. Thus, the possibility of tax evasion, if not entirely ruled out, will be reduced to a minimum. However, proper measures should be implemented to prevent the production of fake invoices to claim the credit of tax at an earlier stage.

It is said that in this method the beneficiary is the trade and industry because in the above example, the total tax collection at all the stages is Rs.712.50 whereas tax received by the State is only Rs. 250. The set-off available is also tax paid. If the profit margin is to be kept at the constant level then the set-off will have to be considered to avoid cascading effects of taxes.

5.3 Subtraction Method

While the above-stated invoice or tax-credit method is the most common method of VAT, another method to determine the liability of a taxable person is the cost subtraction method, which is also a simple method. Under this method, the tax is charged only on the value added at each stage of the sale of goods. Since, the total value of goods sold is not taken into account, the question of grant of claim for set-off or tax credit does not arise. This method is normally applied where the tax is not charged separately. Under this method for imposing tax, 'value added' is simply taken as the difference between sales and purchases. The following illustration will make the working of this system clear:

Stage No.	Particulars	Turnover for tax under VAT *(Rs.)*	Tax @ 12.50% *(Rs.)*
1.	First seller sells the goods to a distributor at say, Rs. 1125 inclusive of tax	1,125	125 $\left[\frac{(1125\times12.50)}{100+12.50}\right]$

2.	Distributor sells the goods to a whole-seller at say, Rs.1,350. Here taxable turnover will be Rs.1,350 - Rs.1,125	225	25 $\left[\frac{(225 \times 12.50)}{100+12.50}\right]$
3.	Wholesaler sells the goods to a retailer at say, Rs 1,687.50. Here taxable turnover will be Rs. 1,687.50 - Rs. 1,350	337.50	37.50 $\left[\frac{(337.50 \times 12.50)}{100+12.50}\right]$
4.	Retailer selling the goods at say, Rs. 2250. Taxable turnover will be' Rs.2250 - Rs. 1687.50	562.50	62.50 $\left[\frac{(562.50 \times 12.50)}{100+12.50}\right]$
		2,250	250

Tax is calculated by the formula $\frac{T \times R}{100+R}$

T = Taxable turnover, R = Rate of Tax

Thus, under this system also, the incidence of tax is at each stage and the incidence of tax on the final sale price to the consumer will remain the same as in the earlier method. However, this holds good till the time the same rate of tax is attracted on all inputs, including consumables and services, added at all the stages of production/distribution. If the rates are not common, then the final tax by the two methods may differ. This is explained in tables given below:

Invoice Method (All inputs taxable under ONE rate)

Particulars	Invoice	Material Value	VAT	Input tax credit	NET
Inputs for A					
Product X(@12.50%)	260	231	29	--	29
Product Y(@12.50%)	450	400	50	--	50
	---	---	---	---	---
'A' sales goods to 'B'	710	631	79	--	79
'B' sales goods to 'C'	1125	1000	125	79	46
'C' sales goods to 'D'	1800	1600	200	125	75
'D' sales goods to 'E'	2250	2000	250	200	50
	2700	2400	300	250	50
FINAL	2700	2400	300	--	300

Subtraction Method (All inputs taxable under ONE rate)

Particulars	Invoice	Purchase Price	Value Added	VAT @ 12.50%
Inputs for A				
On Input	710	--	--	79
'A' to 'B'	1125	710	415	46
'B' to 'C'	1800	1125	675	75
'C' to 'D'	2250	1800	450	50
'D' to 'E'	2700	2250	450	50
FINAL	2700	--	--	300

Invoice Method (Inputs taxable at different rates)

Particulars	Invoice	Material Value	VAT	Input tax credit	NET
Inputs for A					
Product X(@12.50%)	450	400	50	--	50
Product Y(@ 4%)	260	250	10	--	10
	---	---	---	---	---
'A' sales goods to 'B'	710	650	60	--	60
'B' sales goods to 'C'	1125	1000	125	60	65
'C' sales goods to 'D'	1800	1600	200	125	75
'D' sales goods to 'E'	2250	2000	250	200	50
	2700	2400	300	250	50
FINAL	2700	2400	300	--	300

Subtraction Method (Inputs taxable at different rates)

Particulars	Invoice	Purchase Price	Value Added	VAT @ 12.50%
Inputs for A				
On Input	710	--	--	60
'A' to 'B'	1125	710	415	46
'B' to 'C'	1800	1125	675	75
'C' to 'D'	2250	1800	450	50
'D' to 'E'	2700	2250	450	50
FINAL	2700	--	--	281

Thus, on the same consumer price of Rs. 2700 under invoice method VAT works out to be

Rs.300 where as under the subtraction method it works out to be Rs. 281. Therefore, the method is not considered as a good method. The method is being objected to on the ground that under this method, tax is levied on income. The value addition at each stage may not be only due to profit but may be partly due to freight/transportation and other services. The incidence of tax is on the sale of goods. However, the mode of calculation of taxable turnover is value added. Therefore, the method cannot be said to be imposing tax on income/profit.

6. MERITS AND DEMERITS OF VAT

6.1 Merits

1. No tax evasion

It is said that VAT is a logical beauty. Under VAT, credit of duty paid is allowed against the liability on the final product manufactured or sold. Therefore, unless proper records are kept in respect of various inputs, it is not possible to claim credit. Hence, suppression of purchases or production will be difficult because it will lead to loss of revenue. A perfect system of VAT will be a perfect chain where tax evasion is difficult.

2. Neutrality

The greatest advantage of the system is that it does not interfere in the choice of decision for purchases. This is because the system has anti-cascading effect. How much value is added and at what stage it is added in the system of production/distribution is of no consequence. The system is neutral with regard to choice of production technique, as well as business organisation. All other things remaining the same, the issue of tax liability does not vary the decision about the source of purchase. VAT facilitates precise identification and rebate of the tax on purchases and thus ensures that there is no cascading effect of tax. In short, the allocation of resources is left to be decided by the free play of market forces and competition.

3. Certainty

The VAT is a system based simply on transactions. Thus there is no need to go through complicated definitions like sales, sales price, turnover of purchases and turnover of sales. The tax is also broad-based and applicable to all sales in business leaving little room for different interpretations. Thus, this system brings certainty to a great extent.

4. Transparency

Under a VAT system, the buyer knows, out of the total consideration paid for purchase of material, what is tax component. Thus, the system ensures transparency also. This transparency enables the State Governments to know as to what is the exact amount of

tax coming at each stage. Thus, it is a great aid to the Government while taking decisions with regard to rate of tax etc.

5. Better revenue collection and stability

The Government will receive its due tax on the final consumer/retail sale price. There will be a minimum possibility of revenue leakage, since the tax credit will be given only if the proof of tax paid at an earlier stage is produced. This means that if the tax is evaded at one stage, full tax will be recoverable from the person at the subsequent stage or from a person unable to produce proof of such tax payment. Thus, in particular, an invoice of VAT will be self enforcing and will induce business to demand invoices from the suppliers. Another attribute of VAT is that it is an exceptionally stable and flexible source of Government revenue.

6. Better accounting systems

Since the tax paid on an earlier stage is to be received back, the system will promote better accounting systems.

7. Effect on retail price

A persistent criticism of the VAT form has been that since the tax is payable on the final sale price, the VAT usually increases the prices of the goods. However, VAT does not have any inflationary impact as it merely replaces the existing equal sales tax. It may also be pointed out that with the introduction of VAT , the tax impact on raw material is to be totally eliminated. Therefore, there may not be any increase in the prices.

6.2 Demerits

1. The merits accrue in full measure only under a situation where there is only one rate of VAT and VAT applies to all commodities without any question of exemptions whatsoever. Once concessions like differential rates of VAT, composition schemes, exemption schemes, exempted category of goods etc. are built into the system, distortions are bound to occur and the fundamental principle that VAT will totally eliminate cascading effects of taxes will also be subject to qualifications.
2. In the federal structure of India in the context of sales-tax, so long as Central VAT is not integrated with the State VAT, it will be difficult to put the purchases from other States at par with the State purchases. Therefore, the advantage of neutrality will be confined only for purchases within the State.
3. For complying with the VAT provisions, the accounting cost will increase. The burden of this increase may not be commensurate with the benefit to traders and small firms.
4. Another possible weak point in the introduction of VAT, which will have an adverse

impact on it is that, since the tax is to be imposed or paid at various stages and not on last stage, it would increase the working capital requirements and the interest burden on the same. In this way it is considered to be non-beneficial as compared to the single stage-last point taxation system.

5. VAT is a form of consumption tax. Since, the proportion of income spent on consumption is larger for the poor than for the rich, VAT tends to be regressive. However, this weakness is inherent in all the forms of consumption tax. While it may be possible to moderate the distribution impact of VAT by taxing necessities at a lower rate, it is always advisable to moderate the distribution considerations through other programmes rather than concessions or exemptions, which create complications for administration.

6. As a result of introduction of VAT, the administration cost to the State can increase as the number of dealers to be administered will go up significantly.

7. VAT IN INDIAN CONTEXT

The Indian Union is a federal structure under the Constitution of India. The Central Government and the State Governments derive their powers through the instrumentality of the Union List, the State List and the Concurrent List. So far as powers of taxation are concerned there are clearly specified areas over which the Central Government and the States can exercise their jurisdiction.

While Income-tax, excise duty and customs duty[2] constitute the major sources of tax revenue to the Central Government, the State Governments substantially depend on sales-tax as the main source of revenue. The Central Government undertook a series of reforms in indirect taxes, the major among which was the introduction of Modified VAT, which is currently in operation as CENVAT. However, in view of the constitutional constraints, CENVAT applies to goods and services but not to sales tax and State- Level VAT.

7.1 Central value added tax (CENVAT)

At the Central level, at the time of Independence, India inherited a system of commodity taxes in which excise duties were levied on about a dozen articles yielding a small proportion of total tax revenue to the Centre. Following hdependence, the rates were raised, the base was enlarged, and more and more items were brought into its net. Over time, there was a speedy extension of excise duties. It was not only levied on finished goods but also covered raw

[2] Customs duty is levied on import and export of goods. The concepts relating to customs duty shall be taken up in Paper – 8: Indirect Tax Laws at the Final level.

materials, intermediate goods and capital goods.

7.1.1 Structure of CENVAT

As of now, the Central Government levies excise duties on all goods manufactured or produced in the country. Such duty is paid by the manufacturer / producer at the time of removal of goods from the factory at prescribed rates. The prevailing structure of such duties includes (i) CENVAT, (ii) special excise duty (SED), (iii) additional excise duty on goods of special importance, AED (GSI) (iv) additional duty of excise on textiles and textile articles, AED (T&TA), and (v) cesses on specified commodities.

With effect from March 1, 1986, MODVAT was introduced under the union excise duty as a system of giving credit for excise duty on inputs. Initially, it was introduced for a selected number of commodities. Over time, MODVAT was extended and was finally replaced by Central VAT, known as CENVAT in the Budget 2000-01. CENVAT has in general a single rate of 16% with some variations for select commodities.

The CENVAT scheme initially allowed instant credit for specified excise duties paid on inputs and capital goods received in a factory for the manufacture of any dutiable final products . The credit could be utilised to pay excise duty on any final product.

The Finance Act, 2004 marked a beginning for an integrated goods and service tax system wherein the duties of excise paid on inputs / capital goods and service tax paid on input services could be adjusted against a manufacturer's excise duty liability or a service provider's service tax liability. At present, the CENVAT scheme is governed by CENVAT Credit Rules, 2004.

7.2 Committee of State Finance Ministers

After the introduction of VAT in the area of manufacture and services, a need for uniformity arose wherein similar system was proposed to be incorporated in the area of sales thereby replacing the existing sales tax system. To materialize this concept, the then Union Finance Minister called a meeting of the State Finance Ministers in May 1994 and a Committee of State Finance Ministers was constituted on sales tax reform following this meeting. The Committee had to examine all aspects of sales tax reform, including the introduction of VAT.

The Committee recommended several measures to rationalize the existing sales tax with the ultimate aim of introducing VAT at the State level. The major recommendations included simplification of the rate structure, minimization of the exemptions and enhancement of transparency. To this end, the Committee recommended:

(i) The adoption of four general floor rates (0, 4, 8, 12) and two special floor rates (1 and 20) in place of the existing multiple rates being levied in different States;

(ii) Keeping the exemptions to a minimum;

(iii) Preparing a list of exempt goods and fixing a target date beyond which no State/Union Territory should exempt goods other than those mentioned in the list, and;

(iv) Doing away with sales tax incentives for industrialization. No new tax incentives should be given after 1 April, 1997, and the existing ones should be allowed to lapse in due course.

The Committee also recommended several preparatory steps to be taken for the implementation of a full-fledged State-Level VAT. This included a massive taxpayers education programme, computerization of sales tax administration, and preparation of model VAT legislation. For implementing the above decisions, an Empowered Committee of State Finance Ministers was set up.

7.3 White Paper on State-Level VAT in India

The Empowered Committee of State Finance Ministers met regularly and with the repetitive discussions and collective efforts brought out a White paper on 17.01.2005, which provided a base for the preparation of various State VAT legislations. It has been recognized that VAT is a State subject and therefore, the States will have freedom for appropriate variations consistent with the basic design as agreed upon at the Empowered Committee. Broadly, the White Paper consists of the following:

(a) Justification of VAT and Background

(b) Design of State-Level VAT.

(c) Steps taken by the States.

8. PRESENT POSITION

Finally State-Level VAT was introduced on 01.04.2005 by majority of the States. The States have passed State-Level VAT legislations which are modeled on the draft model VAT law, prescribed by the Central Government. The legislations also incorporate the various principles of State-Level VAT as contained in the White Paper released by the Empowered Committee. However, such State Legislations contain provisions to cater to the specific needs of the State finances.

8.1 Discontinuance of central sales tax

With the introduction of State-Level VAT system, it is proposed to phase out the Central sales tax (CST). However, since the states will stand to lose large revenue on account of its

discontinuance a mechanism is being thought of for compensating the States for such loss of revenue.

9. AUDIT PROVISIONS UNDER VAT

Like majority of the developing economies our country is also facing the problem of lack of education and awareness about tax laws, more particularly amongst the trading community. Further, the VAT system of taxation is new to them. Since the trading community is not educated enough and equipped to understand the implications of the VAT system of taxation immediately, there is every possibility that they may not be in a position to arrange their business affairs to fall in line with the requirements of the State-Level VAT and calculate and discharge their exact tax liability under the VAT laws. On the other hand, the tax administrator i.e. the authorities in the taxation department also find themselves devoid of sufficient resources to educate the tax payers and inform them about the procedural and accounting changes that are necessitated by the implementation of VAT system.

Further, under the VAT system a major thrust is to be laid on the 'self assessment' i.e., the tax liability, calculated and paid by the tax payers through their periodical returns, will be accepted by and large and the tax payers will not be called to substantiate the tax liability shown by them in the returns by producing books of account and other relevant material. The assessments with books of account will be an exception.

Therefore, there is a strong need to see that the tax payers discharge their tax liability properly while filing the returns. This can be ensured only when the particulars furnished by the tax payers are verified by an independent auditor in minute details by:

- going through the books of account and
- analysing and interpret the provisions of the State-Level VAT laws and
- reporting the under-assessment, if any, made by the dealer requiring additional payment or
- reporting any excess payment of tax warranting refund to the tax payer.

In most of the countries tax evasion is rampant under the existing tax systems. In India too, evasion of excise and sales-tax is estimated to be very high. If no audit is prescribed under VAT law, the chances of evasion of VAT tax will increase causing revenue leakage for the Government. It is, therefore, essential that the audit of the proposed VAT system is attempted on a regular basis. However, it is not possible to conduct the audit of all the VAT dealers. Therefore, the criteria for audit can be the amount of turnover or the class of dealer dealing in specified commodities.

The concept of audit is popular even in foreign countries where the system of VAT is in practice since long in the field of indirect taxation. In countries like France and Korea the audit has proved to be an effective tool to check the evasion of tax, which was mostly done by producing fake invoices etc.

Since VAT is a new concept, some of the States want to keep the procedural formalities to the minimum. Hence, at the initial stage their law makers refrain from keeping any audit provisions in their Act and rules. Perhaps, this may be due to the initial stage of introduction of VAT. But most of the States, keeping in mind the importance of audit, have incorporated the audit provisions since inception.

Some States like the State of Maharashtra and State of Kerala have provided detailed particulars to be furnished by various dealers in respect of their VAT assessments.

10. ICAI'S ROLE IN VAT

The ICAI has rendered pioneering service in evolving the necessary accounting guidelines both for CENVAT as well as State Level VAT. It has brought out Guidance Notes for accounting for CENVAT as well as State-Level VAT. These Guidance Notes address all the accounting issues in regard to CENVAT and State-Level VAT. Further, the Institute has brought out a comprehensive study on State-Level VAT in India. It contains an elaborate discussion of the various general principles of VAT and State Level VAT. These general principles have been incorporated in the various State-Level VAT legislations. However, there are special provisions contained in the respective State level legislations to cater to the specific needs of the States. Various State governments have issued detailed clarification on different practical issues arising on implementation of the State-Level VAT.

11. ROLE OF CHARTERED ACCOUNTANT IN VAT

Chartered Accountants have a key role to play in proper implementation of VAT.

(i) Record keeping : VAT requires proper record keeping and accounting. Systematic records of input credit and its proper utilisation is necessary for the success of VAT. Chartered Accountants are well equipped to perform such tasks

(ii) Tax planning : In order to establish an efficient plan for purchases and sales, a careful study of VAT is required. A Chartered Accountant is competent to analyze the impact of various alternatives and choose the most optimum method of purchases and sales in order to minimize the tax impact.

(iii) Negotiations with suppliers to reduce price: VAT credit alters cost structure of goods supplied as inputs. A Chartered Accountant will ensure that the benefit of such

cost reduction is passed on by the suppliers to his company. However, if the buyers of his company make the similar demand, he must be ready with full data to resist the claims.

(iv) Handling the audit by departmental officers : There will be audit wing in department and certain percentage of dealers will be taken up for audit every year on scientific basis. Chartered Accountant can ensure proper record keeping so as to satisfy the departmental auditors. The professional expertise of a Chartered Accountant will help him in effectively replying audit queries and sorting out audit objections.

(v) External audit of VAT records : Under VAT system, trust has been reposed on tax payers as there will be no regular assessment of all VAT returns but only few returns will be scrutinized. In other cases, return filed by dealer will be accepted. Thus, a check on compliance becomes necessary. Chartered Accountants can play a very vital role in ensuring tax compliance by audit of VAT accounts.

VAT laws of some States provide for audit by outside agencies. In Karnataka, audit report is required if turnover exceeds Rs.25 lakhs. Andhra Pradesh VAT Act provides for audit by Chartered Accountant, if audit is ordered by Commissioner. Maharashtra VAT laws provide for audit by Chartered Accountant if turnover exceeds Rs.40 lakhs. Other States may also prescribe external audit, once they see the utility of audit reports furnished by Chartered Accountant in ensuring tax compliance.

12. GOODS AND SERVICE TAX

The ultimate system of indirect taxes in India will be of goods and service tax. Under such a system there will be one central authority administering a uniform goods and service tax. Input tax credit will be available between goods and services throughout the country. However, such a development will require constitutional amendment. Under such a uniform tax system, there will be no trade barriers like octroi and entry tax. There will be a free flow of trade and commerce through out the length and breadth of the country. India will then become a vast common market. The Union Finance Minister in his Budget speech for the year 2006-07 has announced 1st April, 2010 as the target date to introduce goods and service tax.

Self-examination questions

1. Value added tax is levied at:
   (a) first stage of sale
   (b) multistage
   (c) last stage of sale
   (d) none of the above

2. A trader purchases raw material from the local market worth Rs.20,000 and pays VAT @12.50% i.e Rs.2,500/. He also imports the material worth Rs.10,000 on which he pays the duty of Rs.1250. He can avail the input credit of:
   (a) Rs.1250/
   (b) Rs.2500/
   (c) Rs.3750/
   (d) None of the above.
3. Which was the first country to introduce VAT?
   (a) France
   (b) Brazil
   (c) Senegal
   (d) Denmark
4. CENVAT is applicable in respect of:
   (a) excise duties
   (b) custom duties
   (c) service tax
   (d) excise duty and service tax
5. The method for computation of tax in which all the factor payments including profits are aggregated to arrive at the total value addition on which the rate is applied to calculate the tax is:
   (a) Invoice method
   (b) Subtraction method
   (c) Addition method
   (d) Direct subtraction method
6. In India, the State-Level VAT has replaced:
   (a) the excise duty
   (b) the State-sales tax
   (c) the import duty
   (d) none of the above

7. Which variant/variants is/are widely used among the three variants of VAT?
   (a) Consumption variant
   (b) Gross product variant
   (c) Income variant
   (d) Consumption and income variant
8. Which of the following statements are true? Give proper explanation for your answer
   (a) CENVAT is paid on the value of goods purchased in India.
   (b) A trader can take credit of the inputs purchased by him only if he has obtained proper tax invoice from the vendor.
   (c) VAT is inflationary in nature.
   (d) White Paper on State Level VAT provides a framework for drafting various State VAT Legislations.
9. Briefly mention the contents of White Paper on State-Level VAT in India.
10. Explain briefly the concept of central value added tax (CENVAT).
11. What are the three variants of VAT? Explain briefly.
12. Write a note on different methods of computation of VAT .
13. Discuss the merits and demerits of VAT system.
14. Discuss the role of Committee of State Finance Ministers in the implementation of State Level VAT in India.
15. Discuss the role of Chartered Accountants in successful implementation of VAT.

Answers

1. (b); **2.** (b); **3.** (a); **4.** (d); **5.** (c); **6.** (b); **7.** (a); **8.**(b),(d)

CHAPTER 5

INPUT TAX CREDIT AND COMPOSITION SCHEME FOR SMALL DEALERS

UNIT – 1 : INPUT TAX CREDIT

Learning objectives

After reading this unit you will be able to:

- understand what is input tax and output tax.
- identify the purchases in respect of which input tax credit can be availed and in respect of which input tax credit cannot be availed.
- understand the concept of carrying over of tax credit.
- understand the provisions relating to refund of input tax credit.
- comprehend the concept of input tax credit in respect of capital goods.

1.1 CONCEPTS OF INPUT TAX AND OUTPUT TAX

Input tax is the tax paid or payable in the course of business on purchases of any goods made from a registered dealer of the State. Output tax means the tax charged or chargeable under the Act, by a registered dealer for the sale of goods in the course of business.

In simple words input tax is the tax a dealer pays on his local purchases of business inputs, which include the goods that he purchases for resale, raw materials, capital goods as well as other inputs for use directly or indirectly in his business. Output tax is the tax that a dealer charges on his sales that are subject to tax.

1.2 INPUT TAX CREDIT (ITC)

The essence of VAT is in providing set-off for the tax paid earlier, and this is given effect through the concept of input tax credit/rebate. This input tax credit in relation to any period means setting off the amount of input tax by a registered dealer against the amount of his output tax.

It is reiterated that tax paid on the earlier point is called input tax. This amount will be adjusted/rebated against the tax payable by the purchasing dealer on his sales. This credit availability is called input tax credit; it can also be referred to as tax credit on a sale within the State or in the course of inter- State trade or commerce.

1.2.1 Scope of input tax credit

Input tax credit shall be allowed to a registered dealer for purchase of any goods made within the State from a dealer holding a valid certificate of registration under the Act. Further, the input tax credit will be given to both manufacturers and traders for purchase of inputs/supplies meant for both sale within the State as well as to other States, irrespective of when these will be utilized/sold.

Even for stock transfer/consignment transfers/branch transfer of goods out of the State, input tax paid in excess of 4% will be eligible for tax credit. It is also to be noted that in some States partial input tax credit is available in respect of inputs used for manufacture of exempted goods.

1.2.2 Input tax credit available on capital goods

Input tax credit on capital goods will also be available for traders and manufacturers. Tax credit on capital goods may be adjusted over a maximum of 36 equal monthly instalments. The States may at their option reduce this number of instalments. The State of Maharastra has decided to give full input tax credit in the month of purchases only. However, if the capital asset is sold within the period of 36 months proportionate input credit will be withdrawn. There is a negative list for capital goods (on the basis of principles already decided by the Empowered Committee) not eligible for input tax credit.

The concepts relating to input tax credit on capital goods have been discussed in para 5.9 of this chapter.

1.3 VAT LIABILITY

The Value Added Tax (VAT) is based on the value addition to the goods, and the related VAT liability of the dealer is calculated by deducting input tax credit from tax collected on sales during the payment period (say, a month).

If, for example, input worth Rs. 1,00,000/- is purchased and sales are worth Rs. 2,00,000/- in a month, input tax rate and output tax rate are 4% and 12.5% respectively, then input tax credit/set-off and calculation of VAT will be as shown below:

(a) Input purchased within the month : Rs. 1,00,000/-

(b)	Output sold in the month	:	Rs. 2,00,000/-
(c)	Input tax paid	:	Rs. 4,000/-
(d)	Output tax payable	:	Rs. 25,000/-
(e)	VAT payable during the month after set-off/input tax credit [(d) – (c)]	:	Rs. 21,000/-

Subject to the provisions relating to credit for input tax, the net tax payable by a taxable person for a tax period can be calculated on the basis of the following formula:

A - B

where

A = Total of the tax payable in respect of taxable supplies made by the taxable person during the tax period and

B = Total input tax credit allowed to the taxable person for the tax period.

In short, net tax payable is total tax liability minus input tax credit i.e. net tax is the difference between output tax and tax credit.

Following example illustrates how excess VAT credit can be availed:

Tax paid on purchases made in the State within a month (input tax)	Rs.10,000
Tax charged for sales in the State within a month (output tax)	Rs.4,500
CST charged for inter-State sales within a month	Rs.15,000
Input tax credit	Rs.10,000
VAT liability (Rs.4,500 - 10,000)	Nil
Excess credit	Rs.5,500
CST to be paid to Govt.(Rs.15,000 - 5,500)	Rs.9,500

In the present case CST to be paid to Government is Rs.9,500 (CST of Rs.15,000 will be reduced by excess VAT credit of Rs.5,500/-)

1.4 ELIGIBLE PURCHASES FOR AVAILING INPUT TAX CREDIT

For the purpose of claiming input tax credit, the taxable goods should be purchased for any one of the following purposes:

(i) for sale/resale within the State;

(ii) for sale to other parts of India in the course of inter-State trade or commerce;

(iii) to be used as-

(a) containers or packing materials;

(b) raw materials; or

(c) consumable stores,

required for the purpose of manufacture of taxable goods or in the packing of such manufactured goods intended for sale in the State or in the course of inter-State trade or commerce;

(iv) for being used in the execution of a works contract;

(v) to be used as capital goods required for the purpose of manufacture or resale of taxable goods;

(vi) to be used as

(a) raw materials;

(b) capital goods;

(c) consumable stores and

(d) packing materials/containers

for manufacturing/packing goods to be sold in the course of export out of the territory of India;

(vii) for making zero-rated sales other than those referred to in clause (vi) above.

1.4.1 Common goods used for taxable goods and tax-free goods

Provisions have been made in most of the States to provide that the purchases should be used for manufacture etc. of taxable goods. Taxable goods means goods other than the goods which are specified in the Schedule for tax-free goods.

Where the purchased goods are used partially for the purpose specified above, input tax credit shall be allowed proportionate to the extent the purchases are used for the purposes specified above.

1.5 PURCHASES NOT ELIGIBLE FOR INPUT TAX CREDIT

Input tax credit may not be allowed in the following circumstances:

(i) purchases from unregistered dealers;

(ii) purchases from registered dealer who opt for composition scheme[1] under the provisions of the Act;

(iii) purchase of goods as may be notified by the State Government;

(iv) purchase of goods where the purchase invoice is not available with the claimant or there is evidence that the same has not been issued by the selling registered dealer from whom the goods are purported to have been purchased;

(v) purchase of goods where invoice does not show the amount of tax separately;

(vi) purchase of goods, which are being utilized in the manufacture of, exempted goods;

(vii) goods in stock, which have suffered tax under an earlier Act but under VAT Act they are covered under exempted items;

(viii) purchase of goods used for personal use/consumption or provided free of charge as gifts (partial credit is available in the State of Maharashtra);

(ix) goods imported from outside the territory of India (commonly known as high seas purchases);

(x) goods imported from other States viz. inter-State purchases.

1.6 CARRYING OVER OF TAX CREDIT

Input tax credit is first to be utilized for payment of VAT. The excess credit can be then adjusted against the central sales tax (CST) for the said period. After the adjustment of VAT and CST, excess credit, if any, will be carried over to the end of the next year. If there is any excess unadjusted input tax credit at the second year, then the same will be eligible for refund. However, some States have decided to grant refund after the end of the first financial year itself.

[1] The concepts relating to composition scheme have been discussed in Unit – 2 of this Chapter.

Illustration

(a)	Inputs purchased within a month	Rs. 10,00,000
(b)	Outputs sold in the month	Rs. 7,50,000
(c)	Input tax paid @12.50% on (a)	Rs. 1,25,000
(d)	Tax @12.5% on sale of goods of Rs.7,50,000/- during the month	Rs. 93,750
(e)	Net VAT payable during the month (d) - (c)	NIL
(f)	Tax credit to be carried to the next month (c) - (d)	Rs. 31, 250

1.7 REFUND TO EXPORTERS WITHIN THREE MONTHS

The White Paper provides for the grant of refund of input tax paid if the goods are exported out of the country. Under the basic design of the White Paper this refund is to be granted within a period of 3 months from the end of the period in which the transaction for export took place.

1.8 EXEMPTION OR REFUND TO SEZ AND EOU UNITS

Units located in Special Economic Zone (SEZ) and Export Oriented Units (EOU) are granted either exemption from payment of input tax or refund of the input tax paid within three months. State Governments may reduce the time period of 3 months.

1.9 CONCEPT OF INPUT TAX CREDIT ON CAPITAL GOODS

A dealer has to purchase capital goods, which may include plant and machinery, furniture, fixture, electrical installations, vehicles etc. Similarly, a dealer may be creating capital assets himself by purchasing materials for capital assets like, building materials etc. Normally all the above items are taxable and the dealer has to pay sales-tax on purchase of the above goods. Each State-VAT legislations may define 'capital goods' differently.

Normally, under VAT system the dealer should get full credit for tax paid on such purchases, more particularly when the basic principle is to avoid the cascading effect. These assets are used for the business and while fixing sale price of the business products the dealer has to include some portion towards the cost of the acquisition of these assets as part of the sale price. If the input credit is not allowed in full then certainly, to the extent of disallowance, the principle of VAT gets defeated. For example, a dealer has purchased furniture for his business, costing Rs.1,00,000/-. Assuming that the vendor has charged tax to him @ 12.5%, he will incur an additional cost of

Rs.12,500/- by way of VAT. Now, if the credit for VAT paid is allowed, the dealer can consider the cost of acquisition at Rs.1,00,000/-. If the credit of tax paid is not allowed then he has to consider the cost of purchase at Rs.1,12,500/-. While marking up his price on account of establishment cost he has to consider this cost of furniture as one of the components. If cost remains higher, obviously to that extent the mark up will go up. If the cost is lower i.e. after considering input credit of Rs.12,500/- the cost will be lower and to that extent the mark up will also be lower, resulting in an overall lower sale price.

When tax paid on purchases is included in cost, the said tax indirectly gets reflected in the sale price and hence there is also an element of tax upon tax. This cascading effect can very well be imagined from the above example. Depending upon the volume of capital goods and the tax component on the same the magnitude of the cascading effect can be imagined. When the tax is collected on sales, indirectly there is collection of tax on the cost of capital goods also which includes tax paid on purchase of such assets.

1.9.1 Policy in the white paper

The policy lays down that in relation to capital goods set off will be available to traders and manufacturers. The most important factor is that the White Paper recognizes the fact that set off is to be given to both traders and manufacturers. It is well known that under traditional sales-tax system, in some States, partial credit was allowed on capital goods to the manufacturers but no credit was allowed to traders. The White Paper, taking into account the very basis of VAT system, laid down a policy statement that set off will be allowed to both manufacturers and traders.

However as per the White Paper, the State Governments can provide to give set off on a staggering basis, at the most in 36 instalments. This is subject to the policy of individual States. The States, like Maharashtra, have provided set off in one slot and the same is to be claimed immediately on effecting purchase.

1.9.2 Restrictions on credit relating to capital goods

It should be noted that credit on capital goods is not being allowed across the floor. As per the White Paper, there will be a negative list for capital goods which will be based on certain pre-agreed principles by the Empowered Committee. The capital goods mentioned in the negative list would not be eligible for input tax credit. However, it appears that the States have taken their own decisions to provide negative lists or reduction in set off in respect of capital goods.

1.9.3 Procedural requirements for claim of set off

Barring the items covered by the negative list and subject to retention rules, the dealers are entitled to set off on capital goods like any other purchases. Thus, the dealer will have to bifurcate their purchase into capital goods eligible for set off and capital goods not so eligible.

In respect of eligible capital goods the dealer will be required to follow the procedural requirements for claiming set off successfully. For example, dealers will be required to support purchase of capital goods with tax invoice. In the absence of such tax invoice set off will be disallowed.

Once a dealer is entitled to set off he has to further comply with the relevant provisions in respect of allowability. If it is subject to certain installments, the dealer will be required to claim set off accordingly in his returns. If the set off is subject to prior permission, the same should be duly obtained.

The allowable set off on capital goods will be, of course, part of normal set off. The dealer will be able to adjust this set off against his other VAT liability. For example, dealer can adjust his set off as per the following illustration:

	Particulars	*(Rs.)*
(i)	VAT paid on procurement of inputs/supplies worth Rs.1 lakh @ 12.50%	12,500
(ii)	VAT paid on procurement of capital goods of Rs.10 lakhs @ 12.50%	1,25,000
(iii)	VAT credit available in the month	1,37,500
(iv)	VAT on sales of Rs.10,00,000 during the month @ 12.50%	1,25,000
(v)	VAT payable during the month	Nil
(vi)	Carry over of tax credit for set off during the next month	12,500

It may be mentioned here that the set off under VAT Acts are subject to one very important condition. It is generally provided in VAT Acts that the set off on any goods should not exceed the tax received on the same goods in Government Treasury. For example, section 48(5) of the Maharashtra VAT Act provides that a dealer will not be entitled to set off more than the amount received in the Government Treasury. Therefore, if the vendor fails to make the payment of tax to the Government, the purchaser's claim of set off will be denied inspite of the fact that he has paid the tax to his vendor. If at any earlier stage some tax was paid, to that extent, the set off can be claimed.

Therefore, the purchasing dealer, desirous of claiming set off, should also look into the credentials of the vendor so as to be sure that he will get the set off of tax paid to him.

Self-examination questions

1. Input tax is

   (a) the tax charged in the course of business for the sale of any goods made to any dealer of the State.

   (b) the tax paid in the course of business on purchases of any goods made from any dealer of the State.

   (c) the tax paid or payable in the course of business on purchases of any goods made from a registered dealer of the State.

   (d) the tax charged or chargeable in the course of business for the sale of any goods made to a registered dealer of the State.

2. Output tax is

   (a) the tax charged or chargeable by a registered dealer for the sale of goods in the course of business.

   (b) the tax paid or payable by any dealer for the purchase of goods in the course of business.

   (c) the tax charged or chargeable by any dealer for the sale of goods in the course of business.

   (d) None of the above

3. Input tax credit in relation to any period means

   (a) setting off the amount of input tax by a registered dealer against the amount of his output tax.

   (b) setting off the amount of output tax by a registered dealer against the amount of his input tax.

(c) setting off the amount of input tax by any dealer against the amount of his output tax.

(d) All of the above

4. For stock transfer/consignment transfers/branch transfer of goods out of the State, input tax paid in excess of _____ will be eligible for tax credit.

(a) 4%

(b) 10%

(c) 5%

(d) 2%

5. Which of the following purchases is not eligible for input tax credit?

(a) Purchases made for sale to other parts of India in the course of inter-State trade or commerce

(b) Purchases to be used in the packing of manufactured goods intended for sale in the State or in the course of inter-State trade or commerce

(c) Purchases to be used as capital goods required for the purpose of manufacture or resale of taxable goods

(d) Purchases from unregistered dealers

6. Which of the following statement is true?

(a) Set off of input tax credit on capital goods is available to both traders and manufacturers.

(b) Set off of input tax credit on capital goods is available only to manufacturers.

(c) Set off of input tax credit on capital goods is available only to traders.

(d) None of the above.

7. Can input tax credit be carried forward? Discuss.

8. Enumerate the eligible purchases in respect of which input tax credit can be availed.

9. Mention the purchases which are not eligible for input tax credit.

10. How will the input tax credit be availed when common inputs are used for taxable and tax-free good?

11. Explain whether units in SEZ and EOU units are required to pay input tax on purchases made by them?

12. Discuss the procedural requirements to be fulfilled in order to claim input tax credit on capital goods.
13. Discuss the policy contained in the White Paper with regard to availment of input tax credit on capital goods.

Answers

1.(c); **2.**(a); **3.**(b); **4.**(a); **5.**(d); **6.**(a)

UNIT – 2 : COMPOSITION SCHEME FOR SMALL DELAERS

Learning objectives

After reading this unit you will be able to understand the:

- policy laid down in the White Paper in respect of small dealers and composition scheme.
- features of composition scheme.
- eligibility for composition scheme.
- VAT chain under composition scheme.

2.1 PRINCIPLES LAID DOWN IN THE WHITE PAPER

The relevant provisions provided in the White Paper in relation to composition scheme read as under:

"Small dealers with annual gross turnover not exceeding Rs.50 lakhs who are otherwise liable to pay VAT, shall however have the option for a composition scheme with payment of tax at a small percentage of gross turnover. The dealers opting for this composition scheme will not be entitled to input tax credit."

2.2 THRESHOLD EXEMPTION LIMIT

The White Paper, in order to provide relief to the small dealers, specifies that registration for VAT will not be compulsory for dealers below a threshold (Rs.5 lakhs) turnover, and there will be a provision of an optional and simple composite scheme of taxation of a small percentage of gross turnover. However, the Empowered Committee of State Finance Ministers subsequently allowed the States to increase the threshold limit for the small dealers to Rs.10 lakhs with the condition that the concerned State would bear the revenue loss on account of increase in the limit beyond Rs.5 lakhs.

2.3 STATE LAWS TO PROVIDE FOR COMPOSITION SCHEME

The VAT Act is so designed that high value taxpayers should not be spared and the small dealers should be free from hassles of compliance procedures. The States have to

provide composition scheme for small dealers i.e. the dealer whose total turnover exceeds Rs.5 lakhs (now 10 lakhs as per the decision of the Empowered Committee of State Finance Ministers) but does not exceed Rs.50 lakhs. Such a dealer would have an option to pay a composite amount of tax based on its annual gross turnover at the applicable rate subject to such conditions as may be prescribed. However, in such cases a dealer shall not be entitled to input tax credit on inputs and shall not be authorized to issue vatable invoices.

The Empowered Committee has permitted the States to reduce the rate of composition tax to as low as 0.25 %. The composition tax at the rate decided by the State Governments can now be levied on the taxable turnover instead of gross annual turnover.

Besides this, the State Governments may also provide for different types of composition schemes to be notified for different classes of retailers.

2.4 FEATURES OF COMPOSITION SCHEME

The decision to join composition scheme will be an individual decision. This decision will depend on the fact as to how VAT affects the dealer's business. The advantage of this scheme is that it saves a lot of labour and effort in keeping records. It also simplifies calculation of tax liability of a dealer. Such schemes generally have the following features:

(i) a very small tax will be payable;

(ii) there will be a simple return form to cover longer return period.

The major disadvantage of this scheme is the ineligibility of the dealer to avail input tax credit and issue tax invoices in order to pass on tax credit. Hence, the dealers desirous of availing input tax credit on their purchases may not prefer to buy from composition dealers.

2.5 ELIGIBILITY FOR THE COMPOSITION SCHEME

Every registered dealer who is liable to pay tax under the respective State VAT Acts and whose turnover does not exceed Rs.50 lakhs in the last financial year is generally entitled

to avail this scheme. However, the following are not eligible for the composition scheme:

(i) a manufacturer or a dealer who sells goods in the course of inter-state trade or commerce; or

(ii) a dealer who sells goods in the course of import into or export out of the territory of India.

(iii) a dealer transferring goods outside the State otherwise than by way of sale or for execution of works contract.

2.6 EXERCISING OF OPTION

It is generally optional for a dealer to opt for this composition scheme. A dealer who intends to avail such composition scheme shall exercise the option in writing for a year or a part of the year in which he gets himself registered. For this the dealer has to intimate to the Commissioner.

If a dealer avails this scheme, he need not maintain any statutory records as prescribed under the Act. Only the records for purchase, sales, inventory should be maintained. However, if a dealer does not avail the scheme, he has to maintain the prescribed statutory records as per the respective State VAT Acts.

The dealer should not have any stock of goods which were brought from outside the State on the day he exercises his option to pay tax by way of composition and shall not use any goods brought from outside the State after such date. The dealer should also not claim input tax credit on the inventory available on the date on which he opts for composition scheme.

2.7 VAT CHAIN UNDER COMPOSITION SCHEME

2.7.1 Loss to the seller

If the composition scheme is availed by a dealer then such dealer cannot avail input tax credit in respect of input tax paid. Hence the dealer will be loosing the input tax credit on purchases made by him. He will not be able to pass on the benefit of input tax credit,

which will add to the cost of the goods.

2.7.2 Loss to the purchaser

The purchaser shall not get any tax credit for the purchases made by him from the dealer operating under the composition scheme. Therefore, as soon as a dealer opts for the composition scheme, the VAT chain will be broken, and the benefit of tax paid earlier will not be passed on to the subsequent buyers.

Self-examination questions

1. As per the White Paper, which of the following dealer may opt for composition scheme?

   (a) the dealer whose total turnover does not exceed Rs.50 lakhs

   (b) the dealer whose total turnover exceeds Rs.70 lakhs

   (c) the dealer whose total turnover exceeds Rs.60 lakhs

   (d) the dealer whose total turnover exceeds Rs.50 lakhs

2. Which of the following statement is false?

   (a) Under the composition scheme, a dealer cannot avail input tax credit.

   (b) Under the composition scheme, a dealer cannot issue tax invoice.

   (c) Under the composition scheme, a dealer can pass on credit by issuing a supplementary invoice.

   (d) None of the above.

3. Which of the following dealer cannot opt for composition scheme?

   (a) a manufacturer or a dealer who sells goods in the course of inter-state trade or commerce

   (b) a dealer who sells goods in the course of import into or export out of the territory of India

(c) a dealer transferring goods outside the State otherwise than by way of sale or for execution of works contract

(d) All of the above

4. Which of the following statement is true?

(a) The composition scheme is optional.

(b) A dealer availing composition scheme need not maintain any statutory records as prescribed under the State VAT Act.

(c) A dealer availing composition scheme should not have stock of goods brought from outside the State on the day he exercises his option and should not use any goods brought from outside the State after such date.

(d) All of the above

5. What do you understand by a composition scheme under VAT laws?

6. What is the eligible turnover to avail the benefit of this scheme?

7. What are the special features of this scheme?

8. Who is not entitled to the benefits of the composition scheme?

9. How does the composite scheme affect the VAT chain?

Answers

1.(a); **2.** (c); **3.**(d); **4.**(d).

CHAPTER 6

VAT PROCEDURES

Learning objectives

After reading this chapter you will be able to understand:

- the provisions relating to registration under VAT laws.
- what is tax payer identification number (TIN).
- the general provisions relating to VAT invoice.
- the type of records to be maintained under VAT laws.
- the basic provisions relating to filing of returns under VAT laws.
- the general provisions relating to assessment and audit as provided under VAT laws.
- the tax rates as prescribed under VAT laws.

1. REGISTRATION

Registration is the process of obtaining certificate of registration (RC) from the authorities under the VAT Acts. A dealer registered under the VAT Acts is called a registered dealer. Any dealer, who intends to carry on the business of purchase and sale of goods in the State and is liable to pay tax, cannot carry on the business unless he is registered and holds a valid registration certificate under the Act.

1.1 Eligibility for registration

As per the provisions contained in the White Paper, registration of dealers with gross annual turnover above Rs.5 lakh will be compulsory. There will be provision for voluntary registration. All existing dealers will be automatically registered under the VAT Act. A new dealer will be allowed 30 days time from the date of liability to get registered. An application for registration should be made to the VAT Commissioner.

The White Paper specifies that registration under the VAT Act will not be compulsory for the small dealers with gross annual turnover not exceeding Rs.5 lakhs. However, the

Empowered Committee of State Finance Ministers subsequently allowed the States to increase the threshold limit for the small dealers to Rs.10 lakhs with the condition that the concerned State would bear the revenue loss, on account of increase in limit beyond Rs.5 lakhs.

Generally, a dealer means any person, who consequent to, or in connection with, or incidental to, or in the course of his business, buys or sells goods for a consideration or otherwise.

All sales or purchases of goods made within the State except the exempted goods would be subjected to VAT.

1.2 Compulsory registration

If an assessee fails to obtain registration under the VAT Act, he may be registered compulsorily by the Commissioner. The Commissioner may assess the tax due from such person on the basis of evidence available with him. In this event the assessee shall have to forthwith pay such amount of tax. Further, failure to get registered shall result in attracting default penalty and forfeiture of eligibility to set off all input tax credit related to the period prior to the compulsory registration.

1.3 Voluntary registration

A dealer otherwise not eligible for registration may also obtain registration if the Commissioner is satisfied that the business of the applicant requires registration. The Commissioner may also impose any terms or conditions that he thinks fit.

1.4 Cancellation of registration

The registration can be cancelled on:

(i) discontinuance of business; or

(ii) disposal of business; or

(iii) transfer of business to a new location; or

(iv) annual turnover of a manufacturer or a trader dealing in designated goods or services falling below the specified amount.

2. TAX PAYER'S IDENTIFICATION NUMBER (TIN)

TIN (Tax Payer's Identification Number) is a code to identify a tax payer. It is the registration number of the dealer. The taxpayer's identification number will consist of 11

digit numerals throughout the country. First two characters will represent the State code as used by the Union Ministry of Home Affairs. The set-up of the next nine characters will be, however, different in different States. TIN will facilitate computer applications, such as detecting stop filers and delinquent accounts. TIN will help cross-check information on tax payer compliance, for example, the selective cross-checking of sales and purchases among VAT taxpayers.

3. VAT INVOICE

Invoice is a document listing goods sold with price, tax charged and other details as may be prescribed and issued by a dealer authorized under the Act.

The whole structure of the VAT with input tax credit is founded on the documentation of a tax invoice, a cash memo or a bill. The White Paper mainly provides for the following provisions, which are mandatory, and failure to comply with these attracts penalty:

(i) Every registered dealer whose turnover of sales exceeds the specified amount shall issue to the purchaser a serially numbered tax invoice, cash memo or bill with the prescribed particulars.

(ii) The tax invoice shall be dated and signed by the dealer or his regular employee, showing the required particulars.

(iii) The dealer shall keep a counterfoil or duplicate of such tax invoice duly signed and dated.

3.1 Importance of VAT invoice (tax invoice)

Invoices are crucial documents for administering VAT. In the absence of invoices VAT paid by the dealer earlier cannot be claimed as set off. Invoices should be preserved with full care. In case any original invoice is lost or misplaced, a duplicate authenticated copy must be obtained from the issuing dealer.

A VAT invoice:

(i) helps in determining the input tax credit;

(ii) prevents cascading effect of taxes;

(iii) facilitates multi-point taxation on the value addition;

(iv) promotes assurance of invoices;

(v) assists in performing audit and investigation activities effectively;

(vi) checks evasion of tax.

3.2 Contents of VAT invoice

VAT legislations of all States provide for the contents of the tax invoice. By and large there would be no need for a separate tax invoice, a regular invoice can also be termed as tax invoice if it has the prescribed contents. Generally, the various legislations provide that the tax invoice should have the following contents:

(i) the words 'tax invoice' in a prominent place;

(ii) name and address of the selling dealer;

(iii) registration number of the selling dealer;

(iv) name and address of the purchasing dealer;

(v) registration number of the purchasing dealer (may not be required under all VAT legislations);

(vi) pre-printed or self-generated serial number;

(vii) date of issue;

(viii) description, quantity and value of goods sold;

(ix) rate and amount of tax charged in respect of taxable goods;

(x) signature of the selling dealer or his regular employee duly authorized by him for such purpose.

3.3 Other invoices

Normally, a VAT dealer is expected to indicate the rate of tax and the amount of tax charged in the invoice issued. However, in case of small dealers or if the sale is to end consumer, other invoices are permitted without the details of tax. Such invoices should contain the following particulars:

(i) name and address of the selling dealer;

(ii) registration number of the selling dealer;

(iii) name and address of the purchasing dealer;

(iv) registration number of the purchasing dealer;

(v) pre-printed or self generated serial number;

(vi) date of issue;

(vii) description, quantity and value of goods sold;

(viii) signature of dealer or his/her representative.

However, to ensure that the revenue legally due to the States is realized and remitted, it is advisable that the invoice should contain the details of the rate of tax and the tax charged in an explicit manner.

3.4 Format of a tax invoice

No prescribed statutory format is given for tax invoice in the White Paper or for that matter in any State VAT Act. Only the contents of the tax invoice have been prescribed. However, a standard format of the same may look like the one given below:

TAX INVOICE

ORIGINAL – BUYER'S COPY

Seller's Name ……
Address ……..
……..

Tax Invoice No. ……
Date:

Challan No. and date

Phone No.
VAT Registration No.
CST Registration No.

Buyer's Name & Address …….
Buyer's VAT Registration No., if any …….

S No.	Quantity	Description of Goods	Price per unit	Value (Rs.)	VAT Rate	Tax Amt.	Total (Rs)	

TOTAL _____

Rupees in figures

E & O.E

Signature
(of selling dealer or his authorized employee)

3.5 Composition scheme

The provisions relating to tax invoice do not apply to a selling dealer who has opted to avail the composition scheme under the respective State VAT laws. Thus, a composition scheme dealer cannot issue a 'tax invoice'.

4. RECORDS

The following records should be maintained under VAT system:

(i) Purchase records

(ii) sales records

(iii) VAT account

(iv) separate record of any exempt sale

Further, the following records should also be kept and produced to an officer:

(i) copies of all invoices issued, in serial number;

(ii) copies of all credit and debit notes issued, in chronological order;

(iii) all purchase invoices, copies of customs entries, receipts for payment of customs duty or tax, and credit and debit notes received to be filed chronologically either by date of receipt or under each supplier's name;

(iv) details of the amount of tax charged on each sale or purchase;

(v) total of the output tax and the input tax in each period and a net total of the tax payable or the excess carried forward, as the case may be, at the end of each month;

(vi) details of goods manufactured and delivered from the factory of the taxable person;

(vii) details of each supply of goods from the business premises, unless such details are available at the time of supply in invoices issued at, or before, that time;

Failure to keep these records may attract penalty. All such records should be preserved for the period specified in respective State provisions.

4.1 No declaration forms

Most of the declaration forms that existed before the introduction of VAT have been dispensed with. Use of declaration forms is expected to be stopped completely. Lot of time and energy is wasted by the dealer in getting declaration forms from the department.

There is no provision for concessional sale under the VAT Acts since the provision for set off makes the input zero-rated. Hence, there will be no need for declaration form.

5. RETURNS

Under VAT laws there are simple forms of returns. Returns are to be filed monthly/ quarterly/annually as per the provisions of the State Acts/Rules. Returns will be accompanied with the payment challans. Some States have devised return cum challans. In these cases the returns along with the payment can be filed with the treasury.

A registered dealer may be required to file a monthly/quarterly/annual return along with the requisite details such as output tax liability, value of input tax credit, payment of VAT etc. Opportunity may be provided to lodge revised returns.

Every return furnished shall be scrutinized expeditiously within the prescribed time limit from the date of filing the return. If any technical mistake is detected on scrutinizing, the dealer shall be required to pay the deficit appropriately.

Return filing procedures under VAT laws are designed with the objective of:

(i) reducing the compliance costs incurred by the businesses in completing and filing their returns; and

(ii) encouraging businesses to comply with their obligations to file returns and pay VAT through the application of penalties in case of late payment of VAT and late filling of returns; and

(iii) ensuring the efficient processing of the data included in the returns.

6. ASSESSMENT

The basic simplification of VAT is with reference to assessment. Under VAT system, there is no compulsory assessment at the end of each year. The VAT liability is self-assessed by the dealer himself in terms of submission of returns upon setting off the tax credit, return forms etc. The other procedures are also simple in all the States.

Deemed assessment concept is a major feature of the VAT. If no specific notice is issued proposing departmental audit of the books of account of the dealer within the time limit specified in the Act, the dealer will be deemed to have been self-assessed on the basis of the returns submitted by him.

VAT pre-supposes that all the dealers are honest. Scrutiny may be done in cases where a doubt arises of under-reporting of transaction or evasion of tax. Honest dealers will be protected and fictitious or dishonest would be penalized heavily.

6.1 System of cross checking

In the VAT system more emphasis has been laid on self-assessment. Hence, a system of cross-checking is essential. Dealers may be asked to submit the list of sales or purchases above a certain monetary value or to give the dealer-wise list from whom or to whom the goods have been purchased/sold for values exceeding a prescribed monetary ceiling.

A cross-checking computerized system is being worked out on the basis of coordination between the tax authorities of the State Governments and the authorities of Central Excise and Income-tax to compare constantly the tax returns and set-off documents of VAT system of the States and those of Central Excise and Income-tax. This comprehensive cross-checking system will help reduce tax evasion and also lead to significant growth of tax revenue. At the same time, by protecting the interests of tax-complying dealers against the unfair practices of tax-evaders, the system will also bring in more equal competition in the sphere of trade and industry.

7. AUDIT

In the VAT system considerable weightage is placed on audit work in place of routine assessment work.

Correctness of self-assessment will be checked through a system of Departmental Audit. A certain percentage of the dealers will be taken up for audit every year on a scientific basis. If, however, evasion is detected in the course of audit, the previous records of the concerned dealer may be taken up for audit.

Authorized officers of the department will visit the business place of the dealer to conduct the audit. The auditors will examine the correctness of the returns *vis-a-vis* the books of account of the dealer or any other information available with them. They will be equipped with the information gathered from various agencies such as suppliers, income tax department, excise and customs department, banks etc. Officers of the higher rank will supervise to ensure that the audit work is done in a free, fearless and impartial manner.

7.1 Accounts to be audited in certain cases

Under the sales-tax laws, tax evasion is considered to be on a large scale. The sales-tax departments of various States have not been able to effectively check the menace of tax avoidance and tax evasion. Therefore, apart from the departmental audit many States have also incorporated the concept of audit of accounts by chartered accountants. The State of Maharashtra has prescribed an elaborate list of particulars to be furnished by the dealers. These particulars have to be verified by the VAT auditor.

However, auditing for all types of dealers may not be necessary. The selection of cases for auditing has to be made in accordance with the criteria of the size of dealers. In such a case, the returns supported by the audited statement can be accepted summarily. However, it might indeed be useful to cull out a fixed proportion of large and medium sized dealers for regular assessments on a regular basis. In Maharashtra and Rajasthan, the dealer whose turnover exceeds Rs.40 lakhs in any year is required to get his accounts audited in respect of such year.

8. PENAL PROVISIONS

Since VAT is purely a State subject, States will have incorporated penal provisions as per their requirements. However, these are in general more stringent than those in the earlier sales tax laws. Since, the State taxation laws have allowed certain additional benefits in the form of input tax credit, which was not available earlier, they have introduced more stringent penal provisions to discourage evasion of taxes.

9. TAX RATES UNDER VAT

Under the VAT system, there are only two basic VAT rates of 4% and 12.5% plus a specific category of tax-exempted goods and a special VAT rate of 1 % for gold and silver ornaments, etc. Thus the multiplicity of rates in the sales-tax system has been done away with under the VAT system.

9.1 Exempted category

Under exempted category, there are about 50 commodities comprising of natural and unprocessed products in unorganised sector, items which are legally barred from taxation and items which have social implications. Included in this exempted category is a set of maximum of 10 commodities flexibly chosen by individual States from a list of goods (finalised by the Empowered Committee) which are of local social importance for the

individual States without having any inter-State implication. The rest of the commodities in the list will be common for all the States.

9.2 4% VAT category

Under 4% VAT rate category, there are largest number of goods, common for all the States, comprising of items of basic necessities such as medicines and drugs, all agricultural and industrial inputs, capital goods and declared goods. The schedule of commodities are attached to the VAT Acts of the States.

9.3 12.5% category

The remaining commodities, common for all the States, fall under the general VAT rate of 12.5%.

9.4 1% Category

The special rate of 1% is meant for precious stones, bullion, gold and silver ornaments etc.

9.5 Non-VAT goods

Petrol, diesel, ATF, other motor spirit, liquor and lottery tickets are kept outside VAT. The States may or may not bring these commodities under VAT laws. However, it is agreed that all these commodities will be subjected to 20% floor rate of tax.

10. MISCELLANEOUS

10.1 Coverage of goods under VAT

In general, all the goods, including declared goods are covered under VAT and get the benefit of input tax credit.

The few goods which are outside VAT are liquor, lottery tickets, petrol, diesel, aviation turbine fuel and other motor spirit since their prices are not fully market determined. These will continue to be taxed under the Sales-tax Act or any other State Act or even by making special provisions in the VAT Act itself at uniform floor rates decided by the Empowered Committee.

10.2 Stock transfer

Inter-State transfers do not involve sale and, therefore they are not subjected to sales-tax. The same position continues under VAT.

However, the tax paid on:

(i) inputs used in the manufacture of finished goods which are stock transferred; or

(ii) purchases of goods which are stock transferred

will be available as input tax credit after retention of 4% of such tax by the State Governments.

10.3 Compensation for losses

Although the introduction of VAT may, after a few years, lead to revenue growth, there may be a loss of revenue in some States in the initial years of transition. Some of the State Governments were resistant to introduce VAT account of this reason. The Government of India therefore agreed to compensate for 100 per cent of the loss in the first year, 75 per cent of the loss in the second year and 50 per cent of the loss in the third year of introduction of VAT. The loss would be computed on the basis of an agreed formula. This position was not only reaffirmed by the Union Finance Minister in his Budget Speech of 2004-05, but a concrete formula for this compensation has also been worked out after interaction between the Union Finance Minister and the Empowered Committee. However, in the first year of introduction, only a few States have claimed such compensation.

10.4 Imports into the VAT chain

Presently States do not have powers to levy a tax on imports. It is also essential to bring imports into the VAT chain. This will need a constitutional amendment. Because of the availability of set-off, not only cascading effect would be reduced but tax compliance would also improve. The Empowered Committee is discussing this issue with the Government of India.

Self-examination questions

1. Who should obtain registration under VAT laws?

   (a) Any person who desires to provide taxable services.

(b) Any dealer, who intends to carry on the business of purchase and sale of goods in the State and is liable to pay tax.

(c) Any dealer, who intends to carry on the business of purchase and sale of goods in the State.

(d) None of the above

2. The registration can be cancelled on:

(a) discontinuance of business

(b) disposal of business

(c) transfer of business to a new location

(d) All of the above

3. The taxpayer's identification number will consist of _____ digit numerals throughout the country.

(a) 10

(b) 12

(c) 11

(d) 9

4. The tax invoice shall be dated and signed:

(a) only by the dealer

(b) only by his regular employee

(c) by the dealer or his regular employee

(d) None of the above

5. Under VAT system:

(a) there will be compulsory assessment at the end of each year

(b) the VAT liability will be self-assessed by the dealer himself.

(c) either compulsory assessment or self-assessment will be made

(d) None of the above

6. The basic tax rates prescribed under VAT laws are:

(a) 4%, 12.5% and 1%

(b) 4% and 12.5%

(c) 2%, 4% and 10%

(d) 3%, 4% and 8%

7. Which of the following records should be maintained under VAT laws?

(a) Purchase records

(b) Sales records

(c) VAT account

(d) All of the above

8. What is the eligible limit of turnover for registration under VAT laws?

9. When can the registration be cancelled?

10. Differentiate between voluntary and compulsory registration.

11. Write a brief note on tax payer's identification number.

12. List the records to be maintained under VAT system.

13. Does VAT system require declaration forms? Discuss.

14. What are the provisions in respect of returns under VAT Acts?

15. Does VAT system recognize self-assessment? Discuss.

16. What are the various types of audits prescribed under VAT provisions?

17. Briefly explain the system of cross checking under VAT laws.

18. Explain the provisions in respect of tax invoice.

19. Enlist the various contents of the tax invoice.

20. Discuss the importance of a tax invoice.

Answers

1.(b); **2.**(d); **3.**(c); **4.**(c); **5.**(b); **6.**(a); **7.**(d)