

PAPER – 7 : DIRECT TAXES

QUESTIONS

1. XYZ co-operative society is engaged in the manufacture and sale of sugar. The tripartite agreement between the society, the Maharashtra State Government and the harvesting and transport contractors provided for payment of a mutually agreed rate and commission by the society to the harvesting and transport contractors for transporting the harvested sugarcane to the factory. The Assessing Officer disallowed the following expenditure –
 - (a) Interest paid by the society on borrowed funds on the ground that the society had borrowed such funds at a higher rate of interest and diverted a portion of the same to the harvesting and transport contractors at a lower rate of interest.
 - (b) Bakshish paid by the society to the skilled labourers employed by the contractors.Is the Assessing Officer correct in disallowing the above expenditure? Discuss with the aid of a recent case law.
2. What is the tax benefit available to an assessee engaged in the business of hotel or business of building, owning and operating a convention centre in the Northern Capital Region and what are the conditions to be fulfilled for availing such tax benefit?
3. MNO Ltd. is engaged in trading rubber footwear of all types. During the A.Y.2008-09, it started the business of manufacture and sale of hawai chappals. MNO Ltd. claimed the expenses incurred on the new unit prior to commencement of the manufacturing process as deduction. The Assessing Officer contended that such expenses incurred prior to commencement of manufacture had to be capitalised and hence, disallowed the expenses. Discuss the correctness of contention of the Assessing Officer.
4. Mr.Rajesh received additional compensation of Rs.5 lakh on compulsory acquisition of his property comprising land and building, which were subject to land acquisition proceedings under the West Bengal Land (Requisition and Acquisition) Act. The said compensation was received by him on 22.3.08. The amount was received pending appeal, that too, on the basis of the conditional interim order passed by the Calcutta High Court. Is the additional compensation received taxable in the year of receipt?
5. ABC Co-operative Bank amalgamated with PQR Co-operative Bank on 1.11.2007. The depreciation for the year ended 31.3.2008 calculated as per Income-tax Rules allowable to ABC Co-operative Bank, if the amalgamation had not taken place, amounts to Rs.12,00,000. Compute the deduction on account of depreciation allowable in the hands of ABC Co-operative Bank and PQR Co-operative Bank for A.Y.2008-09. Explain the method of computing such deduction and the conditions to be fulfilled to avail such deduction.
6. Gamma Ltd. was incorporated on 1.1.2007 for manufacture of tyres and tubes for motor vehicles. The manufacturing unit was set up on 1.5.2007. The company commenced its manufacturing operations on 1.6.2007. 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 2008-09.
7. Mr.A, a non-resident, filed his original return of income for A.Y.2005-06 on 30.10.2005 and for A.Y.2006-07 on 31.10.2006. He filed a revised return for these two assessment years on 30.3.2007 claiming exemption in respect of income relating to purchase of gold ornaments for export by virtue of Explanation 1(b) to section 9(1)(i). Prior to filing such revised returns, Mr.A filed an application on 26.3.2007 before the Authority for Advance Rulings (AAR) on certain questions relating to the exemption claimed. The Department objected that the application was not maintainable on the ground that the point raised in the application was pending before the

income-tax authorities on the date when the application was filed. Discuss the correctness of the contention of the Department.

8. Alpha Ltd. entered into a lease agreement, as per which it took on lease the premises of Beta Ltd. at a monthly rent. The lease agreement provided for the payment of security deposit which was to be reduced by the amount of rent which became payable every six months in accordance with the agreement. The Assessing Officer observed that the amount of security deposit was nothing but advance rent and hence, as per the provisions of section 194-I, Alpha Ltd. should have deducted tax at source therefrom. Thereafter, the Assessing Officer raised a demand of tax under section 201(1A) on Alpha Ltd. Is the action of the Assessing Officer justified? Give reasons for your answer with the aid of a recent case law.
9. The Finance Act, 2007 has increased the rate of tax deduction at source in respect of some payments and the scope of its coverage in respect of certain other payments – Discuss the correctness or otherwise of this statement.
10. 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 31.3.2008:
 - (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 31.3.2008 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 2008-09.
11. The rights of secured creditors and workers' dues have preference over income-tax liabilities in case of a company-in-liquidation. Is this statement correct? Elucidate with the help of a case law.
12. Discuss the following with reference to the provisions of the Income-tax Act, 1961, as amended by the Finance Act, 2007 –
 - (a) Exclusive jurisdiction of the Settlement Commission;
 - (b) Abatement of proceeding before the Settlement Commission;
 - (c) Bar on subsequent application for settlement.
13. Can selling of own land (which was received as a gift), after plotting it out in order to secure a better price, be considered as an adventure in the nature of trade or business? Can an isolated transaction of selling a land be treated as business or is it necessary that there must be regular activities of purchase and sale for treating the activities as business? Answer these questions taking the support of a recent High Court ruling.
14. M/s. XYZ, a firm, consisting of three partners namely, X, Y and Z, carried on the business of purchase and sale of television sets in wholesale and manufacture and sale of pens under a deed of partnership executed on 1.4.2003. X, Y and Z were partners in their individual capacity. The deed of partnership provided for payment of salary amounting to Rs.1,40,000 each to X and Z, who were the working partners. A new deed of partnership was executed on 1.10.2007 which, apart from providing for payment of salary to the two working partners as mentioned in the deed of partnership executed on 1.4.2003, for the first time provided for payment of simple interest @ 11% per annum on the balances standing to the credit of the capital accounts of partners from 1.4.2007. The firm was dissolved on 31.3.2008 and the capital assets of the firm were distributed among the partners on 15.4.2008. The net profit of the firm for the year ending 31.3.2008 after payment of salary to the working partners and debit/credit of the following items to the Profit and Loss Account was Rs.85,000:

- (i) Interest amounting to Rs.1,25,000 paid to the partners on the balances standing to the credit of their capital accounts from 1.4.2007 to 31.3.2008.
- (ii) Interest amounting to Rs.75,000 paid to the partners on the balances standing to the credit of their current accounts from 1.4.2007 to 31.3.2008.
- (iii) Interest amounting to Rs.35,000 paid to the Hindu undivided family of partner X @ 15% per annum.
- (iv) Payment of Rs.32,000 towards purchase of television sets made by crossed cheque on 1.5.2007.
- (v) Rs.12,000 being the value of silver plate received as gift from a manufacturer for achieving sales target.
- (vi) Depreciation amounting to Rs.22,000 on motor car bought and used exclusively for business purposes, but not registered in the name of the firm.
- (vii) Depreciation under section 32(1)(ii) amounting to Rs.60,000 on new machinery bought and installed for manufacture of pens on 1.12.2007 at a cost of Rs.8,00,000. There was no increase in the installed capacity as a result of the installation of the new machinery.
- (viii) Interest amounting to Rs.18,000 received from bank on fixed deposits made out of surplus funds.

The firm furnishes the following information relating to it:

- (a) Closing stock-in-trade was valued at Rs.55,000 as per the method of lower of cost or market rate consistently followed by it. The market value of the closing stock-in-trade was Rs.60,000.
- (b) Brought forward business loss relating to the assessment year 2007-08 was Rs.72,000.
- (c) The fair market value of the capital assets as on 31.3.2008 was Rs.23,00,000 and the cost of their acquisition was Rs.18,00,000.

Compute the total income of M/s. XYZ for the assessment year 2008-09.

You are required to furnish explanations for the treatment of the various items given above.

15. What are the penal provisions under the Income-tax Act, 1961, in case undisclosed income is detected during the course of search initiated on or after 1.6.2007?
16. Can the assessee be absolved of the penal consequences under section 271(1)(c) if he voluntarily files a revised return (before the order of assessment is made) after discovering an omission or wrong statement in the original return?
17. "The Finance Act, 2007 has extended the fringe benefit tax liability to stock options also" – Elucidate this statement. Can the employer recover the fringe benefit tax paid in respect of stock options from the employees?
18. In the original assessment order dated 20.3.2004, the assessee's claim relating to Lease Equalisation Fund was accepted. However, the same was not the subject matter of reassessment, which was initiated on 28.3.2005 in respect of other items. Thereafter, the Commissioner initiated revision proceedings on 27.2.2007 only in relation to the item "Lease Equalisation Fund". Does the period of limitation for revision proceedings by the Commissioner begin from the date of original assessment or from the date of reassessment, in a case where the revision proceedings are related to an item which was not the subject matter of reassessment?
19. What are the circumstances under which an assessee will be deemed to have concealed the particulars of his net wealth or furnished inaccurate particulars thereof?
20. Mr.Mehta furnishes the following particulars of his assets and liabilities as on 31.3.2008:

Assets:	Rs. in lakhs
Residential house at Calcutta	42
Residential house at Pune	17

Plot of land comprising an area of 300 square meters at Calcutta	82
House at Chennai exclusively used for carrying on his business	25
Commercial complex at Baroda	15
Residential house at Bangalore let out for 301 days during the previous year	12
Motor cars used in business of running them on hire	15
Shares in private limited companies	22
Cash in hand	2
Gold jewellery	10
Liabilities:	
Loan borrowed for purchase of land at Calcutta	20
Loan borrowed for purchase of shares in private limited companies	15
Loan borrowed for purchase of gold jewellery	7

Amounts stated against assets, except cash in hand, are the values determined as per section 7 of the Wealth-tax Act, 1957 read with Schedule III thereto.

Compute the net wealth of Mehta for the assessment year 2008-09.

State the reasons for inclusion or exclusion of the various items.

SUGGESTED ANSWERS/HINTS

1. This issue came up before the Bombay High Court in CIT v. Samarth Sahakari Sakhar Karkhana Ltd. (2007) 294 ITR 540 (Bom.)

The High Court observed that –

- (a) timely supply of harvested sugarcane by the harvesting and transport contractors is very critical for the assessee during the crushing season. Therefore, it was in the business interest of the assessee to give some amount in advance to meet the requirements of the contractors. Such advances were interest-bearing and were given to guarantee that the contractors supplied harvested sugarcane on time. Thus, interest paid on funds borrowed by the assessee cannot be disallowed since such funds were advanced to the contractors in the business interests of the assessee.
- (b) the practice of giving bakshish to the workers employed by the harvesting and transport contractors has been prevailing in the State of Maharashtra for decades. Such expenditure had been consistently allowed in the past in the case of the assessee and also many other sugar factories. Since only the skilled labourers could do the job of harvesting and transporting the sugarcane, bakshish to the tune of Rs.200 to Rs.250 was given to induce them to continue the work during the summer months as well. Such payment is, therefore, deductible.

Therefore, the Assessing Officer is not correct in disallowing the above expenditure.

2. (i) New section 80-ID has been inserted to provide 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) "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.
 - (v) "Hotel" means a hotel of two-star, three-star or four-star category as classified by the Central Government;
 - (vi) 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.
 - (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) 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) The deduction under this section should not exceed the profits of such eligible business of the undertaking.
 - (x) 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.
3. The facts of this case are similar to the case of CIT v. Relaxo Footwears Ltd. (2007) 293 ITR 231, where the Delhi High Court held that the new unit was a part of the existing business and there was unity of control and interlacing of the units. Therefore, the expenditure incurred by the assessee to set up the new unit which was a part of the existing business was allowable as a revenue expenditure.
- Therefore, the contention of the Assessing Officer, in this case, is not correct. MNO Ltd. can claim such expenses as deduction.
4. This issue was addressed by the Madras High Court, in Anil Kumar Forma (HUF) v. CIT (2007) 163 Taxman 182. The High Court applied the ratio of the decision in CIT v. Smt. T.Girija Ammal (2006) 282 ITR 614, and held that the right of the assessee on the amount received by them as enhanced compensation was only an inchoate right during the pendency of appeals before the Calcutta High Court and the amounts could be assessed only when the appeals were finally determined by the Calcutta High Court. Therefore, it cannot be said that the right over the amounts had accrued to the assessee on the date of receipt. The High Court held that the amounts were received pending appeals and therefore, the amounts received as per interim conditional orders of the Court were not liable to tax.
- Therefore, the additional compensation of Rs.5 lakh received by Mr. Rajesh on compulsory acquisition of his property is not taxable in the year of receipt (i.e. P.Y.2007-08) since it was received pending an appeal.
5. (i) Section 44DB provides the manner in which the deduction, inter alia, under section 32 is to be allowed in a case where business reorganisation of a co-operative bank has taken place during the financial year.

- (ii) Business reorganisation means the reorganisation of business involving the amalgamation or demerger of a co-operative bank.
- (iii) The amount of deduction allowable to the amalgamating co-operative bank (i.e. ABC 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. ABC Co-operative bank, in this case) if the business reorganisation had not taken place. In this case, the amount of deduction is Rs.12 lakh.

B = the number of days comprised in the period beginning with the 1st day of the financial year (i.e. 1.4.2007, in this case) and ending on the day immediately preceding the date of business reorganization (i.e. 31.10.2007, in this case); and

C = the total number of days in the financial year in which the business reorganisation has taken place (i.e. 366 days).

- (iv) The amount of deduction allowable to the amalgamated co-operative bank (i.e. PQR 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. ABC Co-operative bank, in this case) if the business reorganisation had not taken place. In this case, the amount of deduction is Rs.12 lakh.

B = the number of days comprised in the period beginning with the date of business reorganisation (i.e. 1.11.2007, in this case) and ending on the last day of the financial year (i.e. 31.3.2008); and

C = the total number of days in the financial year in which the business reorganisation has taken place (i.e. 366 days).

- (v) In this case, the deduction allowable under section 32 to ABC co-operative bank is Rs.12,00,000 and the business re-organisation took place on 1.11.07. Therefore, the deduction allowable to ABC co-operative bank under section 32 would be Rs.7,01,639 i.e. Rs.12,00,000 x 214/366. The deduction allowable to PQR co-operative bank would be Rs.4,98,361 i.e. Rs.12,00,000 x 152/366.
- (vi) It must be noted that for the purpose of availing benefit under this section, the amalgamation should fulfill the following conditions –
- (1) all the assets and liabilities of ABC co-operative bank immediately before the merger (other than the assets transferred, by sale or distribution on winding up, to PQR co-operative bank) should become the assets and liabilities of PQR co-operative bank;
 - (2) the members holding 75% or more voting rights in ABC co-operative bank should become members of PQR co-operative bank; and
 - (3) the shareholders holding 75% or more in value of the shares in ABC co-operative bank (other than the shares held by PQR co-operative bank or its nominee or its subsidiary, immediately before the merger) should become shareholders of PQR co-operative bank.

6. Computation of depreciation allowable for the A.Y. 2008-09 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)	<u>15.00</u>	
	<u>105.00</u>	
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)	<u>15.00</u>	<u>35.00</u>
		85.00
Additional Depreciation at 20%		<u>17.00</u>
Depreciation allowable for A.Y.2008-09		<u>32.75</u>

Notes:

- 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.
- As per section 32(1)(ia), 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, –

- any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person;
- 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 -

- Second hand plant and machinery;
 - 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).
7. The facts of the case are similar to the case of *Mustaq Ahmed In Re.* (2007) 293 ITR 530, where the Authority for Advance Rulings (AAR) rejected the claim of the Department holding that the point relating to the exemption was not raised at the time of filing of the original return of income for both the assessment years. Further, the application for advance ruling had been filed before the date of filing the revised return in which the claim for exemption was made for the first time. Therefore, on the date of filing of application before the AAR, the question raised in the application was not pending before any income-tax authority and hence, the restriction contained in the proviso to section 245R(2) was not attracted.

Hence, in this case, the contention of the Department is not correct. The application made by Mr.A for advance ruling is, therefore, maintainable.

8. This issue was taken up by the Delhi High Court in CIT v. Reebok India Co. (2007) 163 Taxman 61. The High Court observed that as per the lease agreement, the sum paid by the assessee to the lessor was in the nature of advance rent and not security deposit since such "security deposit" was to be reduced by the amount of rent which became payable every six months. This means that the amount was adjustable against rental payment and the same was so adjusted. The Court observed that had the amount been a security deposit, it would have been in the nature of a refundable amount at the time of termination of lease. Further, there would have been no reduction in the security amount after every six months. Therefore, the payment was in the nature of advance rent and tax was deductible at source under section 194-I.

Therefore, the action of the Assessing Officer, in this case, is justified.

9. This statement is correct. The Finance Act, 2007 has increased the rate of tax deduction at source in respect of some payments and the scope of coverage in respect of certain other payments. The scope of coverage under sections 193 and 194C has been increased. The rates of TDS has been increased in respect of commission and brokerage payments under section 194H and fees for professional and technical services under section 194J.

Section	Nature of payment	Existing provision	Amendment by the Finance Act, 2007
193 Clause (iv) of the proviso	Interest on Government securities	Interest payable on these bonds is taxable under the Income-tax Act. However, TDS provisions are not attracted in respect of interest payable on any security of the Central Government or State Government.	Tax has to be deducted at source in respect of 8% Savings (Taxable) Bonds, 2003, if interest payable exceeds Rs.10,000 during the financial year.
194C(1)	Payment to contractors	TDS provisions are not attracted in respect of payments made by an individual or a HUF to a contractor.	Scope of TDS provisions expanded w.e.f. 1.6.2007 to cover contract payments by specified individuals/HUFs also. Payments made by Individuals/ HUFs to a contractor to attract TDS if their total sales/turnover exceeds Rs.40 lakhs (in case of business) and gross receipts exceed Rs.10 lakhs (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.
194H	Commission or brokerage	Tax to be deducted at source in respect of payment of commission or brokerage at 5%.	(i) The rate of TDS on commission and brokerage has been increased from 5% to 10% w.e.f. 1.6.2007. (ii) However, 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.

194J	Fees for professional or technical services	Tax has to be deducted at source @5% in respect of payment of fees for professional services or fees for technical services to a resident.	This rate has been increased to 10% w.e.f. 1.6.2007.
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10. Section 44BBA incorporates special provisions for computing profits and gains of the business of operation of aircraft in the case of non-residents. Section 44BBA starts with a non-obstante clause. Therefore, section 44BBA overrides the provisions contained in sections 28 to 43A. As such, the business income of Mr. Tiwari is required to be computed in accordance with the provisions of 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 -

- 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
- 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.

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
	<u>8,00,00,000</u>

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.2008-09.

11. This statement is correct. The Gujarat High Court, in Asst. CIT v. O.L. of Minal Oil & Industries Ltd. (2007) 163 Taxman 1, made the following observations -
- The proviso to section 178(3) provides that the liquidator of the company is not debarred from making any payment to secured creditors whose debts are entitled under law to priority of payment over debts due to the Government on the date of liquidation.
 - Section 529A of the Companies Act, 1956 provides that workmen's dues and debts due to secured creditors as envisaged in section 529(1) have priority over all other debts. This is notwithstanding anything contained in any other provision of this Act or any other law for the time being in force.
 - Section 530(1)(a) of the Companies Act, 1956 which provides for preferential payment of Government dues is subject to the provisions of section 529A.

Therefore, considering the proviso to section 178(3) of the Income-tax Act read with sections 529A and 530(1)(a) of the Companies Act, the workers' dues and debts due to secured creditors envisaged under section 529(1) would have preference/priority over the dues of the Income-tax Department.

12. (a) Exclusive jurisdiction of the Settlement Commission [Section 245F]

- (i) Under section 245F, the Settlement Commission has exclusive jurisdiction over the case during the period between the admission of the application and its final disposal by passing an order under section 245D(4).
- (ii) In respect of an application made under section 245C on or after 1.6.2007, such exclusive jurisdiction would begin with the date of filing of application with the Settlement Commission.
- (iii) The exclusive jurisdiction of the Settlement Commission would end on –
 - (a) the date of passing an order under section 245D(4); or
 - (b) the date of passing the order rejecting the application (made on or after 1.6.2007) under section 245D(1); or
 - (c) the date on which the application is not allowed to be proceeded with under section 245D(2A); or
 - (d) the date on which the application is declared invalid under section 245D(2C); or
 - (e) the date on which the application is not allowed to be further proceeded with under section 245D(2D).

(b) Abatement of proceeding before the Settlement Commission [Sections 245HA & 245HAA]

- (i) In the following cases, the proceedings before the Settlement Commission shall abate on the specified date as given below –

	Case	Specified date
(1)	where an application made to the Settlement Commission on or after 1.6.2007 has been rejected under section 245D(1).	The date on which the application was rejected.
(2)	where any application is not allowed to be proceeded with under section 245D(2A) or further proceeded with under section 245D(2D).	31.7.2007
(3)	where an application has been declared invalid under section 245D(2C).	The last day of the month in which the application was declared invalid.
(4)	Where an order under section 245D(4) has not been passed within the time allowed under section 245D(4A).	The date on which the time or period specified in section 245D(4A) expires.

- (ii) On abatement of proceedings, the case would revert back to the Assessing Officer having jurisdiction or any other income-tax authority before whom the proceedings were pending at the time of making the application. Such income-tax authority shall dispose of the case in accordance with the provisions of the Act.
- (iii) For completing the proceedings, the Assessing Officer or other Income-tax authority shall be entitled to use the material and information produced by the assessee before the Settlement Commission as if such material and information had been produced before the Assessing Officer or other income-tax authority. Similarly, the Assessing Officer or other Income-tax authority shall be entitled to use the results of the inquiry held or evidence recorded by the Settlement Commission in the course of the proceedings before it, as if such inquiry or evidence had been held or recorded by him in the course of the proceedings before him.

- (iv) The period from the date on which the application was made before the Commission up to the date on which proceedings get abated shall be excluded from the time limit for completion of proceedings by the Assessing Officer and for payment of interest under section 243, 244 or 244A.
- (v) In case of abatement of settlement proceedings, the Assessing Officer is required to give credit for the tax and interest paid on or before the date of making the application or during the pendency of the case before the Settlement Commission. This has been provided by insertion of section 245HAA.
- (c) Bar on subsequent application for settlement [Section 245K]
- (i) In the event of occurrence of any of the following, the person concerned shall not be entitled to apply for settlement in relation to any other matter –
- (1) the order of settlement passed under section 245D(4) provides for imposition of penalty for concealment of income; or
 - (2) after the passing of order under section 245D(4) in relation to a case, the person is convicted of an offence under Chapter XXII in relation to that case; or
 - (3) the case of such person was sent back to the Assessing Officer by the Settlement Commission on or before 1.6.2002.
- (ii) Further, with effect from 1.6.2007, the option of going to the Settlement Commission would be available only once in the lifetime of a person. Therefore, where an application for settlement is made on or after 1.6.2007 and such application has been allowed to be proceeded with, then such person will not be subsequently entitled to make any application under section 245C.
13. These questions were answered by the High Court of Madhya Pradesh in CIT v. Suresh Chand Goyal (2007) 163 Taxman 54. The High Court held that selling of own land, after plotting it out to secure a better price, cannot be considered as an adventure in the nature of trade. Therefore, it cannot be treated as a business activity. An isolated transaction or activity cannot be a part of a business. There must be regular activities of purchasing and selling to constitute a business. In this case, there was nothing on record to show that the land was purchased for the purpose of selling. The land in question was a gifted land, which was developed and sold after having converted into plots with a view to secure a better price. The High Court held that such isolated activity could not come within the purview of adventure in the nature of trade or business.
- Note – In this context, it may be noted that in some cases, the Courts have opined that even a single and isolated transaction can be held to be capable of falling within the definition of “business”, but only if it bears clear characteristics of trade. However, a stray activity of a non-businessman would not be a business.

14. Computation of total income of M/s.XYZ for the A.Y. 2008-09

Particulars	Rs.	Rs.
Net profit as per profit & loss account		85,000
Add: Interest to partners on capital accounts for the period from 1.4.2007 to 30.9.2007	62,500	
Interest to partners on current accounts from 1.4.2007 to 31.3.2008	75,000	
Payment made by a crossed cheque for purchase of television sets	32,000	
Difference on account of valuation of closing stock-in-trade at market value	5,000	
Salary paid to working partners considered separately	2,80,000	
		<u>4,54,500</u>
		5,39,500

Less: Additional depreciation on new machinery	80,000
	4,59,500
Less: Interest received from bank on fixed deposits considered separately	18,000
Book profit	4,41,500
Less: Salary to working partners -	
On first Rs.75,000 book profit @ 90%	67,500
On next Rs.75,000 book profit @ 60%	45,000
On balance Rs.2,91,500 book profit @ 40%	1,16,600
	2,29,100
	2,12,400
Less: Business loss relating to assessment year 2007-08 set off	72,000
Income from business	1,40,400
Income from other sources	
Interest received from bank on fixed deposits	18,000
Total Income	1,58,400

Explanation for the treatment of various items

- (i) Interest to partners authorised by the partnership deed will be allowed as deduction only for the period beginning with the date of the partnership deed and not for any earlier period as per section 40(b)(iv). Therefore, interest paid to the partners on the balances standing to the credit of their capital accounts from 1.10.2007 alone is eligible for deduction, since the partnership deed was executed only on 1.10.2007. Interest for the period prior to 1.10.2007 is not allowed.
- (ii) The partnership deed of 1.10.2007 provided for payment of interest on balances in capital accounts of partners only. As such, the interest paid on the balances standing to the credit of the current accounts of partners is not allowable under section 40(b). The Kerala High Court has, in *Novel Distributing Enterprises v. DCIT & Anr.* (2001) 251 ITR 704, on identical facts, held that interest paid to the partners on their current account balances is not allowable.
- (iii) Since X is a partner in his individual capacity, interest paid to the Hindu Undivided Family of partner X does not attract disallowance under section 40(b)(iv).
- (iv) As per section 40A(3), any payment towards expenditure incurred exceeding Rs.20,000 made otherwise than by an account payee cheque / account payee bank draft will attract disallowance @ 100% thereof. Since the firm has made payment towards purchase of television sets by a crossed cheque and not by an account payee cheque, 100% of such expenditure would be disallowed.
- (v) Silver plate valued at Rs.12,000 received as gift from a manufacturer for achieving sales target is taxable under section 28(iv), being a benefit arising from business.
- (vi) Depreciation on motor car bought and used exclusively for purposes of business is allowable though not registered in the name of the firm in view of the ratio of the decision of the Supreme Court in *Mysore Minerals Ltd. v. CIT* (1999) 239 ITR 775 (SC).
- (vii) The firm is entitled to additional depreciation @ 20% under section 32(1)(ia) in respect of the new machinery installed for manufacture of pens. Since the new machinery is put to use for less than 180 days during the relevant previous year, the additional depreciation is restricted to 50% of the prescribed rate of 20% i.e. it is restricted to 10%.

- (viii) Interest received from bank on fixed deposits made out of surplus funds is assessable under the head 'Income from other sources'. Hence, it is not taken into account for the purpose of computing book-profit.
 - (ix) The Supreme Court has, in *A.L.A Firm v. CIT* (1991) 189 ITR 285 (SC), held that the closing stock has to be valued at market rate in the case of a dissolved firm. As such, the closing stock-in-trade of the firm has to be valued at the market rate.
 - (x) Net profit shown in the profit and loss account computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners constitutes book profit as per Explanation 3 to section 40(b). Carry forward and set off of business loss is covered under Chapter VI. Hence, brought forward business loss relating to the assessment year 2007-08 is not considered for calculation of book-profit.
 - (xi) Section 45(4) is not applicable to the firm for the assessment year 2008-09, since though the dissolution of the firm took place on 31.3.2008, there was no transfer by way of distribution of capital assets during the relevant previous year. The distribution of the capital assets took place on 15.4.2008. The capital gains will be assessable in the assessment year 2009-10.
15. The provisions of penalty in respect of search initiated on or after 1.6.2007 is summarized in the table below –

Section	Relevant previous year to which the undisclosed income relates	Penalty
Explanation 5A to section 271(1)	Previous year which has ended before the date of search, in respect of which the due date has expired, but the return has not been furnished. For example, in respect of P.Y.2006-07, if the date of search is 15.11.2007, then the previous year has ended before that date (i.e., on 31.3.2007) and the due date of filing return (31.7.2007/31.10.07, as the case may be) has also expired, but the return has not been furnished. In such a case, penalty would be attracted under this section.	100% to 300% of the tax sought to be evaded.
271AAA	(i) Previous year which has ended before the date of search, but the due date for filing return has not expired before the date of search, and the return has not been furnished. For example, in respect of P.Y.2006-07, if the date of search is 15.5.2007, then the previous year has ended before the date of search, but the due date of filing the return has not expired. (ii) Previous year in which the search is conducted.	10% of the undisclosed income. However, no penalty is leviable if disclosure is made under section 132(4), manner of earning is disclosed and tax and interest is paid.

16. The Gujarat High Court considered this issue in *CIT v. Manibhai and Bros.* (2007) 294 ITR 501. On this issue, the High Court observed that for imposition of penalty under section 271(1)(c), there should be a deliberate concealment of particulars or furnishing of inaccurate particulars by the assessee. For finding out whether there was a deliberate attempt to conceal particulars or furnish inaccurate particulars, the conduct of the assessee from the beginning till the end of the

assessment proceedings in totality should be taken into consideration. If a revised return is filed by the assessee after the Assessing Officer has discovered, in the course of assessment proceedings, an omission or wrong statement in the original return, then the assessee cannot escape the liability for imposition of penalty under section 271(1)(c). However, if the assessee voluntarily files a revised return suo motu before the assessment order is passed, after he himself discovered an omission or wrong statement in the original return, then in such a case, penalty cannot be imposed under section 271(1)(c).

17. A new clause (d) has been inserted in section 115WB(1) to provide for levy of FBT on the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer free of cost or at a concessional rate to his employees, including former employees. Specified security means "securities" as defined in section 2(h) of the Securities Contracts (Regulation) Act, 1956 and includes employees' stock option. 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, for the purpose of levy of FBT, shall be the fair market value of such security or shares on the date on which the option vests with the employee, as reduced by any amount actually paid by, or recovered from, the employee 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.

A new section 115WKA has been inserted for the purpose of enabling the employer to recover the FBT in respect of any specified security or sweat equity shares from the employees. If sweat equity shares are allotted or transferred, directly or indirectly, by an employer on or after 1.4.2007, it shall be lawful for the employer to vary the agreement or scheme under which such specified security or sweat equity shares has been allotted or transferred. The agreement or scheme can be modified so as to recover from the employee, the FBT, to the extent to which such employer is liable to pay the FBT in relation to the value of fringe benefits provided to the employee and determined in the manner specified above.

18. This issue was settled by the Supreme Court in CIT v. Alagendran Finance Ltd. (2007) 293 ITR 1. The Supreme Court observed that though there was no doubt that once an order of assessment is reopened, the previous assessment will be held to be set aside and the whole proceedings would start afresh, however, it would not mean that even when the subject-matter of reassessment is distinct and different, the entire proceeding would be deemed to have been reopened. The doctrine of merger would apply only in a case where the subject-matter of reassessment and the subject-matter of assessment are the same. However, in this case, the revision proceedings related to Lease Equalisation Fund, which was not the subject matter of reassessment. Therefore, the doctrine of merger does not apply in this case and the revision proceedings are barred by limitation.

Section 263(2) provides no order shall be made under section 263(1) after the expiry of two years from the end of the financial year in which the order sought to be revised was passed. Therefore, in this case, the revision proceedings are barred by limitation since the original assessment order was made on 20.3.2004 and the revision should have been made by 31.3.2006.

19. The circumstances under which an assessee will be deemed to have concealed the particulars of his net wealth or furnished inaccurate particulars thereof are follows:
 - (i) Where a person fails to offer an explanation or offers an explanation which is found to be false in respect of any facts material to the computation of net wealth, he will be deemed to have concealed the particulars. Further, where such person offers an explanation which he is unable to substantiate and fails to prove that such explanation is bonafide and that all the facts relating to same and material to the computation of his net wealth have been disclosed by him, he will be deemed to have concealed the particulars.

- (ii) Where a person not previously assessed to wealth tax, fails, without reasonable cause, to furnish within the due date, a return of his net wealth which he is required to furnish and the Assessing Officer is satisfied that the person has assessable wealth, he shall be deemed to have concealed the particulars of his assets.
- (iii) Where the value of any asset returned by any person is less than 70% of the value of such asset as determined in an assessment under section 16 or 17, such person shall be deemed to have furnished inaccurate particulars.
- (iv) Where in the course of search under section 37A, the assessee is found to be the owner of any money, bullion, jewellery or other valuable article or thing and such assets have been neither declared in the return of wealth nor recorded in the books of account, he shall be deemed to have concealed the particulars of such assets or furnished inaccurate particulars of such assets.

20. Computation of net wealth of Mr. Mehta for the A.Y. 2008-09

Particulars	Amount in Rs.
(a) Residential house at Calcutta is an asset	42,00,000
(b) Residential house at Pune is an asset	17,00,000
(c) Plot of land comprising an area of 300 square meters at Calcutta is an asset but exempt under section 5(vi)	Nil
(d) House at Chennai exclusively used for carrying on his business is not an asset	Nil
(e) Commercial complex at Baroda is not an asset	Nil
(f) Residential house at Bangalore let out for 301 days during the relevant previous year is not an asset	Nil
(g) Motor cars used in the business of running them on hire are not assets	Nil
(h) Shares in private limited companies are not assets	Nil
(i) Cash in hand in excess of Rs.50,000 is includible in net wealth	1,50,000
(j) Gold jewellery is an asset	10,00,000
	70,50,000
Less: Debts incurred in relation to assets	
(k) Loan borrowed for purchase of land at Calcutta (not deductible since exemption under section 5(vi) has been claimed in respect of the said land)	Nil
(l) Loan borrowed for purchase of shares in private limited companies (not deductible since shares are not included in net wealth)	Nil
(m) Loan borrowed for purchase of gold jewellery	7,00,000
Net Wealth	63,50,000

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

- (a) Residential house at Calcutta is included, as residential house is an "asset" within the meaning of section 2(ea) of the Wealth Tax Act, 1957. Exemption under section 5(vi) is not claimed in respect of this house as it is more beneficial for the assessee to claim exemption in respect of plot of land at Calcutta, whose value is higher.
- (b) Residential house at Pune is an asset under section 2(ea) and, therefore, included in the net wealth.
- (c) Plot of land measuring 300 square metres at Calcutta is exempt under section 5(vi) and, therefore, does not form part of net wealth. One house or part thereof or a plot of land, not

exceeding 500 square metres, belonging to an individual or a Hindu Undivided Family is exempt under section 5(vi) without any monetary ceiling.

- (d) House at Chennai, occupied for own business purposes, is excluded from net wealth as it is not an asset.
- (e) Commercial complex at Baroda is excluded as it is not an asset.
- (f) Any residential property let out for a minimum period of 300 days in the previous year is not considered as an asset. Residential house at Bangalore let out for 301 days is, therefore, excluded from net wealth.
- (g) Motor cars used in business of running them on hire are not assets as per section 2(ea)(ii) and, therefore, excluded from net wealth.
- (h) Shares in private limited companies are not assets and, therefore, excluded from net wealth.
- (i) Cash in hand, in excess of Rs.50,000, of individuals constitutes an asset. Therefore, Rs.1,50,000, being cash in hand in excess of Rs.50,000, is included in net wealth.
- (j) Gold jewellery constitutes an asset as per section 2(ea) and is includible in net wealth.
- (k) Debts incurred in relation to an exempted asset are not deductible in computing net wealth. Loan borrowed for purchase of land at Calcutta is not deductible as exemption under section 5(vi) has been claimed in respect of the said land.
- (l) Loan borrowed for purchase of shares in private limited companies is not deductible while computing net wealth as shares are not included in net wealth.
- (m) Gold jewellery, being an asset, has been included in the net wealth. Therefore, loan borrowed for purchase thereof is deductible in computing the net wealth.

IMPORTANT CIRCULARS / NOTIFICATIONS ISSUED BETWEEN 1.5.07 and 31.10.07

I CIRCULARS

1. Circular No.4/2007 dated 15.6.2007 - Distinction between shares held as stock-in-trade and shares held as investment - Tests for such a distinction

The Income Tax Act, 1961 makes a distinction between a capital asset and a trading asset. Capital asset is defined in section 2(14). Long-term capital assets and gains are dealt with under section 2(29A) and section 2(29B). Short-term capital assets and gains are dealt with under section 2(42A) and section 2(42B). Trading asset is dealt with under section 28.

The Central Board of Direct Taxes (CBDT) had, through Instruction No.1827 dated August 31, 1989, brought to the notice of the Assessing Officers that there is a distinction between shares held as investment (capital asset) and shares held as stock-in-trade (trading asset). In the light of a number of judicial decisions pronounced after the issue of the above instructions, the same have been further updated for the information of assesseees as well as for guidance of the Assessing Officers.

- (1) The Supreme Court, in, CIT (Central), Calcutta vs Associated Industrial Development Company (P) Ltd 82 ITR 586, observed that:

“Whether a particular holding of shares is by way of investment or forms part of the stock-in-trade is a matter which is within the knowledge of the assessee who holds the shares and it should, in normal circumstances, be in a position to produce evidence from its records as to whether it has maintained any distinction between those shares which are its stock-in-trade and those which are held by way of investment.”

- (2) In the case of CIT, Bombay vs H. Holck Larsen 160 ITR 67, the Supreme Court observed that:

“The High Court, in our opinion, made a mistake in observing whether transactions of sale and purchase of shares were trading transactions or whether these were in the nature of investment was a question of law. This was a mixed question of law and fact.”

- (3) The Authority for Advance Rulings (AAR) 288 ITR 641, referring to the decisions of the Supreme Court in several cases, has culled out the following principles :-
- (i) where a company purchases and sells shares, it must be shown that they were held as stock-in-trade and that existence of the power to purchase and sell shares in the memorandum of association is not decisive of the nature of transaction;
 - (ii) the substantial nature of transactions, the manner of maintaining books of accounts, the magnitude of purchases and sales and the ratio between purchases and sales and the holding would furnish a good guide to determine the nature of transactions;
 - (iii) ordinarily the purchase and sale of shares with the motive of earning a profit, would result in the transaction being in the nature of trade/adventure in the nature of trade; but where the object of the investment in shares of a company is to derive income by way of dividend etc. then the profits accruing by change in such investment (by sale of shares) will yield capital gain and not revenue receipt.

It is possible for a tax payer to have two portfolios, i.e., an investment portfolio comprising of securities which are to be treated as capital assets and a trading portfolio comprising of stock-in-trade which are to be treated as trading assets. Where an assessee has two portfolios, the assessee may have income under both heads i.e., capital gains as well as business income.

The above principles would help in determining whether, in a given case, the shares are held by the assessee as investment (and therefore giving rise to capital gains) or as stock-in-trade (and therefore giving rise to business profits). It is to be noted that no single principle would be decisive and the total effect of all the principles should be considered to determine whether, in a given case, the shares are held by the assessee as investment or stock-in-trade.

2. Circular No. 6/2007, dated 11-10-2007 - Allowability of harvesting and transportation expenses in the case of Co-operative sugar mills

This Circular is to clarify 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.

II NOTIFICATIONS

1. Notification No. 208/2007, dated 27-6-2007

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

As per this rule, no disallowance under clause (a) of 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 clause (b) of sub-section (3) of section 40A where any payment in a sum exceeding twenty thousand rupees is made otherwise than by an account payee cheque drawn on a bank or account payee bank draft in the cases and circumstances specified hereunder, namely:

- (a) where the payment is made to
 - (i) the Reserve Bank of India or any banking company;
 - (ii) the State Bank of India or any subsidiary bank;
 - (iii) any co-operative bank or land mortgage bank;

- (iv) any primary agricultural credit society or any primary credit society;
- (v) the Life Insurance Corporation of India;
- (b) where the payment is made to the Government and, under the rules framed by it, such payment is required to be made in legal tender;
- (c) where the payment is made by
 - (i) any letter of credit arrangements through a bank;
 - (ii) a mail or telegraphic transfer through a bank;
 - (iii) a book adjustment from any account in a bank to any other account in that or any other bank;
 - (iv) a bill of exchange made payable only to a bank;
 - (v) the use of electronic clearing system through a bank account;
 - (vi) a credit card;
 - (vii) a debit card.
- (d) where the payment is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee;
- (e) where the payment is made for the purchase of -
 - (i) agricultural or forest produce; or
 - (ii) the produce of animal husbandry (including livestock, meat, hides and skins) or dairy or poultry farming; or
 - (iii) fish or fish products; or
 - (iv) the products of horticulture or apiculture,
 to the cultivator, grower or producer of such articles, produce or products;
- (f) where the payment is made for the purchase of the products manufactured or processed without the aid of power in a cottage industry, to the producer of such products;
- (g) where the payment is made in a village or town, which on the date of such payment is not served by any bank, to any person who ordinarily resides, or is carrying on any business, profession or vocation, in any such village or town;
- (h) where any payment is made to an employee of the assessee or the heir of any such employee, on or in connection with the retirement, retrenchment, resignation, discharge or death of such employee, on account of gratuity, retrenchment compensation or similar terminal benefit and the aggregate of such sums payable to the employee or his heir does not exceed fifty thousand rupees;
- (i) where the payment is made by an assessee by way of salary to his employee after deducting the income-tax from salary in accordance with the provisions of section 192 of the Act, and when such employee -
 - (i) is temporarily posted for a continuous period of fifteen days or more in a place other than his normal place of duty or on a ship; and
 - (ii) does not maintain any account in any bank at such place or ship;
- (j) where the payment was required to be made on a day on which the banks were closed either on account of holiday or strike;
- (k) where the payment is made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person;
- (l) where the payment is made by an authorised dealer or a money changer against purchase of foreign currency or travellers cheques in the normal course of his business.

2. Notification No. 213/2007, dated 3-8-2007

Section 2(48) defining zero coupon bonds requires that such bonds should be notified by the Central Government. Accordingly, the Central Government has, vide Notification No. 213/2007 dated 3.8.2007, specified the 15 year zero coupon bonds of Power Finance Corporation (PFC), to be issued on or before 31.3.2009, as zero coupon bonds for the purposes of section 2(48).

3. Notification No. 214/2007, dated 3-8-2007

The Central Government has, vide notification no.214/2007 dated 3.8.2007 specified the cost inflation index for the financial year 2007-08. The CII for F.Y. 2007-08 is 551.

S. No.	Financial Year	Cost Inflation Index
1.	1981-82	100
2.	1982-83	109
3.	1983-84	116
4.	1984-85	125
5.	1985-86	133
6.	1986-87	140
7.	1987-88	150
8.	1988-89	161
9.	1989-90	172
10.	1990-91	182
11.	1991-92	199
12.	1992-93	223
13.	1993-94	244
14.	1994-95	259
15.	1995-96	281
16.	1996-97	305
17.	1997-98	331
18.	1998-99	351
19.	1999-2000	389
20.	2000-01	406
21.	2001-02	426
22.	2002-03	447
23.	2003-04	463
24.	2004-05	480
25.	2005-06	497
26.	2006-07	519
27.	2007-08	551

4. Notification No. 262/2007, dated 16-10-2007

Rule 117C has been inserted in the Income-tax Rules, 1962 to empower the Tax Recovery Officer to exercise or perform certain powers and functions of an Assessing Officer.

The Chief Commissioner or the Commissioner, by general or special order in writing, may authorise a Tax Recovery Officer to exercise or perform the powers and functions conferred on or assigned to an Assessing Officer under section 154 for rectifying any mistake apparent from record in respect of an order passed by the Assessing Officer consequent to which a sum is

payable and the Tax Recovery Officer has drawn a Certificate under section 222 in respect of such sum. The Tax Recovery Officer shall exercise or perform such powers and functions concurrently with the Assessing Officer.

5. Notification No. 264/2007, dated 23-10-2007

Valuation of specified security or sweat equity share being a share in the company for the purpose of levy of fringe benefit tax (FBT).

The Finance Act, 2007 has amended the provisions of the Income-tax Act to provide that employers will be liable to pay fringe benefit tax on the value of ESOPs granted to employees as and when the ESOPs were allotted or transferred to the employees. The value of ESOPs for the purposes of levy of FBT shall be the fair market value of the ESOPs on the date of vesting of the options as reduced by the amount actually paid, or recovered from, the employee.

Explanation (i) to clause (ba) of sub-section (1) of section 115WC of the Income-tax Act defines fair market value to mean the value determined in accordance with the method as may be prescribed by the Board. Accordingly, a new Rule 40C has been inserted in the Income-tax Rules for this purpose.

The new Rule 40C, which will take effect from the 1st April, 2008 and will, accordingly, apply in relation to the assessment year 2008-09 and subsequent years, provides as follows -

- (1) For the purposes of clause (ba) of sub-section (1) of section 115WC, the fair market value of any specified security or sweat equity share, being an equity share in a company, on the date on which the option vests with the employee, shall be determined in the manner laid down in (2) and (3) below.
- (2) In a case where, on the date of the vesting of the option, the share in the company is listed on a recognized stock exchange, the fair market value shall be the average of the opening price and closing price of the share on that date on the said stock exchange. However, where, on the date of vesting of the option, the share is listed on more than one recognized stock exchanges, the fair market value shall be the average of opening price and closing price of the share on the recognised stock exchange which records the highest volume of trading in the share.

Further, if, on the date of vesting of the option, there is no trading in the share on any recognized stock exchange, the fair market value shall be -

- (a) the closing price of the share on any recognised stock exchange on a date closest to the date of vesting of the option and immediately preceding such date; or
- (b) the closing price of the share on a recognised stock exchange, which records the highest volume of trading in such share, if the closing price, as on the date closest to the date of vesting of the option and immediately preceding such date, is recorded on more than one recognized stock exchange.
- (3) In a case where, on the date of vesting of the option, the share in the company is not listed on a recognized stock exchange, the fair market value shall be such value of the share in the company as determined by a merchant banker [Category I merchant banker registered with SEBI] on the specified date [i.e. the date of vesting of the option or any date earlier than the date of the vesting of the option, not being a date which is more than 180 days earlier than the date of the vesting].
- (4) Closing price of a share on a recognised stock exchange on a date shall be the price of the last settlement on such date on such stock exchange. However, where the stock exchange quotes both buy and sell prices, the closing price shall be the sell price of the last settlement.
- (5) Opening price of a share on a recognised stock exchange on a date shall be the price of the first settlement on such date on such stock exchange. However, where the stock exchange quotes both buy and sell prices, the opening price shall be the sell price of the first settlement.