



STUDY NOTE-17

DIFFERENT ASPECTS OF DIRECT TAX PLANNING

This Study Note includes

- Different Aspects Of Direct Tax Planning

INTRODUCTION

The provisions of the Income-Tax are contained in the Income-Tax Act, 1961 (the Act), which extends to whole of India and is operative from the 1st day of April, 1962 (the Rules). The Act provides for determination of taxable income, tax liability, procedures for assessment, appeals, penalties, interest levies, the tax payment schedules and its determination, refunds and prosecutions.

Depending upon Government policies certain income is exempted from tax, for example SEZ (Special Economic Zone) units income, Agriculture income, etc. and deduction are also provided on fulfillment of prescribed criteria. Provisions relating to such exemptions and deduction are also contained in the Act.

Corporate form of business is much in vogue. Therefore, certain taxes specific to companies like Tax on Book profit (115JB), tax on Dividend Distributed (115O), are levied.

At times in Cross border transactions income earned get exposed to tax in India as well as in some other countries. Provisions for upholding relief from double taxation are also made in the Income Tax Act.

In respect of certain perquisites given to the employees as a group, it becomes difficult to identify income flowing from such benefits with an employee and to overcome this limitation Fringe Benefit tax (FBT) is charged on employers. The law of FBT is also contained in the Act.

The Act also lays down the powers duties of various income-tax authorities. Being revenue legislation, the act is amended once a year through union budgets and the finance bill is normally presented to the Parliament for approval around February. The Act has empowered the Central Board of Direct Taxes (CBDT) to frame the rules and these rules are implemented after necessary Gazette notifications. The CBDT also issues circulars and clarifications from time to time for implementation by the income-tax authorities by virtue of section 119, which gives such rule making powers to the CBDT. It is impracticable for the Act to provide exhaustively for everything relating to limits, conditions, procedures, forms and various other aspects. Therefore this power has been delegated to CBDT and thus periodical changes and modification by an executive authority is facilitated. The power to frame rules is vested with the Board u/s 295 of the Act and the word 'prescribed' used in section 2(33) means what is prescribed by rules made under the Act.

The Income-Tax Act gives definitions of the various terms expressions used in the Act. Unless the context otherwise requires, these definition should be applied. The words 'means' 'includes' and 'means and includes' are used in these definitions and the significance of these terms needs to be understood. When a definition uses the word 'means' the definition is self-explanatory, restrictive and in a sense exhaustive. It implies that the term or expression so defined

means only as to what is defines as and nothing else. For example, the terms ‘agricultural income’ ‘assessment year’ ‘capital asset’, are exhaustively defined. When the legislature wants to widen the scope of a term or expression and where an exhaustive definition cannot be provided, it uses the word ‘includes’ in the definition. Generally an inclusive definition provides an illustrative meaning and the definition could include what is not specifically mentioned in the definition so long as the stipulated criteria are satisfied. To illustrate refer to the definitions of ‘income’, ‘person’, ‘transfer’ in the Act. When the legislature intends to define a term or expression to mean something and also intends to specify certain items to be included, other the words ‘ means’ as well as ‘ includes’ are used. Such definition is not only exhaustive but also illustrative in specifying what is intended to be included. Sometimes specific items are included in an exhaustive definition in order to avoid ambiguity and to provide clarity. Please refer to definitions of ‘assessee’, ‘Indian company’, ‘recognised provident fund’, under the Act. Further any decision given by the Supreme Court also becomes a law on the subject and will be binding on all the courts, tribunals, income-tax authorities as well as the taxpayers. In case of apparent contradictions in the Supreme Court rulings, the following rules may have to be followed:-

1. The decision of the larger bench would prevail.
2. The principle of the later decision shall prevail, where the decisions are by equal number if judges.

Decisions given by High Courts are binding on all taxpayers and It authorities, which fall under its jurisdiction till it is overruled by higher authority.

RATES OF TAX

1. Tax Rates for Individuals/HUF/AOP/BOI :

Tax Rates for Individuals/HUF/AOP/BOI : For A.Y. 2007-08	
Income	Rate (%)
Up to 100000*	NIL
100001 to 150000	10
150001 to 250000	20
Above 250000	30

* Threshold limit for resident women assessee below 65 years of age and resident individuals of 65 years and above to be increased to Rs. 1,35,000 / - and Rs. 1,85,000 / - respectively.

Surcharge @ 10% applicable if total income exceeds Rs. 10,00,000 / -.

Marginal relief would be provided to ensure that the additional income tax payable including surcharge, on the excess of income over Rs. 10,00,000 / - is limited to the amount by which the income is more than Rs. 10,00,000 / -.

Education Cess @ 2% leviable on tax plus surcharge.

For A.Y. 2008-09

For A.Y. 2008-09

Income	Rate (%)
Up to 110000*	NIL
110001 to 150000	10
150001 to 250000	20
Above 250000	30

* Threshold limit for resident women assessee below 65 years of age and resident individuals of 65 years and above to be increased to Rs. 1,45,000/- and Rs. 1,95,000/- respectively.

Surcharge @ 10% applicable if total income exceeds Rs. 10,00,000/-.

Marginal relief would be provided to ensure that the additional income tax payable including surcharge, on the excess of income over Rs. 10,00,000/- is limited to the amount by which the income is more than Rs. 10,00,000/-.

Education Cess @ 2% and Secondary and Higher education cess @ 1% leviable on tax plus surcharge.

2. Tax Rates for Firms :

Asst.Year	Tax %	Surcharge %	Education Cess/Secondary and Higher Education cess %	Total %
2007-08	30	10	2	33.66
2008-09	30	10*	3	33.99

3. Tax Rates for Domestic Companies :

Assessment Year	Tax %	Surcharge %	Education Cess/Secondary and Higher Education cess %	Total %
2007-08	30	10	2	33.66
2008-09	30	10*	3	33.99

* No surcharge will be levied on companies having total income of not more than Rs. 1 crore.

4. Dividend Distribution Tax :

Asst.Year	Tax %	Surcharge %	Education Cess/Secondary and Higher Education cess %	Total %
2007-08	12.5	10	2	14.025
2008-09	15	10	3	16.995

5. Income Distribution Tax for Mutual Fund :

	A.Y. 2007-08		A.Y. 2008-09	
Rate	If Distributed to Individual/HUF	If Distributed to any other person	If Distributed to Individual/HUF	If Distributed to any other person
Tax %	12.5	20	12.5	20
Surcharge %	10	10	10	10
Edn.Cess %	2	2	3	3
Total %	14.025	22.44	14.1625	22.66

Note: From A.Y. 2008-09 income distributed by a money market mutual fund or liquid fund will be taxed @25% plus surcharge and education / Higher secondary cess.

6. Co-operative society :

Income	Rate %	Education Cess/Secondary and Higher Education cess %	Total %
Up to 10000	10	3	10.3
10001 to 20000	20	3	20.6
20001 and above	30	3	30.9

7. Special Rates :

1. Long Term Capital Gains

a. On Equity shares and units

Long term capital gain arising on transfer of equity shares in a recognized stock exchange in India or units of an equity oriented Mutual Fund (if 65% of total proceeds of the fund are invested in equity shares), and on which Securities Transaction tax is chargeable.

For All Assesses	Nil – Exempt under section 10(38)
------------------	-----------------------------------

b. On other assets and equity shares, units except falling in (a) above

Income Tax on Long Term Capital Gains	
Resident Individual or HUF	20%
Domestic Companies	20%
Non-residents	20%
NRIs (for gains u / s 115E)	10%
Any other case	20%

Notes:

If tax payable in case of Long Term Capital Assets, being listed securities or units or zero coupon bond, exceeds 10% of Capital gains before indexation, then such excess may be ignored.

Surcharge at the rates applicable to the assessee. Education cess @2% and Secondary and Higher education cess @ 1% (from A.Y. 2008-09) applicable on tax inclusive of surcharge.

In case of resident individual and HUF, where tax liability arises only because of the inclusion of long term capital gains tax to be levied at 20% or 10% as the case may be, on the excess over the minimum exemption limit.

In case of resident individual and HUF, relief from LTCG is available in respect of the amount by which the Taxable Income other than LTCG falls short of Basic Exemption Limit.

No deduction under Chapter VI-A (80C to 80U)

2. Short Term Capital Gains
a. On Equity shares and units

Short term capital gain arising on transfer of equity shares on recognized stock exchange in India or units of an equity oriented Mutual Fund (if 65% of total proceeds of the fund are invested in equity shares), and on which Securities Transaction Tax is chargeable

For All Assesseees	10% plus surcharge, if applicable plus Education Cess & Secondary and Higher education cess.
--------------------	--

Notes:

1. No Deduction under Chapter VI-A (80C to 80U)
 2. In case resident individual and HUF, relief from STCG available in respect of the amount by which the taxable income other than STCG, falls short of Basic Exemption Limit
- b. On Short Term Capital Gain Other than in (a) above**

8. Advance Tax

Advance Tax Obligation (If tax payable exceeds Rs. 5,000)		
Due Date of Installment payable on or before	Amount Payable as a % of Tax	
	For Companies*	For Other Assesseees
15th June	15%	—
15th September	45%	30%
15th December	75%	60%
15th March	Balance	Balance

Advance Tax Obligation (In respect of Fringe Benefit Tax payable)		
Due Date of Installment payable on or before	Amt. Payable as a % of Tax	
	For Companies*	For Other Assesseees
15th June	15%	—
15th September	45%	30%
15th December	75%	60%
15th March	Balance	Balance

MARGINAL RELIEF

In case of such individuals / HUFs / AOPs / BOIs having a total income exceeding Rs.10,00,000, the additional amount of income-tax payable (together with surcharge) on the excess of income over Rs.10,00,000 should not be more than the amount of income exceeding Rs.10,00,000. This is called 'marginal relief'.

Illustration : Suppose Mr. X has total income of Rs.10 lakhs.

Tax on this income = Rs.0 + 10% of Rs.50,000 + 20% of Rs.1,00,000 + 30% of Rs.7,50,000 = Rs.2,50,000.

Surcharge is not attracted on this tax since the total income does not exceed Rs.10 lakhs.

However, if his total income is Rs.10,30,000, then

Tax on this income = Rs.0 + 10% of Rs.50,000 + 20% of Rs.1,00,000 + 30% of Rs.780,000 = Rs.2,59,000.

Add: Surcharge = Rs 25,900 [10% of Rs.2,59,000]

Rs 2,84,900

On comparing the two situations, it is seen that for Rs.30,000 [i.e. Rs.10,30,000 – Rs.10,00,000] increase in the total income, the tax liability including surcharge has increased by Rs.34,900 [i.e. Rs.2,84,900 – Rs.2,50,000].

Marginal relief = Rs.34,900 – Rs.30,000 = Rs.4,900

Tax payable = Rs.2,50,000 + Rs.30,000 = Rs.2,80,000



Certain Important Concepts

Understanding of basic concepts is necessary for tax planning. Important concepts are as under:

1. “person” includes—
 - (i) An individual,
 - (ii) A Hindu undivided family,
 - (iii) A company,
 - (iv) A firm,
 - (v) An association of persons or a body of individuals, whether incorporated or not,
 - (vi) A local authority, and
 - (vii) Every artificial juridical person, not falling within any of the preceding sub-clauses

Assessment Year

“Assessment year” means the period of twelve months commencing on the 1st day of April every year

Previous Year

For the purposes of this Act, “previous year” means the financial year immediately preceding the assessment year:

Provided that, in the case of a business or profession newly set up, or a source of income newly coming into existence, in the said financial year, the previous year shall be the period beginning with the date of setting up of the business or profession or, as the case may be, the date on which the source of income newly comes into existence and ending with the said financial year.

Income

“Income” includes—

- (i) Profits and gains;
- (ii) Dividend;
- (iii) Voluntary contributions received by a trust created wholly or partly for charitable or religious purposes or by an institution established wholly or partly for such purposes [or by an association or institution referred to in clause (21) or clause (23), or by a fund or trust or institution referred to in sub-clause (iv) or sub-clause (v) *[or by any university or other educational institution referred to in sub-clause (iiiad) or sub-clause (vi) or by any hospital or other institution referred to in sub-clause (iiiiae) or sub-clause (via)]* of clause (23C) of section 10].

- (iii) The value of any perquisite or profit in lieu of salary taxable under clauses (2) and (3) of section 17 ;
- (iiia) Any special allowance or benefit, other than perquisite included under sub-clause 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;
- (iiib) Any allowance 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 a place where he ordinarily resides or to compensate him for the increased cost of living;
- (iv) 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;
- (iva) The value of any benefit or perquisite, whether convertible into money or not, obtained by any representative assessee mentioned in clause
- (ivb) of sub-section (1) of section 160 or by any person on whose behalf or for whose benefit any income is receivable by the representative assessee (such person being hereafter in this sub-clause referred to as the “beneficiary”) and any sum paid by the representative assessee in respect of any obligation which, but for such payment, would have been payable by the beneficiary.
- (v) Any sum chargeable to income-tax under clauses (ii) and (iii) of section 28 e.g. any compensation or income of a trade association from specific services or section 41 or section 59 e.g.; ”profits and gains of business or profession.
- (va) Any sum chargeable to income-tax under clause (iiia) of section 28 ; i.e.; profit on sale of License under Import and Export (Control) Act, 1947
- (vb) Any sum chargeable to income-tax under clause (iiib) of section 28 ; i.e.; cash received or receivable by any person against Export
- (vc) Any sum chargeable to income-tax under clause (iiic) of section 28 ; i.e. any duty re-paid or repayable against export
- (vd) the value of any benefit or perquisite taxable under clause (iv) of section 28 i.e. any benefit or perquisite, whether convertible into money or not



- (ve) any sum chargeable to income-tax under clause (v) of section 28; e.g. any interest, salary, bonus, commission or remuneration received by partner
- (vi) any capital gains chargeable under section 45 i.e.; profits or gains from transfer of capital assets.
- (vii) the profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society, computed in accordance with section 44 or any surplus taken to be such profits and gains by virtue of provisions contained in the First Schedule ;
- (viii) *the profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members;*
- (ix) any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever.
- (x) any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or any fund set up under the provisions of the Employees' State Insurance Act, 1948 (34 of 1948), or any other fund for the welfare of such employees ;
- (xi) any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.
- (xii) any sum referred to in [clause (va)] of section 28; e.g.; any sum received or receivable for not carrying out any business
activity or not sharing any patent, copyrights, trade-mark, licence, franchise or carry on any similar business.
- (xiii) any sum referred to in clause (v) or (vi) of sub-section (2) of section 56 i.e. gift of money

Definition of 'income' is inclusive i.e. whatever is stated in the definition is income and in addition, what is normally considered as income is also income for the purpose of taxation.

Charge of income-tax [section 4]

The income-tax takes special cognizance of the following

1. The period of stay in the case of an individual and the control and management of affairs in the case of entity other than individual.
2. The income-tax liability under the Indian tax laws is computed not only based upon income actually received but also those incomes that are constructively received. As a corollary to the above, income once taxed on accrual basis, will not be taxed again on receipt.

3. The income-tax liability under the Indian tax laws is worked out based on the rates of income-tax announced in each year's Finance Act.
4. The income-tax liability is not related to the accounting treatment given to the income in the Balance sheet of the assessee. To illustrate, if an income is included in the Balance Sheet prepared in India it is not necessary to tax it in the same year as a constructive income.
5. The income-tax is collected where tax is payable, either by way of deduction at the time of payment or as advance tax in periodic installments.
6. The Act recognizes the distinction between earning of income and its apportionment and the demarcation between a capital receipt and a revenue receipt.
7. The word 'income' has not been exhaustively defined by the Indian tax Laws and what is included under the definition clause is only illustrative and not exhaustive.
8. If a person is resident in a previous year in respect of any source of income, he shall be deemed to be resident in respect of each of his other sources of income.
9. Indian income-tax laws are applicable irrespective of the citizenship.

Scheme of Taxation

Every person, whose total income of the previous year exceeds the maximum amount, which is not chargeable to income tax, is an assessee and chargeable to income tax at the rate(s) prescribed in the Finance Act for the assessment year. However, his total income shall be determined on the basis of his residential status in India.

RESIDENTIAL STATUS

In determining the total income, it becomes important to decide on the residential status of the taxpayer, as the total income is different according to the residential status. The incidence of tax shall also vary according to the 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 ordinarily 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 assessee are:



(1) Residential status of Individuals:

a) Resident : 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 at least 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.

b) Not-ordinarily resident : Only individuals and HUF can be resident but not ordinarily resident in India. All other classes of assessee 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 proceeding the relevant previous year been in India for a period of 729 days or less.

c) An individual is classified as non-resident if:

- 1) He has not stayed in India for more than 181 days in the previous year.
- 2) He has not stayed in India for more than **59** days during the previous year and has stayed for less than **365** days during the four previous years preceding the previous year.
- 3) He has not been resident in India in nine out of the 10 previous years proceeding the previous year.
- 4) He has stayed for less than 730 days during the 7 previous years proceeding the previous year.

RESIDENTIAL STATUS OF HINDU UNDIVIDED FAMILY – [Sec. 6(2)]

A Hindu undivided family (HUF) is resident in India if control and management of its affairs is, wholly or partly, situated in India. A HUF is non-resident in India if control and management of its affairs is wholly situated outside India.

A resident HUF is ordinarily resident in India if karta or manager of the family satisfies the following two additional conditions-

- (i) he has been resident in India in at least 9 out of 10 previous years (according to basic conditions mentioned in case of individuals) preceding the relevant previous year; and
- (ii) he has been present in India for a period of 730 days or more during 7 years preceding the previous year.

The HUF will be resident but not ordinarily resident in India if the karta or the manager of the family of a resident HUF does not satisfy the above two additional conditions.

RESIDENTIAL STATUS OF A COMPANY- [Sec. 6(3)]

An Indian company is always resident in India. A foreign company is resident in India only if, during the previous year, control and management of its affairs is situated wholly in India.



A foreign company is treated as non-resident if, either wholly or partly situated out of India. “Control and management” refers to “hand and brain” which directs affairs of the policy, finance, disposal of profits and other vital things concerning the management of the company.

RESIDENTIAL STATUS OF FIRM AND ASSOCIATION OF PERSONS –

[Sec. 6(4)]

A partnership firm or an association of persons is said to be resident in India if control and management of their affairs are wholly or partly situated within India during the relevant previous year. If control and management is situated wholly outside India, such firm or association of persons will be treated as non-resident in India. In case of a firm the control and management is vested in partner whereas in case of association of persons it is vested in the principal officer. Usually control and management is situated at a place where the hand, the seat and the directing powers are situated.

RESIDENTIAL STATUS OF “EVERY OTHER PERSON” – [Sec. 6(4)]

Every other person is resident in India if control and management of his affairs is wholly or partly situated within India during the relevant previous year. Every other person will be non-resident in India if control and management of its affairs is wholly situated outside India.

STATUS AND INCIDENCE OF INCOME-TAX

The incidence of tax on a tax-payer depends on his residential status as well as on the place and time of accrual or receipt of income. A suitable table is given below :

Particulars of income Tax incidence in case of –

	Resident	Resident but not ordinarily resident	Non-resident
a. Income received in India whether accrued in India or outside India	Yes	Yes	Yes
b. Income deemed to be received in India whether accrued in India or outside India.	Yes	Yes	Yes
c. Income accruing or arising in India whether received in India or outside India.	Yes	Yes	Yes
d. Income deemed to accrue or arise in India, whether received in India or outside India.	Yes	Yes	Yes
e. Income received and accrued outside India from a business controlled in profession set up in India	Yes	Yes	No
f. Income received and accrued outside India from a business controlled from outside India or profession set up outside India.	Yes	No	No
g. Income earned and received outside India but later on remitted to India.	No	No	No
Total	a to f	a to e	a to d

Important Paragraphs

The previous year in the following cases shall be as spelt out against each category of income or the assessee as given hereunder:

Category of Income:

- Unexplained cash credits – the year of credit (section 68).
- Unexplained investments – the year of investment (section 69).
- Unexplained money, etc – the year in which the assessee was found to be the owner (section 69A).
- Understated investment – the year in which such understatement was found (section 69B).
- Unexplained expenditure – the year in which such expenditure was incurred (section 69C).
- Amount borrowed or repaid other than through an account payee cheque – the year of



borrowal or repayment, whichever is earlier. The amount repaid shall include the amount of interest paid on the amount borrowed. In case the person is assessed to tax on the amount borrowed, he shall be liable to be assessed again in respect of repayment.

Category of assesses:

- (a) Non-resident shipping business – will be charged to tax in the year in which the ship is allowed to leave the Indian port (section 172).
- (b) Person leaving India – In the year of departure (section 174).
- (c) Association of persons or Body of individuals or artificial judicial person formed for assessee particular event or purpose – in the year in which dissolution takes place (section 174A).
- (d) Person trying to alienate his assets with a view to avoid tax – the period commencing from the expiry of the previous till the date when the Assessing Officer commences proceedings (section 175).
- (e) Discontinued business – the period commencing from the expiry of the previous year till the date of discontinuance (section 176).

‘Average rate of tax’ is defined to mean the rate arrived at by dividing the amount of tax calculated on the total income by such total income. This definition becomes relevant in view of rebate u/s 110 in the assessment of member of an AOP.

‘Maximum marginal rate’ is defined to mean the rate of income-tax (including surcharge on tax, if any) applicable in relation to the highest slab of income in case of an individual, AOP or BOP as the case may be as prescribed in the Finance Act of the relevant year. This would mean that there will not be any exemption limit or slab rate in such cases.

‘Gross total income’ means total income computed in accordance with the provisions of the Income-tax Act before making any deductions under chapter VI-A and total income means the total income referred to in section 5; computed in the manner laid down in the Income-tax Act.

Scope of total income.

Section 5 of the Act scope of income, for the purpose of taxation, depends upon location where the income arises, accrues or is received and his residential status. The scope is as under:

Location	Resident		Non-Resident
	and Ordinarily Resident	But not Ordinarily Resident	
Income is <u>received</u> or is deemed to be received <u>in India</u>	Taxable	Taxable	Taxable
Income <u>accrues or arises</u> or is deemed to accrue or arise to him <u>in India</u>	Taxable	Taxable	Taxable
Income <u>accrues or arises</u> to him <u>outside India</u>	Taxable	Not Taxable (Refer Note)	Not Taxable

Note : For a person 'not ordinarily resident in India, the income which accrues or arises to him outside India shall not taxable in India unless it is derived from a business controlled in or a profession set up in India

Notes:

1.—Income accruing or arising outside India shall not be deemed to be received in India within the meaning of this section by reason only of the fact that it is taken into account in a balance sheet prepared in India

2.—Income which has been included in the total income of a person on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him shall not again be so included on the basis that it is received or deemed to be received by him in India.

In considering what is total income under section 5, one has to exclude such income, as is excluded from the scope of total income by reason of any other provision of the Income-tax Act and not that the other provisions of the Income-tax Act override the provisions of section 5 - CIT v. F.Y. Khambaty 159 ITR 203 (Bom.).

The burden of proving that an amount was taxable because it was received in the year of account lay upon the department - CIT v. Bikaner Trading Co. Ltd. 78 ITR 12 (SC).

**Constructive Income:**

Income is taxed at the point of receipt under certain circumstances. The following incomes shall be deemed to be received in the previous year:

1. Annual accretion in the previous year to the balance to the credit of an employee participating in a recognized provident fund to the extent in the Act, and
2. The transferred balance in a recognized provident fund as provided in the Act.
3. In the case of dividend income, it will be taken as an income in the previous year in which it is declared / distributed / paid as the case may be. In the case of interim dividend, it will be taken as income in the previous year in which it is unconditionally made available. However, under section 10(34) any corporate dividend referred to in section 115O is exempt from tax.
4. Salaries are normally taxed based on the situs of service. If the services were outside India, it is not normally taxed.
5. In case of assessee liaison or branch office of a non-resident engaged in procurement and export of Indian goods, the income earned is exempt.
6. In the case of assessee non-resident engaged in media publishing, news gathering or shooting of films in India no income is deemed to accrue in India.

The tax incidence in the case of varying residential status of the assessee is explained hereunder:-

	Resident	Not Ordinarily Resident	Non-resident
Business Income (Indian operations only)	Taxable	Taxable	Taxable
Purchase of goods for re-export	Taxable	Taxable	Not Taxable
Collection / transmission of news & services for media	Taxable	Taxable	Not Taxable
Shooting any cinematography in India	Taxable	Taxable	Not Taxable
Salaries in India	Taxable	Taxable	Taxable
Dividend paid by any Indian company outside India	Taxable	Taxable	Taxable
	However, Corporate Dividends are Exempt under section 10(34)		
Interest Income	Taxable	Taxable where the entire income is earned in India	Taxable where the entire income is earned in India
Royalties	Taxable	Taxable where used for earning income in India	Taxable where used for earning income in India
Fees for Technical services	Taxable	Taxable where used for earning income in India	Taxable where used for earning income in India
Pension paid outside	-----	-----	Not taxable based on contract of service



Agricultural Income and Aggregation of Incomes

Article 270 of the Constitution of India empowers Government of India to collect tax on income other than agricultural income. Agricultural income has been placed in the State list and as such Parliament cannot levy tax on agricultural income.

According to sec. 2(1A), agricultural income means –

- a) any rent or revenue derived from land which is situated in India and is used for agricultural purposes.
- b) any income derived from such land by-
 - i) agriculture; or
 - ii) the performance by a cultivator or receiver of rent-in-kind of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render the produce raised or received by him fit to be taken to market; or
 - iii) the sale by a cultivator or receiver of rent in kind of the produce raised or received by him, in respect of which no process has been raised or received by him, in respect of which no process has been performed other than a process of the nature described in para (ii) of the sub-clause:
- c) any income derived from any building owned and occupied by the receiver of rent or revenue of any such land provided the following conditions are satisfied-
 - i) the building should be on or in the immediate vicinity of land and is used for agricultural purposes;
 - ii) the cultivator or receiver of rent-in-kind uses the building as a dwelling house or a store house; and
 - iii) the land is assessed to land revenue or local rate or the land is situated within the jurisdiction of municipality /cantonment having a population of not less than 10,000 persons or within distance of not more than 8 k.m.

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. 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.

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.

Example: Suppose Milind sells agricultural land situated in New Delhi for Rs. 10 lakhs and makes a surplus of Rs.8 lakhs over its cost of acquisition.

This surplus will not constitute agricultural income exempt under section 10(1) and will be taxable. It will be taxable as capital gain under section 45, if held as a capital asset and as business income under section 28, if held as stock in trade.

If land sold was used for more than two years for 'agriculture, by the seller or an exemption u / s 54B can be claimed by reinvesting the proceeds in another agricultural land within the stipulated period and subject to the satisfying the requirements of that section.

Agriculture Income and it's Taxability :

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, since 1973, a method has been found out 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 be 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.1,95,000 for senior citizens, Rs.1,45,000 for women assesseees below 65 years of age, Rs.1,10,000 for all other individuals A.Y. 2008-09.)

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.



Exemption for Compulsory Acquisition of Agricultural Land

Under Section 10 (37) exemption is provided for in the case of an individual or a Hindu undivided family, any income chargeable under the head “Capital gains” arising from the transfer of agricultural land, where—

- (i) such land is situate in any area referred to in item (a) or item (b) of sub-clause (iii) of clause (14) of section 2;
- (ii) such land, during the period of two years immediately preceding the date of transfer, was being used for agricultural purposes by such Hindu undivided family or individual or a parent of his;
- (iii) such transfer is by way of compulsory acquisition under any law, or a transfer the consideration for which is determined or approved by the Central Government or the Reserve Bank of India;
- (iv) such income has arisen from the compensation or consideration for such transfer received by such assessee on or after the 1st day of April, 2004.

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.1,10,000 / Rs.1,45,000 / Rs.1,95,000). 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: Deduct rebate u/s 88E from the amount of tax obtained in step 3.

Step 5: Add surcharge, if applicable, to the amount obtained in step 4 above.

Step 6: The sum so arrived at shall be increased by education & higher secondary cess @3%.

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, the 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:

- (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.

Example :

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
= [Rs.10 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.

Example :

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.

Computation Logic

Step No.	Particulars
Step 1	Determine the residential status.
Step 2	Include the income covered in the scope based on Residential status
Step 3	Classify the income on Following basis (A) Income from salaries (salaries plus bonus plus commission plus taxable allowances plus taxable perquisites less deductions u/s 16). (B) Income from house property [Net annual value of the property less deductions u/s 24 (1)]. (C) Income from business profession (Net profit as per Profit & Loss account plus adjustments required as per the Act). (D) Income from capital gains (short term and long term) (capital gains less exemptions u/s 54, 54B, 54D etc.) (E) Income from other sources (Gross income less deductions) (F) Compute income to be clubbed e.g. minor children, spouse, etc. (G) Income Exempt from Tax
Step 4	Aggregate the income to arrive at gross total income for the previous year.
Step 5	Arrive at Gross income after adjusting brought forward loss/set-offs.
Step 6	Compute Total Income after adjusting deductions as provided in Chapter VI-A of the Act.
Step 7	Round off the amount arrived at as above to the nearest multiple of ten rupees (section 288A)
Step 8	Add net agricultural income for rate purposes.
Step 9	Apply the rates of tax prescribed in the relevant Finance Act.
Step 10	Round off the tax amount to the nearest ten rupees (section 288B)
Step 11	Compute tax liability by including surcharge, if applicable, and education cess and higher secondary education cess as per the Finance Act.
Step 12	Provide for relief u/s 86, 89 to 91 of the Act.
Step 13	Provide tax credits for advance tax/tax collected at source of payment including those in respect of income clubbed.
Step 14	Compute interest payable for belated tax payments.
Step 15	Provide for self assessment tax paid.
Step 16	Calculate tax payable/refund due.



TAX PLANNING VS. TAX EVASION

The word ‘tax planning’ connotes the exercise carried out by the taxpayer to meet his tax obligations in proper, systematic and orderly manner availing all permissible exemptions, deductions and reliefs available under the statute as may be applicable to his case. To illustrate, assessee software company setting up assessee software technology park in assessee notified area to avail benefits of section 10A of the Act is assessee legally allowable course. Planning does not necessarily mean reduction in tax liability but is also aimed at avoiding controversies and consequential litigations.

Every taxpayer is expected to voluntarily make disclosures of his incomes and tax liabilities through legal compliance. When a tax payer deliberately or consciously do not furnish material particulars or furnishes inaccurate or false particulars or defrauds the State by violating any of the legal provisions, it shall be termed as ‘tax evasion’. It is also illegal, but also unethical and immoral. Inflation of expenditure, suppression of income, recording of fictitious transactions, claiming deductions wrongly are few examples.

Benjamin Franklin is credited with this classical statement: There are two certainties in this world – death and taxes. This makes all tax payers in general, and the companies in particular, realize the bitterness or hardship of taxes. Three methods of saving taxes have been developed in most countries of the world in the past few decades: tax evasion, tax avoidance and tax planning. A great deal of confusion prevails in corporate sector about correct connotations of these terms. Hence, we shall attempt to explain these terms to show tax planning is absolutely legal. The expression ‘Tax Evasion’ means illegally hiding income or concealing the particulars of income or concealing the particular source or sources of income or in manipulating the accounts so as to inflate the expenditure and other outgoings with a view to illegally reduce the burden of taxation. Hence, tax evasion is illegal and unethical. It is uneconomical as well. It deserves to be deprecated not only by the Government but by the companies as well. The next expression is ‘Tax avoidance’ which is assessee art of dodging taxes without breaking the law. In my opinion, tax avoidance means traveling within framework of the law or acting as per language of the law only in form, but murdering the very spirit of the law and defeating the purpose of the particular legal enactment. If, by adopting an artifice or device against the intension of the legislature but apparently on the face of it acting within the framework of the law, a company is able to dodge income tax, it would be a clear case of tax avoidance. In contrast, ‘Tax Planning’ takes maximum advantages of the exemptions, deductions, rebates, reliefs, and other tax concessions allowed by taxation statutes, leading to the reduction of the tax liability of the tax payer. Tax planning has been contrasted with the expression tax avoidance and has the legal sanction of the Supreme Court as well. In recent years the sentiments in favor of tax avoidance have changed and the courts view tax avoidance with displeasure. For example, Lord Sumner in *IRC Vs Fisher’s Executors* ac 395, 412 had earlier as per the ratio of *Westminster’s* case said:

“My Lords, the highest authorities have always recognized that the subject is entitled so to arrange his affairs as not to attract taxes imposed by the Crown, so far as he can do so with the law, and that he may legitimately claim the advantage of any express terms or any omissions

that he could find in this favor in taxing Acts. In so doing, he neither comes under liability nor incurs blame.”

The significance of Ramsay as assessee turning point in the interpretation of tax laws in England and the departure from the principle of Westminister’s case were explained in TRC Vs. Burmah Oil Co. Ltd., STC 30 where Lord Diplok said:

“It would be disingenuous to suggest and dangerous on the part of those who advise on elaborate tax-avoidance scheme to assume, that Ramsay ‘s case did not mark assessee significant change in the approach adopted by this House its judicial role to assessee pre-ordained series of transactions into which they were inserted steps that have no commercial purpose apart from the avoidance of tax liability, which in the absence of those particular steps would have been payable. The difference is in approach.”

Commenting on this judgment the Supreme Court of India in the McDowell Co. Ltd., Vs. CTO 154 ITR 148(SC) said:

“It is neither fair nor desirable to except the legislature to intervene and take care of every device and scheme to avoid taxation, it is up to the court to determine the nature of new and sophisticated legal devices to avoid tax and consider whether the situation created by the devices for what they really are and to refuse to give judicial benediction.”

In the same judgment, Supreme Court Judges made a clear distinction between tax avoidance and tax planning. This is what the judges of the Supreme Court have said in the same case:

“Tax Planning may be legitimate provided it is within the framework of law. Colorable devises cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honorable to avoid the payment of tax by resorting to dubious methods. It is the obligation of every citizen to pay the taxes honestly without resorting to subterfuges.”

Form the above it is very clear that tax planning by Assessee Company cannot be called a crime or an illegal activity or an immoral action as is wrongly considered by confused thinkers on the subject. What constitutes a crime is tax evasion and what is undesirable is tax avoidance but it is certainly desirable to engage in the exercise of tax planning.

In UK, wherefrom the principal coined in McDowell’s case was coined, the House of Lords expressly reaffirmed the basic principle, ‘A subject is entitled to arrange his affairs so as to reduce his liability to tax. The fact that the motive for a transaction may be to avoid tax does not invalidate it unless a particular enactment so provides’.

The House of Lords expressly reaffirmed the cardinal principle of *Duke of Westminister*, ‘Given that a document or transaction is genuine, the Court cannot go behind it to some supposed underlying substance’. They only ruled against the principle being overstated or overextended.

Mukharji J, who in his prompt and lethal report in CWT v Arvind Narottam said: ‘...no amount of moral sermons would change people’s attitude towards tax avoidance’, and soon thereafter in UoI v Playworld Electronics stated: ‘one should avoid subverting the rule of law’. As a matter of law, the Supreme Court in these two latter cases reiterated that where the true effect



of a transaction is clear, the appeal to discourage tax avoidance is not a relevant consideration.

In any event, when the language of a deed of settlement is clear, an attempt to invoke McDowell would be futile even if the deed results in tax avoidance. as the Madras High Court held in Valliapan Vs. ITO, McDowell does not hit tax planning.

The manner in which McDowell is to be dealt with was well summed up by the Gujarat High Court in Banyan and Berry Vs. CIT thus:

The court (in McDowell) nowhere said that every action or inaction on the part of the taxpayer which results in reduction of the tax liability to which he may be subjected in future, is to be viewed with suspicion and be treated as a device for avoidance of tax irrespective of legitimacy or genuineness of the act.... The principle enunciated in the above case has not affected the freedom of the citizen to the act in a manner according to his requirements, his wishes in the manner to do any trade, activity or planning his affairs with circumspection, within the framework of law, unless the same falls in the category of colourable device.

The House concluded that steps which had no commercial purpose and had been artificially inserted for tax purposes into a composite transaction, should be disregarded; but that a transaction which came into statutory language could not be disregarded merely because it was entered into solely for tax purposes.

Therefore, while tax planning these principles emanating from court made law need to be kept in sight. Otherwise, planning looking good on paper may fail in practice.

Tax Management

Planning which leads to filing of various returns on time, compliance of the applicable provisions of law and avoiding of levy of interest and penalties can be termed as efficient tax management. In short, it is an exercise by which defaults are avoided and legal compliance is secured. Through proper tax planning and management, the penalty of upto Rs.100000 for delay in furnishing of tax audit reports u/s 44AB can be avoided.

Similarly by applying for Permanent Account Number (PAN), the penalty under the Act can be avoided. The borrowal of loan otherwise than by way of an account payee cheque or bank draft attracts 100% penalty and this can be avoided by conscious planning of the execution of loan transactions. Planning is a perception conceived on legitimate grounds and achieved through genuine transactions within the framework of law e.g. contribution to Public Provident Fund and claiming rebate u/s 88 of the Act. The filing of the returns with all proper documentary evidence for the various claims, rebates, reliefs, deductions, income computations and tax liability calculations would also be termed as tax management.

Tax management is also an important aspect of tax planning.

Assessee is exposed to certain unpleasant consequences if obligations cast under the tax laws are not duly discharged. Such consequences take shape of levy of interest, penalty, prosecution, forfeiture of certain rights, etc.

Therefore, any effort in tax planning is incomplete unless proper discharge of responsibilities is not made.

Tax management includes:

1. Compiling and preserving data and supporting documents evidencing transactions, claims, etc.
2. Making timely payment of taxes e.g. advance tax, self assessment tax, etc.
3. TDS and TCS compliance
4. Following procedural requirements e.g. payment of expenses or acceptance of loans or repayment thereof, over Rs. 20,000 by account payee bank cheque or bank draft, etc.
5. Compliance with the prescribed requirements like tax audit, certification of international transactions, etc.
6. Timely filing of returns, statements, etc.
7. Responding to notices received from the authorities.
8. Preserving record for the prescribed number of years.
9. Mentioning PAN, TAN, etc. at appropriate places.
10. Responding to requests for balance confirmation from the other assesseees.

Tax Implications in Planning

The main objectives in any exercise on tax planning are to :—

1. Avail all concessions and relief's and rebates permissible under the Act.
2. Arrange the affairs in a commercial way to minimize the incidence of tax.
3. Claim maximum relief where taxes are paid in more than one country.
4. Become tax compliant and avoid penalties, prosecutions and interest payments.
5. Fruitful investment of savings.
6. Timely compliance of procedural requirements like tax audit, TDS, TCS, etc.
7. Appropriate record keeping
8. Avoidance of litigation.
9. Growth of economy and its stability.
10. Pay taxes – not a penny more, not a penny less.



Legal Status of Business Units

Individuals, HUFs, AOPs, BOIs:

The incidence of tax would vary depending upon the legal constitution of the person. In the case of individuals, HUFs, AOPs or BOIs and every artificial judicial person (except where different rates or maximum marginal rates are specifically provided), the tax rates are as under

Up to Rs.110000	Nil
Rs. 110001 to 150000	10 percent
Rs. 150001 to 250000	20 percent
Above 250000	30 percent

In case of every individual, being a women, resident in India and below the age of 65 years at any time during the previous year, the rate of income-tax on total income will be as under –

Up to Rs.145000	Nil
Rs. 145001 to 150000	10 percent
Rs. 150001 to 250000	20 percent
Above 250000	30 percent

In case of every individual, being a resident in India, who is of the age of 65 years or more at any time during the previous year, the rate of income-tax on total income will be as under –

Up to Rs.195000	Nil
Rs. 195001 to 250000	20 percent
Above 250000	30 percent



In addition to the above surcharge at 10% is leviable in case the total income exceeds Rs.1000000. Surcharge is calculated on the income-tax payable after claiming rebate u/s 88, 88B and 88C. The same is applicable in respect of tax on long term capital gains u/s 112, tax on undisclosed income assessed under block assessment at 60% u/s 113 and tax rate of 30% in respect of winnings from lotteries, etc u/s 115BB. In case the total income does not exceed Rs.1000000,

The above rates are applicable to AOPs and BOIs where none of the members have taxable income. These rates are applicable to private trusts, political parties and other artificial judicial persons, except where maximum marginal rate is specifically made applicable by law.

Firms and Companies

Partnership firms and domestic companies shall be liable to tax at the rate of 30%. Surcharge @ 10% is payable on the income-tax if income exceeds rupees one cr. Education cess @ 2% and Secondary and higher secondary education cess @1% of income tax plus surcharge is applicable to all firms and companies.

The formation of a partnership firm even in the corporate sector as a method tax planning is very popular as it enables the distribution of profits even amongst minor and ladies of the family of directors who cannot otherwise have large incomes. All profits of a partnership firm after allowing deduction at 12% interest on capital or salary to working partners are normally distributed to the partners. It is often advantageous for individuals to convert their sole proprietary business into a partnership concern and to take the loan creditors as partners and not to further convert the business into a company. That is why even the corporate sector one of the accepted and well – known methods of tax planning is by the formation of a partnership firm and by getting it assessed as a firm by the Assessing Officer. Ladies can also join a partnership firm as full-fledged partners and can be assessed separately in respect of their salary or interest income from the firm.

Sometimes it is advantageous for a sole proprietary concern to convert the same into a limited liability company. In case of a sole proprietary concern, surcharge becomes applicable when income exceeds Rs. 10 lac. A limited liability company enables the director's remuneration and salaries to the members of the family to be regulated within the purview of law so as to achieve the best advantage of income -tax rates. The total corporation tax on industrial profits and the personal income – tax on the salary and perks are sometimes lower than the individual income – tax on income falling in the highest income bracket. This is an immense benefit and is usually taken advantage of in the formation of a company and results in preservation of working capital. Generally speaking, where the individual income is substantially high and the profits are derived from industries it is advantageous for individuals to convert the business into private Ltd. companies. When the remuneration payable to the directors is taken into consideration, the incidence of income – tax on the conversion of the sole proprietary concern into a limited company is very much lessened.

One of the most important questions that is often asked in the case of medium scale business enterprises is: whether it would be advisable for a partnership firm to convert itself into a limited company? There is no straight answer to this question as the answer to the question



would depend upon the facts and circumstances of each case. In the case of partnership firm income – tax payable by firm @ 30% plus surcharge as applicable, partners pay tax on salary and interest. It contrasts with this position the income – tax payable by company is 30% and applicable surcharge but various perquisites, many of which are tax-free for employees. Thus, generally speaking, the effective rate of income-tax payable by a closely held company and directors is much lower than the highest income-tax rates payable by the firm and the partners. Besides, there are various allowances which, if given to the partners of the firm on becoming directors or executives of the company, get complete tax deduction while computing the taxable income of the company like salary and perquisites. The salary and perquisites payable to the partner are not fully allowed as a deduction while computing the income of the partnership firm whereas the same are allowable as a deduction while computing the income of the company concerned. There are various perquisites like rent – free residential accommodation, medical reimbursement, etc., which are completely exempt from income-tax up to a certain level of the perquisite value and only a very nominal amount is added as the taxable value of the perquisite whereby a lower amount becomes taxable in the hands of the employees concerned. Besides, in the case of a company it is possible to distribute the share capital to the various members of the family in such a way that the dividend distributed by the company gets a complete exemption under section 10(33).

All these factors combined together generally result in a lower rate of income-tax incidence in the case of a company and for the directors and executives as compared to the partnership firm and its members. However, the answer to the question whether a partnership firm converts itself into a limited company depends upon the total income of the firm, the various individual incomes of the individual members who were partners and who now become directors or executives of the companies and various other circumstances, the correct answer can be found only on completing this calculation. In the case of two alternatives, when the second alternative, i.e. of formation of a company through the conversion of the partnership firm into the company, results in a lower incidence of tax from the company and the directors together, in comparison to that in the case of the partnership firm and the partners together, then it is a case for consideration as to whether through proper tax planning the firm should convert into a limited company. In most of the cases, it may not be possible to convert the partnership firm into a limited company even though the rate of income-tax generally applicable to the profits and gains of the public limited company is 30% plus applicable surcharge thereon. Yet due to various formalities and the complications involved in the process of running a public limited company, it may not be worthwhile for a firm to convert themselves into a public limited company straightaway.

Under the provisions of section 45(4) of the income-tax Act income-tax is payable on the deemed capital gains if there is a distribution of capital assets on the dissolution or otherwise of a partnership firm. Where a partnership firm is converted into a private limited company or a public limited company, and the assets are taken over at the written down value in the income-tax records, there is no capital gain accruing to partnership firm as such. As there is no distribution of capital assets on the dissolution of a firm which is simply a necessary step made to effect conversion of the firm into a limited company, there is also no deemed capital gains under

Section 45(4). Hence, there is no risk of income-tax payable on the deemed capital gains when there is a conversion of a partnership firm into a company.

When a partnership firm converts into a limited company, whether a private or a public one, it loses the advantages of carry forward of unabsorbed depreciation and a carry forward of past business losses.

Under the new Section 47(xiii) of the Act full exemption would be allowed in case of capital gains on the conversion of a partnership firm into a company effective from AY 1999-2000. Thus, it is provided that where a firm is succeeded by a company in the business carried on by it as a result of which the firm sells or otherwise transfers any capital assets or intangible assets to the company, the entire capital gains would be exempt from tax provided that the following conditions are fulfilled:-

- (a) All the assets and liabilities the firm relating to the business immediately before the succession becomes the assets and liabilities of the company;
- (b) All the partners of the firm immediately before the succession become the shareholders of the company in the same proportion in which their capital accounts stood in the books of the firm on the date of succession;
- (c) The partners of the firm do not receive any consideration or benefit directly or indirectly, in any form or manner other than by way of allotment of shares in the company; and
- (d) The aggregate of the shareholding in the company of partners of the firm is not less than 50% of the total voting power in the company and their shareholding continues to be as such for a period of five years from the date of succession.

Likewise, when a sole proprietary concern is succeeded by a company in business carried on by it as a result of which the sole proprietary concern sells or otherwise transfer any capital asset or intangible assets to the company, the entire amount of capital gains would be fully exempt from tax under Section 47(xiv) from the AY 1999-2000. However, the following conditions will have to be fulfilled;

- (a) All the assets and liabilities of the sole proprietary concern relating to the business immediately before the succession become the assets and liabilities of the company;
- (b) The shareholding of the sole proprietor in the company is not less than 50% of the total voting power in the company and his shareholdings continues to so remain as such for a period of five years from the date of the succession; and
- (c) The sole proprietor does not receive any consideration or benefit, directly or indirectly, in any form or manner other than by way of allotment of shares in the company.

Section 47A(3) has, with effect from AY 1999-2000 as inserted by the Finance (No. 2) Act, 1998 provided that if any of the above conditions are not complied with, the benefit availed by the firm or the sole proprietor, as the case may be, would be deemed to be profits and gains charge-

able to tax of the successor company for the previous year in which the above requirement are not complied with.

Foreign Companies:

The effective tax rate applicable to a foreign company is 40%. In respect of certain specified income, such as royalty, fees for technical services, etc, special rates of tax are prescribed at 20% or even less. The ultimate tax liability of a foreign company or any other non- resident will depend upon the applicability of Double Taxation Avoidance Agreement (DTAA), if any entered into between India and the respective country. The rates prescribed under the DTAA or the normal rates prescribed under the Act, whichever is more beneficial to the assessee shall be applicable.

Cooperative Societies:

The rate of tax applicable to cooperative societies is as under:

Income	Rate of tax
Upto Rs. 10000	10%
Rs10001 to Rs. 20000	20%
Above Rs. 20000	30%

Local Authority:

In the case of local authorities, the rate of income-tax specified is 30% on the whole of the total income.

Tax Planning and Salaries

A good remuneration package is one, which meets the following objectives:

- 1) Optimizing the tax liability of the employee.
- 2) Maximizing the take-home pay.
- 3) No disallowances are faced by the employer in respect of such remuneration.
- 4) Incidence of Fringe Benefits Tax (FBT) on employer.

Taking the above objectives, the following are some the tax planning measures:

- 1) Instead of paying fixed amount of salary, the salary can be structured into basic pay with allowances and perquisites so that the employee can avail exemptions under various provisions. Employer in any case can claim deduction for the all amounts paid e.g. conveyance allowance paid to meet the expenditure in performance of duties of an office which is exempt under section10(14) in the hands of employees.
- 2) In respect of the own accommodation provided to the employee, employer is eligible to claim depreciation on such accommodation. The employer also can avail the repairs and

maintenance and other cost as business expenses. The employee will be taxed for the perquisite of rent free accommodation, which is concessionally valued. Moreover, the employer will have advantage of appreciation in value of the property.

- 3) The employer can institute welfare oriented long term savings on behalf of the employee such as recognized provident fund (RPF), approved superannuation fund, pension plans, gratuity fund which are exempt from tax in the case of employee and deductible in the case of employer, incidentally such measures compel the employee save in rainy days.
- 4) To ensure that dearness allowance forms part of salary because incidence on entertainment allowance, gratuity, commuted pension and employer's contribution to RPF is considerably reduced. Any commission scheme paid as a percentage of turnover can also be introduced as it serves the above objective.
- 5) The employer may introduce LTC facility at all levels as this is exempt u / s 10(5) subject to limits provided therein and the employee shares the benefit with his spouse, children and dependent parents, brothers and sisters.
- 6) The employer may introduce leave encashment facility, as employee can earn tax free remuneration under section 10 (10AA).
- 7) Certain perquisites are not taxable in the hands of employees while employer is also not liable for FBT :
 - i) food or beverages provided by the employer to his employees in office or factory
 - ii) provision of paid vouchers which are not transferable and usable only at eating joints or outlets
 - iii) conference fee for participation
 - iv) facilities to fulfill any statutory obligation or mitigate occupational hazards
 - v) provide first aid facilities in the hospital or dispensary run by the employer

Providing such perquisites is a win-win situation both for an employer as well as an employee.

- 8) Certain perquisites are not taxable in the hands of employees however the employer is liable for FBT :
 - i) Reimbursement of medical expenses up to Rs. 15,000
 - ii) Provision of car for personal use,
 - iii) Provision of telephone for personal use,
 - iv) maintenance of any accommodation in the nature of guest house
 - v) festival celebrations
 - vi) use of health club and similar facilities;



- vii) use of any other club facilities;
- viii) gifts;
- ix) scholarships;

While providing such perquisites cost of FBT and tax saving of employee can be compared.

Tax Planning and Income from House Properties

The scope for tax planning in respect of property income is very limited since the deductions are specifically stipulated u/s 24 without any flexibility. However the following are illustrative examples as to how tax planning can be achieved under this head:

1. Where a building belonging to HUF is a subject matter of partition, the portion generating income can be allotted to a member who does not derive any income. And in case of the self occupied portion, it should be allotted to the member who has huge income from other sources.
2. Where the construction of a house is being undertaken on the land owned by a husband or wife the amenities such as electrical fittings, sanitary ware etc. can be provided by the other spouse. In such a case the rent can be earned by the owner while the charge for the amenities can be taken by the provider of the amenities. In this way the rent income gets split among the husband and wife. The investment in amenities of course should be made by the spouse who is earning income.
3. Where the tax payer occupies more than two houses for self occupation, he may transfer the house to his major son or daughter or any other family member except the spouse and minor children, who presently reside in that house. In such case, the provisions of section 27 deeming the owner as tax payer will not get attracted. The transferee who becomes the legal owner can treat it as self-occupied and adopt the annual value as NIL. Clubbing provisions of section 24 and section 4 wealth tax would not be applicable.
4. If a second house is proposed to be bought in the name of the spouse then instead of first buying it and the gifting it to the spouse, cash gifts should be thought of and the house should be directly bought in the name of the spouse. It ensures that the expenses on registration and stamp duty are incurred only once. This will avoid applicability of Section 27. However clubbing provisions of Section 64 will be attracted. If such house is self occupied the annual value will be taken as NIL and no tax impact arises even on account of section 64.
5. Interest on loan taken for construction or purchase of house is paid to a non resident outside India; tax should be deducted at source to avoid denial of deduction u/s 25 in computing the taxable income from house property.
6. If assessee proposes to construct/buy two houses out of self-owned as well as borrowed funds, self-owned funds should be invested in the unit which will be self-occupied, while in respect of the unit which is to be let out, borrowed funds can be invested, as there is no restriction in terms of interest deduction u/s 24 in the computation of property income.

7. It is possible that both husband and wife earn income and they may want to invest their funds in a house for self occupation. In such a case, they can raise funds together and become co-owners of the property. Repayment of loan and interest shall be borne by both of them, thereby enabling them to avail deduction for interest in each case upto the permissible limit as well as rebate under section 88 on repayment of principal amount. If properly planned, deduction on account of interest on loan will be available to the extent of Rs. 1,50,000 u/s 24 for each assessee subject to the fulfillment of other conditions and rebates upto Rs. 20,000 u/s 88 in case.
8. One of the important considerations while adopting tax planning for investment in real property is particular needs of the family. For example: the house is owned by the head of the family, a portion of the house can be reserved for carrying a business or a profession, etc.
9. Depending upon the liquidity needs of the family, the tenure of the investment in property, whether for a short term of 2 to 5 years or for long term of 5 to 10 years or 15 years or even longer has to be planned.
10. In case of self occupied property obtained from borrowed funds if the interest is subsequently more than Rs. 1,50,000 then possibility of letting it out to other member may be considered because in case of let out property there is not restriction on deduction for interest.
11. Where property is used for business it becomes the part of block of assets. When the block of asset is sold resultant gain is short term capital gain, irrespective of period of holding. When house property is sold which is held for more than 36 months resultant gain is long term capital gain. Therefore in when own asset is used for business planning can be made availing the benefits of long term capital gains depending upon probable tenure of use.
12. The amount of municipal tax is deductible on 'payment' basis and not on 'due' or 'accrual' basis. It should, therefore, be ensured that municipal tax is actually paid during the previous year if assessee wants to claim deduction. If tax of more than one year is paid in any previous year, the entire amount of tax paid qualifies for deduction in the year of payment.
13. Where the assessee gives certain quarters on rent to his employees and charges rent from them then the rental income would be treated as business income and not income from house property. CIT Vs Delhi Cloth & General Mills Co. Ltd. 59 ITR 162 (Punj). Therefore, there will be no income from house property.
14. Where buildings owned by a company were occupied as rent free by directors and senior executives, it was held building was occupied for business purposes. CIT Vs Vazir Sultan Tobacco Ltd. 173 ITR 290 (AP). Therefore, there will be no income from house property.
15. The assessee can claim certain deduction under Section 57 from the income chargeable under the head "Income from other sources"
 - (a) In case of family pension Rs.15000 or 1/3 of such income whichever is lower



- (b) In case of machinery, plant or furniture let on hire, cost of repairs, insurance premium, depreciation etc.

Tax Planning and Income from Business or Profession

1. Choosing legal entity:

In view of the differential tax rates prescribed and various concessions and deductions that may be available only in respect of certain entities, choosing appropriate legal form assumes importance. Under the tax laws, the definition of the term 'person' is illustrative. Apart from tax considerations would throw up needs to associate with others, ensuring limited liability, capital raising capabilities, etc. Even amongst companies, a company can be a public limited company in which public are substantially interested, commonly known as 'widely held company', a closely held company, etc. There are certain provisions of Income-tax Act that are applicable only to closely held companies. Example: Section 2(22)(e) - deemed dividend, section 79.

Further, with the advent of Dividend Distribution Tax (: DDT - section 115O), take home by owners by way of dividend in case of company DDT is attracted, which is saved in case of a partnership firm. Further tax on book profits (commonly called MAT) is applicable to companies only and not to the other forms of organisations.

2. Nature of business:

Apart from economic factors such as scope, profitability, feasibility factors the benefits and concession available to each line of business may also be pursued before expanding an existing line of business. To illustrate, export business is eligible for tax holiday u/s 10B for 10 years subject to fulfilment of certain conditions. If such a unit is situated in Free Trade Zone (FTZ) / Special Economic Zone (SEZ), etc. can be explored. Further in the case of certain manufacturing units, hotels, hospitals, and ships covered u/s 80-IB, deduction from profits is available for a period of 10 years / 8 years at the appropriate percentages specified. Infrastructure projects in electricity, communication, natural gas, etc. deductions are provided under section 80IA.

3. Other activities:

Allied activities to existing business can also be planned keeping in view the additional benefits that may be available. Any scientific research activity that may be necessary for promoting or expanding the existing capital and revenue expenditure incurred in connection therewith in computing the profit u/s 35 of the Act.

4. Location of business:

Although certain factors such as nearness to the source of raw materials or market or availability of infrastructure may be factored in taking a decision on the location of the business, tax considerations also play a role. If an industry is located in Backward State or a Backward District, deduction u/s 80-IC is available. Hotels and convention centers in specified areas are al-

lowed deduction under section 80ID. If it is situated in a FTZ or Export Processing Zone (EPZ) or SEZ, exemption u/s 10A is available. Besides, eligibility for subsidy in certain locations would also prove to be attractive.

5. Sources of funds:

An entity mobilizes funds by way of capital stock or debt instruments. Plough back of profits is yet another way of resource mobilisation. In the case of proprietary concerns, the entire profits computed under the law would be taxable without any allowance for salary or interest on the effort and the capital contributed by the owner. In case of partnership firms, the salary and the interest paid to the partners can be claimed as deduction subject to the limits and conditions prescribed u/s 40(b) and the balance profits as computed in accordance with the law shall be taxed at 30% plus applicable surcharge and cess. Interest and salary received by the partners shall be charged to tax as business income to the extent allowed in the case of the firm. In case of the corporate entity, dividend can also be declared on equity to the shareholders in the presence of profits subject to the provision of the Company Law. Declaration of dividend attracts tax @ 15% plus applicable surcharge and cess and in turn the shareholder enjoys tax free income. While dividend is only an appropriation of profits, interest is a charge against the profits. On payment of dividend, the taxable income of the company remains unaltered. However, interest on loans or debentures is deductible from profits of the business. The financial commitments on loan obligation may lead to or enhance the business loss irrespective of whether the business earns profit or not. It would always be better to have proper debt-equity ratio and clear policy on return on capital employed.

6. Ownership Vs lease of assets:

This is more elaborately discussed elsewhere in study material and this is yet another factor that is considered as an area of tax planning.

7. Commencement of business:

In availing certain exemptions or deductions that are permissible for certain number of years under the provisions of the Income-tax Act, the timing of the commencement of business assumes significance. For example Section 10A, 10B, 32, 35A, 35D, 80-IA, etc.

Besides expenditure incurred prior to commencement of business can be either capitalised or amortised u/s 35D. However deduction cannot be claimed in respect of such expenditure after commencement of such business unless expressly stated as in the case of section 35 with reference to scientific research expenditure during three years preceding commencement of business.

Interest on loan borrowed required to be capitalised upto the date of commencement of production as was held in Challapalli Sugars Limited Vs CIT 98 ITR 167 (SC). This decision is supplemented by an explanation 8 to section 43(1) which makes it clear that interest relating to the period after the asset is first put to use shall never form part of actual cost.



Interest relating to the period after the business commences but before the asset is first put to use can still be claimed as revenue expenditure-34 ITR 265 (Bom); 120 ITR 37 (Kar). Interest on loans borrowed and used for acquisition of asset for business expansion and diversification is a revenue expenditure – CIT Vs Prithvi Insurance Company Limited 63 ITR 632 (SC); Produce Exchange Corporation Limited Vs CIT 77 ITR 739 (SC); BR Limited Vs CIT 113 ITR 647 (SC); 169 ITR 499 (Raj). However, section 36 the interest paid, in respect of capital borrowed for acquisition of an asset for extension of existing business or profession; 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, shall not be allowed as deduction. Therefore, such interest should be capitalised and depreciation should be claimed on enhanced value of asset.

8. Choice of method of accounting:

Section 145 of the Act stipulates that the income of profits and gains of business or profession and income from other sources shall be computed on the basis of method of accounting regularly employed by the taxpayer. Though an assessee has the option of either accrual or cash or hybrid system of accounting, the corporate bodies are required to follow accrual system of accounting only u/s 209 of the Act. Further section 145 as amended with effect from assessment year 1997-98, does not recognize hybrid system of accounting. The revenue recognition irrespective of the method followed has to have nexus with the nature and character of the amount accrued or received and the year of such accrual or receipt - State Bank of Travancore Vs CIT 158 ITR 102 (SC); City Bank's case 208 ITR 930 (Bom). Also CBDT circular 491 dated 30-06-1987 (166 ITR St. 149); 49 ITD 190; 50 ITD 14. A mere book entry or an accounting treatment may not be relevant or conclusive evidence for tax purposes. Not recording of expenditure in the books will not render such expenditure inadmissible for tax purposes - Kedarnath Jute Mfg. Co. Ltd Vs CIT 82 ITR 363 (SC). By routing an item of income through suspense account to the balance sheet instead of the P&L account by crediting the relevant income head will not deny the chargeability of such item- State Bank of Travancore Vs CIT 158 ITR 102 (SC). It is open to an assessee to change the method of accounting regularly adopted by him, provided it is not for a casual period. Such a bonafide change should be accepted even if it results in reduction of tax liability- 193 ITR 349 (Bom); 42 ITD 35; 43 TTJ 319. However an assessee cannot be permitted to maintain mercantile basis for other laws and cash basis for income-tax purposes - 43 ITD 386. Every assessee covered by the provisions of section 44AA read with Rule 6F is required to maintain proper books of account. Once the books are so maintained, computation of taxable income shall be on that basis. Where the books of accounts are incomplete or incorrect, the Assessing Officer can reject the books of accounts and complete the assessment u/s 144. The same consequence would follow if the assessee does not follow the accounting standards notified u/s 145(2) with effect from AY 1997-98.

9. Stock valuation:

Inventories should normally be valued at lower of the historical cost and net realizable value. Either FIFO or weighted average method or specific identification method in certain circumstances as permitted in AS-2 issued the Institute of Chartered Accountants of India can be followed. As per the revised standard, the other methods namely LIFO, average cost, base

stock method have been omitted. Similarly in the case of manufactured inventories, only absorption costing method is recognized. Section 145A of the Income-tax Act requires valuation of purchase and sale of goods and inventory in accordance with the method of accounting regularly employed by the assessee. To such valuation, adjustments towards duty, tax, cess or fee actually paid or incurred to bring the goods to the place of its location and condition as on the date of valuation is allowed. Such inclusion should be without giving credit for any benefit that may accrue in the form of Modvat, etc. Therefore for tax purposes, the principle involved is inclusive of duties, etc. Dual method of accounting, one for tax purposes and another for bookkeeping is well recognised – United Commercial Bank Vs CIT 240 ITR 355 (SC). The Assessing Officer has power to substitute incorrect method with proper method as was held in British Paints India Ltd. 188 ITR 44 (SC). When the method of valuation is changed, the valuation of opening stock need not be disturbed and the difference between the old and new methods of valuation of closing stock should not be included for assessment – Carborandum Universal Ltd. 149 ITR 759 (Mds); Mopeds India Ltd. 173 ITR 347 (AP). Where the firm is dissolved, the closing stock should be valued at market rates – ALA firm Vs CIT 189 ITR 285 (SC). If the stock of the firm is taken over by a partner at cost, the value of the stock should be based on market rates to arrive at the correct profit taxable in the hands of the firm. If there is no discontinuance of the business on account of dissolution and the remaining partners reconstitute the firm, the stock need not be valued at market price. It can be valued at cost or market price; whichever is less – Sakthi Trading Co. Vs CIT 250 ITR 871 (SC). Where the firm is converted into a company as a going concern with identify of beneficial ownership remaining the same, there is no need for stock valuation – CIT Vs Koder 233 ITR 620 (Ker).

10. Expenditure on scientific research:

- (a) Expenditure incurred on in-house R&D is a business expense, if the research is related to the business. In certain cases possibility of weighted deduction exists, where necessary approvals are obtained.
- (b) If the research is not related to the business, it would be better to contribute to an approved research association to undertake such research work. Such contribution is business expenditure.
- (c) Land acquired for R&D project is not business expenditure. If the same land is taken on lease, lease rentals paid is business expense u/s 35 as well as under section 37.
- d) Where any asset used for scientific research is sold without having used for any other purpose, the implication of deemed business profits u/s 41 should be analysed.

11. Travel expenses:

The travel expenses of the spouse were held inadmissible, if such travel is not for business consideration - CIT Vs T. S. Hajeemoosa & Co., 153 ITR 422 (Mds). If the wife were to travel on account of business expediency, she may be made a partner in the firm. In such case both the husband and wife can travel not only as business partners but also as life partners and claim



business expenditure on travel. The share of profit of the spouse cannot be clubbed with that of the husband as the same is exempt u/s 10(2A).

12. Employee welfare funds:

The contribution of the employees' welfare funds should not be delayed beyond the time limits prescribed under the relevant Acts. It would be better to borrow and pay the tax liability on or before the relevant due date. Contribution made to the welfare funds after the due date does not qualify for deduction even in the year of payment. However interest on money borrowed for meeting this liability qualifies as business expense.

13. Disallowances

There are certain provisions which provide for express disallowances. In certain cases disallowance is attracted only if the conditions laid down are not observed. Care should be taken to avoid disallowance by making necessary compliances. For example:

- i) Interest, salary, royalty, fees for beneficial services or any other sum payable outside India is not deductible unless tax is deducted at source or tax is paid.
- ii) TDS where required is not made or not paid to the government in case of payments to residents.
- iii) In case of partnership, Interest to a partner or remuneration to any working partner by a firm is not deductible unless the necessary conditions are fulfilled.
- iv) Any payment by way of interest, salary, bonus, commission or remuneration paid by an association of persons or body of individuals to any of its members is disallowed.
- v) Where the assessee incurs any expenditure incurred over Rs. 20,000 otherwise than by account payee cheque drawn on a bank or account payee bank draft, deduction will not be allowed in respect of such expenditure.

14. Fringe Benefits Tax (FBT)

Certain expenses are exposed to FBT. This tax incidence should be reduced. Discussion is made elsewhere.

15. Allocation of Expenses between Exempt and Taxable Sources of Income:

Expenditure incurred in relation to income not includible in total income is not deductible from income under any source which is taxable (Section 14A).

It is, therefore necessary to plan as follows:

1. Investments for sources that yield tax free income e.g. agricultural income, shares (since dividend is exempt), P.P.F. deposit (since interest is exempt), SEZ, etc. should be made from own capital. If borrowed funds are necessary less costly funds should be used for such activities.

2. Where common overheads are incurred, while availing benefit for exempt source keeping in view that part of such common costs will be apportioned. Therefore, care should be taken to preserve data that will help in reducing such allocation to exempt source e.g. instead of using any vehicle from the common fleet, depending on user, less expensive vehicle can be directly allocated and used for exempt source.

This provision is applicable to all sources of income

Tax Planning and Income from Capital Gains

1. Capital gains is chargeable to tax in the year in which the transfer takes place except in certain exceptional cases such as compulsory acquisition by Government, conversion of capital asset into stock in trade, insurance claim received on destruction of the asset.

It is therefore not advisable to transfer the properties without ensuring availability of cash for tax payment and investment for saving capital gains tax.

2. Where joint property development is resorted to by landowner with the builder and if the consideration is receivable in built up area to be constructed, it is advisable to avoid the applicability of section 53A of the Transfer of Property Act. This can be achieved by granting licence to the builder to enter the premises and develop the property without giving any rights of enjoyment of the property. The possession still remains with the landowner and the same will be handed over as and when the built up area is constructed and delivered. In this way, the transfer will take place only in the year in which the built up area is sold and not before. However, the gain from land will be capital gain and that from development activity will be business income.
3. The capital gains tax will arise only where the investment is a capital asset within the meaning of section 2(14). If the investments are not capital assets, the capital gains tax will not arise. E.g. personal effects of movable nature such as silver, household utensils, motor-car, agricultural lands outside the specified area, etc.
4. Planning can be done in such a way that the capital asset is transferred through any transaction, which is not regarded as transfer under section 47 i.e. transfer in a scheme of amalgamation, transfers between 100% subsidiary and holding companies, partition of HUF, etc.
5. Where an asset is transferred, it can be ensured that it is a long-term capital asset so that the benefit of indexation can be availed and the concessional rate of tax prescribed u/s 112 can be availed.
6. Exemptions u/s 54, 54B, 54D, 54EC, 54ED, 54F, 54G can be availed.
7. It must be noted that chapter VI A deductions and rebate cannot be claimed in respect of long-term capital gains - section 112).
8. In respect of capital gain arising on account of:
 - (a) Conversion of capital asset into stock in trade;



- (b) Compulsory acquisition under any law in force; taxability does not arise in the year of transfer.

In the case of conversion, it arises only in the year of sale of stock in trade and in the case of compulsory acquisition; it arises in the year of receipt of compensation. Wherever permissible, year of chargeability can be accordingly planned. Where adhoc amount is received pending dispute in the case of compulsory acquisition, the same cannot be charged to tax - CIT Vs Hindustan Housing & Land Development Trust, 161 ITR 524 (SC).

9. In the case of non-residents, foreign companies, foreign institutional investors and overseas corporate bodies, the special and the concessional rates prescribed under sections 112, 115A can be taken advantage of.
10. Where an asset is acquired prior to 01-04-1981 is transferred, the fair market value as on that date can be availed as the cost of acquisition as it may be more than the actual cost.
11. Subject to fulfillment of conditions, planning can be done to claim exemptions u/s 54 to 54G. If the investment in the eligible asset is not immediately possible, then deposit under capital gains account scheme can be made within the due date for filing the return or before the actual date of filing the return of income, whichever is earlier.
12. Even if the amount deposited in capital gains account scheme is not utilized within the stipulated period, the amount shall be taxed as capital gain only in the year in which such period expires and not in the year in which exemption was availed. Therefore it postpones the liability to capital gains tax.
13. Where exemptions under sections 54, 54B, 54D or 54G had been claimed in respect of any asset acquired, transfer of such asset within three years will result in the reduction of the amount of such exemption from the cost of acquisition of such asset. This will have the effect of increasing the short term capital gain and assessee will end up paying more tax, whereas exemption earlier availed might be in respect of long term capital gain which was taxable at a concessional rate u/s 112. Therefore the new asset should not be sold within a period of 36 months. In the alternative, loan can be availed by mortgaging the property to meet any financial crisis and such loan can be cleared by selling the property after 36 months.
14. Where the assessee transfers an agricultural land situated in a specified area, he can avail exemption u/s 54B by investing in another agricultural land. If the agricultural land so acquired is outside the specified area, the exemption can still be availed. If such agricultural land is sold even within 36 months, there will not be any tax implication as it is not a capital asset.
15. Where an assessee holds original shares as well as bonus shares in a company and intends to transfer part of his holdings, bonus shares can be retained and original shares can be transferred. This will enable the assessee to reduce the capital gain by availing deduction for the cost of acquisition. Imagine if bonus shares were to be sold, the cost of acquisition would be NIL and more the tax liability!

16. Where any long-term capital asset is transferred and is invested in the eligible asset, exemptions are available in the computation of capital gain. The Kerala High Court has held that where the net consideration on sale of asset is invested in business and later on money is borrowed for investment in the eligible asset within the time limit prescribed, the exemption is allowable - ITO Vs K C Gopal, 107 Taxmann 591 (Ker). Following this analogy an assessee may invest the net consideration in business or use it for any other purposes. Housing loan can be obtained for investment in house property to avail exemption u/s 54 or 54F as the case may be. Assessee can avail interest as deduction u/s 24, repayment of principal u/s 88 as rebate. The loss if any computed under the head income from house property can be set off against business income.
17. As far as possible taxpayers should so plan as to transfer their capital assets normally only 36 months* after acquisition since long term capital gain lower capital gain. It is important to note that if capital asset is one which became the property of the assessee in any of the manner as specified u/s 49(1), the period for which it was held by the previous owner is also to be counted in 36 months*.

The reason for this is the category of gain becomes a 'long term capital gain' and in such a case tax rate is lower as well as certain opportunities for tax saving are also prescribed for it.

[*12 months in case of Equity or Preference shares in a company, Securities, Units of UTI, Units of a mutual fund specified under section 10(23D)]

18. Provision of section 47A apply and exemption availed u/s 47 is withdrawn under certain circumstances e.g. ceasing of 100% subsidiary status, failing to maintain condition for conversion of proprietary / partnership in to company, etc.

Withdrawal of exemption should be avoided.

19. In case of sale of an undertaking instead of selling assets in piecemeal possibility of slump sale u/s 50B should be explored. In such a case if the undertaking is more than 36 months the entire gain will be considered to be of long term nature.
20. In respect of asset on which depreciation has been claimed, capital gain is of short term nature. However, for the purpose making investment and claiming exemption if the asset is held for more than 36 months it can be considered as a long term capital asset – ACE Builders Ltd. Vs ACIT 76 ITD 389 (Mum).
21. Exemption from tax is provided under section 10 (38) for any income arising from the transfer of a long-term capital asset, being an equity share in a company or a unit of an equity oriented fund where—
- (a) the transaction of sale of such equity share or unit is entered into on or after the date on which Chapter VII of the Finance (No. 2) Act, 2004 comes into force; and
 - (b) such transaction is chargeable to securities transaction tax under that Chapter :



22. Concessional Tax rate of 10% (from A.Y. 2009-10 – 15%) on short term capital gains is applicable under section 111A for short term Capital gains arise from the transfer of an equity share in a company or a unit of an equity oriented fund if securities transaction tax under Chapter VII of the Finance (No. 2) Act, 2004 is paid.

Tax Planning and Income from Other Sources

1. Assessee share holder having substantial interest in assessee closely held company and not having any credit balance with the company makes withdrawals during the accounting year. Such withdrawals would amount to receipt of notional dividend. Subsequent adjustment against the credit balance of another shareholder on the last day of the accounting year will not alter the position. the shareholder is chargeable to tax on the deemed dividend by virtue of section 2(22)(e) – Miss. p Sarada Vs CIT, 229 ITR 444 (SC).
2. Where composite rent is received from tenant in respect of property it should be split up and the amount attributable to the amenities should be assessed as income from other sources and amount attributable to the building should be computed u/s 22.
3. Where an assessee borrows for the purpose of investment in shares and securities, interest on the loan is an allowable expenditure even there is no income – CIT Vs Rajendra Prasad Moody, 115 ITR 519 (SC).
4. Winnings from motorcar rally is assessee return for skill and endurance and is taxable as income and can not be treated as casual and nonrecurring receipt – CIT Vs G R Karthikeyan, 201 ITR 866 (SC)
5. In the case of winding up of company, where interest is earned by Official Liquidator fixed deposits, expenditure incurred on establishment charges and staff salary are not deductible from such interest income – Swami Motor Transports Pvt. Ltd. Vs CIT, 217 ITR 241 (Mad). On the same basis, where an assessee takes a loan against security of fixed deposit, interest on such interest is not deducted from the interest income earned on the fixed deposit – CIT Vs Dr. V P Gopinathan, 248 ITR 449(SC).
6. Interest income earned on the deposits made out of surplus funds before commencement of business is taxable as Income from other sources. The interest income so derived from out of investment in the nature of deposit cannot be reduced from the cost of construction as it has no nexus with the construction of plant – Tuticorin Alkali Chemical & fertilizers Ltd. Vs CIT, 227 ITR 172(SC); CIT Vs Coromendal Cements Ltd., 234 ITR 412 (SC). If loan is borrowed from IDBI and placed in short term deposits till the money is paid to the supplier of plant and machinery, the interest earned thereon cannot go to reduce the cost of plant and machinery, but will be charged under Income from other sources – CIT Vs Autocast Ltd., 248 ITR 110(SC).
7. If the receipts during the construction period have close nexus with the construction, the amount shall be regarded as capital receipts and would go to reduce the construction cost of the plant. The following receipts are treated as capital:

- (a) Rent charged from contractors for housing workers and staff employed by contractor for construction work of the assessee.
 - (b) Hire charges for plant and machinery given to contractors for use in construction work.
 - (c) Interest from advances made to contractors for purpose of facilitating construction work.
 - (d) Royalty for excavation and use of stones lying on assessee's land for construction work and therefore taxable – CIT Vs Bokaro Steels Ltd., 236 ITR 315 (SC).
8. Any amount deposited to open Letter of Credit (LC) for purchase of plant and machinery required for setting up assessee plant, interest on such amount is directly connected and incidental to construction of plant. Therefore interest receipt is capital in nature and would reduce the cost of asset – CIT Vs Karnal Cooperative Sugar Mills Ltd., 243 ITR 2 (SC). The ratio laid down in Tuticorin Alkali's case is not followed by the court but has applied the rationale followed in Bokaro Steel Ltd case. Similar view has been upheld in Karnataka Power Corporation, 247 ITR 268 (SC) and Bongaigaon Refinery & Petrochemicals Ltd., Vs CIT ITR 329(SC).
9. The assessee inherited the assets and liabilities on the father's death. The overdraft was taken by his father from bank by pledging securities to meet tax liabilities. the interest on overdraft claimed as deduction against income from securities received by the assessee. Distinction should be made between assets being charged with obligation to discharge the liability and income from assets being charged with liability to pay interest. In this case, interest is not diverted by overriding title and it is only application of income to pay interest. Assessee not entitled to deduction of interest payments – CIT Vs Mathubhai. C. Patel, 238 ITR 403 (SC)
10. Under section 10 (34) any income by way of corporate dividends referred to in section 115-O are exempt from tax and under section 10 (35) any income by way of dividends on units of mutual funds are exempt from tax. Therefore, investment in such instruments be preferred to debt instruments or interest bearing deposits, etc.

Gift is Income from other sources

Section 56 provides that certain 'Gifts' received by an assessee shall be chargeable to income-tax under the head "Income from other sources". Definition of 'income' now considers certain gifts received as income.

It is provided that where any sum of money is received, the aggregate value of which exceeds fifty thousand rupees, without consideration, by an individual or a Hindu undivided family, in any previous year from any person or persons on or after the 1st day of April, 2006, the whole of the aggregate value of such sum shall be deemed to be income from other sources.



However, from the purview of the provision that 'gift' being considered as income, certain exemptions are provided. The gifts received which are not considered as income are the following :

- (a) received from any relative;
- (b) received on the occasion of the marriage of the individual;
- (c) received under a will or by way of inheritance;
- (d) received in contemplation of death of the payer;
- (e) received from any local authority as defined in the Explanation to section 10(20);
- (f) received 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)
- (g) received from any trust or institution registered under section 12AA.

For the purposes of this provision, "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;
- (vii) spouse of the person referred to in clauses (ii) to (vi).

Therefore, as a tax planning measure,

1. The 'gift' should be received from the categories listed for exemption, as aforesaid.
2. Since gift received in the form of 'any sum of money' is being treated as income, gift should be received in kind e.g. gold, silver, land, house, furniture, gadgets, etc. as gift in kind will not be treated as income.

INTERNATIONAL AND CORPORATE TAXATION

Tax Implications on International Joint Ventures

Under the existing provisions of the Income Tax Act in India, a resident is taxed on his global income subject to specific exemptions and deductions sanctioned under the law. Under section 9 of the Income Tax Act, any income that is deemed to accrue or arise in India is taxable. The crucial factor in determining the deeming accrual in India is the existence of 'business connection'. Equally important is the Double Taxation Avoidance Agreement (DTAA) if it exists between India and the respective country.

The concept of 'Permanent Establishment' (PE) dealt with in each DTAA is for taxability of certain income with reference to the country in which the income is earned. Normally the two important criteria for taxability under any tax law are the 'residence' and the 'source'. On account of this, when a resident of the country derives income from a source in other country, he is likely to get taxed both in the residence country (Home state) and the source country (Host state). This gives rise to double taxation of the same income in the case of same person by two different countries. If DTAA exists double taxation is avoided either by exemption or by tax credit method. Under our tax laws a resident gets relief u / s 90 and 91 of the Act. The specific provisions of the DTAA should override the general provisions of the Income Tax Act.

As per the source of the Income Tax Rule, the income may be subject to tax in the country where the source of such income exists (where the PE is situate or where the asset or property is located) whether the income earner is a resident in that country or not. On the other hand the income earner may be taxed on residential basis in the country. For example, if a person is a resident of a country, he may have to pay tax on the income earned outside the country as well. Further some countries may follow a mixture of the above two rules. Thus a problem of double taxation arises if the person in respect of any income on the basis of source of income rules in one country on the basis of residence in another country or on the basis of mixture of the above two rules. Relief against such hardships normally takes either of the two routes-

- (a) Bilateral relief and
- (b) Unilateral relief.

The Governments of two countries can enter into treaty agreements under bilateral relief and where no such treaty agreements exist, the home state can provide relief unilaterally in respect of such double taxation issues (Section 90 and 91).

Under section 90 of the Act, the Central Government may enter into an agreement with the Government of any country outside India to provide for the following:

- a) A relief in respect of income on which income-tax has been paid in both the countries
- b) The type of income, which shall be chargeable to tax in either country with a view to provide relief under double taxation.
- c) Exchange of information on evasion or avoidance of Income-tax or investigation in latter cases.
- d) For recovery of Income-tax under either of the country laws.



Although treaties entered into by various countries are unique, a certain amount of uniformity is desirable in its framework. With this end in view, the tax treaties either the Organisation of Economic Co-operation and Development (OECD) model or United Nations (UN) model of Double Taxation Convention between developed and developing countries 1980. Most of the Indian treaties are based on the former. The agreements in turn can also be categorised into-

- (a) limited agreements and
- (b) comprehensive agreements

Limited agreements are generally entered into to avoid double taxation relating to income derived from operation of aircrafts, ships, carriage of cargo and freight. On the other hand, comprehensive agreements are very elaborate documents, which lay down in detail how income under various heads may have to be dealt with. Limits under various heads like income from immovable property, capital gains, dividends, interests, royalties, fees for technical services, etc and the manner of taxing the same are generally laid down in the comprehensive agreements. Some the agreements provide for taxation of annuities and pensions.

Section 91 of the Income Tax Act deals with the double taxation reliefs in respect of countries with which no agreement exists. The relief will be available subject to the following conditions satisfied:

1. The assessee in question must have been resident in the taxable territories.
2. That some income must have accrued or arisen to him outside the taxable territory during the previous year and it should India.
3. In respect of that income, the assessee must have paid by deduction or otherwise tax under the law in force in the foreign country in question in which the income outside India has arisen.

If the above conditions are satisfied, the person would be entitled to relief from the Indian Income-tax payable by him on such doubly taxed income at the average Indian rate of tax or the average rate of tax of the said country, whichever is lower or at the Indian rate of tax, if both rules are equal. The average rate of tax means the tax payable on total income divided by the total income.

In a landmark judgement, the Income-tax Appellate Tribunal has held that the Central Government cannot withdraw from the tax payer exemptions granted under DTAA with another country.

DTAA is discussed elsewhere.

FOREIGN COLLABORATION AGREEMENTS

The following may have to be borne in mind in entering into foreign collaboration agreements:

Choose the right country:

It is essential to choose the right country from where the investments must be made into the Indian country. Such choice would depend upon the effective rate of taxation in the hands of the foreign company on dividend income and income tax on capital gains. Similarly technology transfer should take place from a country where the effective rate of taxation on royalty income / fees for technical services earned by the foreign company is the least. The right choice of the country can mitigate the tax burden to a large extent.

Tax credit:

DTAA provide for the tax credit in respect of taxes paid in the other country. Tax credit is normally a benefit, which accrues to the foreign collaborator and should be taken into account in fixing the consideration payable to the foreign collaborator. Generally treaties contain a provision that any tax credit received by the foreign collaborator would be passed on by him to his Indian counterpart.

Dependent services:

Generally, the salaries, wages and other remunerations received by the foreign

personnel deputed to India are not taxable if the period of stay does not exceed 181 days in a fiscal year. In case the period of stay is likely to exceed 181 days in a fiscal year, it may be worthwhile to spread the stay of the foreign technicians to 2 fiscal year so that it does not exceed 181 days in aggregate in a single fiscal year.

Royalty and technical service fees:

Royalty and technical service fees can be negotiated nett of Indian taxes. The Indian tax will than be separately paid by Indian party. The payment will however be towards meeting the foreign parties Indian tax liability. The tax so paid by the Indian party is not treated as Indian income in the hands of the foreign party. This has the effect of some tax saving.

The hypothetical tax situation may be illustrated with the help of DTAA with Denmark on royalty fees:

Tax paid on gross basis	5%
Tax on 20% of 5%	1%
Net remittance	4%
Taxes on net basis	4.165%
Tax at 20% of 4.165%	0.833%
Net remittance	4.165%



Thus there is an advantage of 0.165% to the foreign company while the Indian company pays only 5% tax. This situation has arisen because there is no tax on tax paid in respect of royalties and technical service fees under section 10(6A). In both the situations, the Foreign company would be eligible for a credit of Indian tax against its foreign tax liability. The aforesaid exercise may not be worthwhile, if the foreign company is able to take full advantage of tax credit abroad for the tax paid in India.

Split up of total consideration payable to foreign party:

In respect of many treaties, different rates are provided for royalty and technical service fees. For example under the DTAA with some country, royalty is taxed at 10% of the gross sum and the technical service fees are taxed at 20% of the gross sum. In such a situation it would be advantageous to split up the consideration into royalty and technical service fees and maximum consideration should be attributed to either royalty or technical service fees, whichever is taxed at a lower rate.

Take advantages of the examples given in the treaty:

The examples given in the treaty entered into with United States offer an excellent medium for tax planning. These examples draw distinction between situations where may be taxed as fees for included services and those situations where it may not be so taxed. The agreements may be drafted in such a manner so as not to include the services within the purview of fees for included services.

Tax sparing:

Tax sparing provisions in the treaties should be carefully considered. For instance, in the treaty with Japan, the credit with respect of interest income will be provided not only for tax paid in India but also for tax spared u/s 10(15)(iv) of the Income-tax Act as per agreement between the two Governments vide Article 23 of the convention. Similarly, as per paragraph 3(b) of Article 23 of the Convention with Japan, Japanese taxpayer deriving dividend income from an Indian company in which the Japanese taxpayer owns not less than 25% of the voting share capital, will be eligible for credit against Japanese tax not only in respect of 15% tax paid on dividend income, but also for Indian tax payable by the company paying dividend in respect of its income.

Render services outside India to save tax:

In some treaties like that with Austria technical services fees would be taxed in India if the activities were performed in India. In such cases, the parties to the agreement may consider rendering of technical services outside India.

Royalty vis-a-vis business profits:

In many countries, the definition of royalties is narrower than the definition in the Indian Income-tax Act and this may have a bearing on the tax liability of the foreign enterprise providing technical know-how. The tax liability in India may be avoided, for instance, in respect of

payments received by say a UK enterprise if the payment is not in the nature of royalty as per the definition of the DTAA although it may be so under the Indian Income-tax Act. For instance lumpsum payment for transfer of technical know-how package abroad may not constitute royalty as per the DTAA. The same may be taxed as business profit if the UK enterprise has a PE in India. In case it does not so have, it would not be taxed in India. The Calcutta High Court in CIT Vs Davy Ashmore India Ltd. (1991) 190 ITR 62 has held that where there is an outright purchase or sale as per the DTAA between India and UK, the consideration is for the transfer of such designs, secret formula, etc and cannot be treated as royalty.

Presumptive tax:

There are provisions in the Indian Income-tax Act pertaining to presumptive taxation like section 44B, 44BB, 44BBA and 44BBB. The same may be advantageous vis-à-vis getting the business income taxed on the basis of income less expenses. The foreign parties should take advantage of such provisions. It may be mentioned that as per section 90 of Income-tax Act, the provisions of the Treaty or the normal provisions of the Income-tax Act, whichever is more beneficial would be applicable to the foreign party:

Improvements provided free of cost:

In case the foreign technical cum financial collaboration agreement with a foreign party provides for making available updates free of cost, it is advisable to show in the agreement that in consideration of providing free updates, equity shares are being issued to the foreign party. This would enable the foreign party to claim the cost of updates as part of the cost acquisition of equity shares and may enable the foreign party to mitigate tax on capital gains in the event of sale of shares. It is advisable that the agreement should provide for such free updates only for a limited period.

Accommodation/ living expenses for technicians:

It is advisable to provide in the agreement that the accommodation and living expenses the foreign technicians deputed should be met by the Indian company. The same would be taxable in India because of:

- a) There is no employer - employee relationship and there is no question of taxing perquisite u/s 9(I)(ii) of the Act [ITAT Hyderabad Bench in Flores Gonther Others Vs ITO 29 TTJ 392.]
- b) If it is assumed that such benefits accrue to the foreign technicians by virtue of contract of service entered into by them with the foreign collaborators, the same would be exempt u/s 10(14) if the Income-tax Act [CIT Vs D S Blackwood (1989) 178 ITR 470 (Cal); ITO Vs R T Lowerance 15 ITD 490 (All) and E Bettelli Vs ITO (1986) 26 TTJ 96 (Ahd)].

**E-Commerce and Taxation:**

In the era of e-commerce, the determination of the place of source with reference to an item of income may quite often pose difficulty. The source-based taxation of business income depends on physical presence in the form of fixed place of business or a dependent agent in the source country. With e-commerce the need for physical presence virtually ceases. The change in mode of delivery from physical to online raises characterization issues and the lack of physical presence also creates problems in enforcement of tax laws. Therefore the long-term solution of the problems created by characterization lies in making direct taxation identical for all streams of income in a manner aimed at ensuring equitable sharing of revenues between residence country and source country. The following rulings by the Authority for Advanced Ruling may be worth remembering in this context:

1. A company incorporated in Mauritius for sale and distribution of television channels enters into an agreement with an Indian company where under the latter would solicit orders from purchasers of airtime and pass on those orders to the former. The business profits earned by the Mauritian company through Indian company are profits deemed to accrue or arise in India u/s 9 of the Act. However by virtue of Article 7 of the DTAA between India and Mauritius, they are not liable to be taxed in India, if:
a) The liability of the Mauritian company to pay tax in Mauritius was established and
b) The Mauritian company and not the Indian company is shown to exercise generally the power to conclude the advertisement contract for sale of airtime - P No. 296 of 1996 T V M Vs CIT 237 ITR 230 (AAR).
2. An American company is engaged in providing international credit cards, travelers cheques and travel related services. It has Central Processing Unit (CPU) in USA and Consolidated Data Network (CDN) in Hong Kong. Indian company is given access to the CPU through CDN for the reporting and processing of information on travel by customers in India. Charges for the use of CPU and CDN of American company paid by Indian company is royalty for the case of 'design or model ,plan secret formula and process' and therefore taxable in India under Article 12(3)(a) of DTAA between India and USA – p. no. 30 of 1999 238 ITR 296 (AAR).
3. Where there is a PE for a non resident income attributable to such PE is chargeable to tax in the country in which such PE exist – p. no.28 of 1999 242 ITR 208 (AAR). A foreign company having a fixed office will be constructed to have a PE-p. no.13 of 1995 228 ITR 487 (AAR).

TAX ASPECTS OF MERGERS AND AMALGAMATIONS

The business and economic environment has thrown up the need for rationalization of laws relating to business reorganization for restructuring of production system and better utilization of resources, which have become necessary with a view to enabling the Indian industry to rearrange itself to become globally competitive. It was in this background that tax concessions to conversion of proprietary / partnership concerns into company were provided for in the Finance Act, 1998.the Act now provides for tax concessions in the following cases of business reorganization.

1. Amalgamation / merger of companies.
2. Conversation of proprietary concern / firm in to a company.
3. De-merger of a company.
4. Slump sale.

Merger is a combination of two or more companies into one company and may involve either absorption or consolidation. Where the assets and liabilities of one company are taken over by another and former loses its identity, it is referred to as absorption, for e.g. TOMCO with HLL, RPL with RIL, etc. In case a new company comes into existence and the participating companies go out of existence, the re-arrangement is known as amalgamation, e.g. RenuSager with Hindalco.

Examples for the amalgamation/consolidation variety include the merger of Tetrapack and Alfalaval to form Tetralaval. In merger transactions, the consideration is paid for and received in shares and both the merging partners receive money in future in the form of dividends / yields. No money transaction is usually implied at the time of entering into a merger agreement. Whether the share capital is pooled or assets are pooled, so long as a share for share exchange takes place between the contracting parties, the transaction is merger. In an acquisition, the consideration is in the form of cash. The person or the corporation intending the control another corporation pays cash for number of shares that give the controlling interest. Thus the seller of the shares receives money in the current period of the transaction and the buyer of the shares also pays in today's values.

The de-merger signifies spinning-off or hiving-off the existing divisions of the company into a separate company. Therefore the de-merger means a split or division of the company. The division hived off could be transferred to a new company or it could be sold to an existing company. A de-merger takes place in the cases of internal restructuring or family settlements or in cases of tax planning. For example, in settlement of disputes between Ambani brothers de-merger of Reliance Industries Ltd. (RIL) took place and companies like Reliance Communications Ltd; Reliance Natural Resources Limited; etc. were demerged and shareholders of the RIL received free of cost, shares in the demerged companies.

The slump sale refers to the sale of the undertaking as a going concern. In this case, the consideration is not fixed for each and every asset separately and a lump sum consideration is arrived at for the undertaking as a whole.

The term amalgamation has not been defined u/s 394 of the Companies Act and various judicial decisions point to the meaning of term. The amalgamation under the company law may be pursuant to a court order or under an order of the central Government, if it is in the public interest.

The term 'amalgamation' has been defined u/s 2(1B) of the income-tax Act and if the amalgamated company wishes to set off the losses and unabsorbed depreciation of the amalgamating company with its profits, the condition laid down u/s 72A of the Act shall have to be complied with. For amalgamation of banking companies, provisions are made u/s. 72AA.



In order that an amalgamation may fall under section 2(1B) of the Income-tax Act, the following conditions must necessarily be fulfilled:

1. All the property of the amalgamating company should be vested in the amalgamated company.
2. All the liabilities of the amalgamating company should become the liabilities of the amalgamated company.
3. Shareholders holding not less than $3/4^{\text{th}}$ in the value of the share in the amalgamating company should become the shareholders of the amalgamated company. However the shares already held by or its subsidiary immediately before the amalgamation shall be excluded.

In the following cases the merger will not be called an amalgamation:

- a. Where the property of the company say 'A', which merges is sold to the other company say 'B' and the amalgamation comes about by virtue of a transaction of sale. This is to exclude from amalgamation, the cases where the amalgamation scheme is not approved by the High Court;
- b. Where the company 'A' which is wound up in liquidation and the Liquidator distributes the property of company 'A' to the company 'B' and the amalgamated company 'B' receives the property of the company 'A' (the amalgamating company) from the liquidator as on liquidation.

The amalgamated company is entitled to carry forward the unabsorbed depreciation and brought forward loss of the amalgamating company provided the following conditions are fulfilled (S. 72A):

1. The amalgamation should be of
 - (a) a company owning an industrial undertaking or a ship or a hotel with another company; or
 - (b) a banking company referred to in clause (c) of section 5 of the Banking Regulation Act, 1949 with a specified bank; or
 - (c) one or more public sector company or companies engaged in the business of operation of aircraft with one or more public sector company or companies engaged in similar business,
2. *If the above conditions are satisfied then, (i) the accumulated loss and (ii) the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or, as the case may be, unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected. The amalgamated company shall set off and carry forward of loss and unabsorbed depreciation. For the purpose of carry forward, year of amalgamation shall be considered to be the year of origination.*
3. *The benefit of set off and carry forward of loss and unabsorbed depreciation is not allowed if the following further conditions are not complied with [s. 72A(2)]:*

- (a) the amalgamating company—
 - (i) has been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for three or more years;
 - (ii) has held continuously as on the date of the amalgamation at least three-fourths of the book value of fixed assets held by it two years prior to the date of amalgamation;
 - (b) the amalgamated company—
 - (i) holds continuously for a at least of five years from the date of amalgamation at least three-fourths of the book value of fixed assets of the amalgamating company acquired in a scheme of amalgamation;
 - (ii) continues the business of the amalgamating company for a minimum period of five years from the date of amalgamation;
 - (iii) fulfils such other conditions as may be prescribed.
4. In a case where any of the conditions laid down in section 72A (2) are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the amalgamated company shall be deemed to be the income of the amalgamated company chargeable to tax for the year in which such conditions are not complied with.

Tax concessions/Incentives in the case of amalgamation

If any amalgamation takes place within the meaning of the section 2(1B) of the Income-tax Act, the following tax concessions are available:

I. Tax concessions to amalgamating company.

II. Tax Concessions to the shareholders of the amalgamating company.

III. Tax concessions to the amalgamated company.

I. Tax concessions to the amalgamating company.

- a. Capital gains tax is not attracted as section 47(iv) exempts from capital gains tax liability in case of any transfer of capital assets in a scheme of amalgamation of the amalgamating company to the amalgamated company provided the amalgamated company is an Indian company.
- b. Even if there is a transfer of any asset by an amalgamating company for inadequate consideration in the scheme of amalgamation, no tax implications exist.
- c. Tax concessions to a foreign amalgamating company – Where a foreign company holds any shares in an Indian company and transfers the same in the scheme of amalgamation to another foreign company, such transactions will not be regarded as transfer for the purpose of capital gain u / s 45 of the Income-Tax Act if the following conditions are satisfied:



1. Atleast 25% of the shareholders of the amalgamating foreign company should continue as shareholders of the amalgamated foreign company and,
2. Such transfer does not attract tax on capital gains in the country in which the amalgamating company is incorporated.

II. Tax concessions to the shareholders of an amalgamating company.

Where a shareholder of an amalgamating company transfers his shares in a scheme of amalgamation, such transactions will not be regarded as a transfer for capital gain purpose if the following conditions are satisfied:

- a. The transfer of shares is made in consideration of the allotment to him of any share or shares in the amalgamated company, and
- b. The amalgamated company is an Indian company.

The cost of acquisition of such assets of shares in the amalgamated company shall be the cost of acquisition of shares in the amalgamating company and for computing the period of holding of such shares, the period for which such shares were held in the amalgamating company shall also be included.

III. Tax concessions to the amalgamated company.

The amalgamated company shall be eligible for tax concessions provided the amalgamation satisfies all the three laid down in section 2(1B) and the amalgamated company is an Indian company. Subject to the above, the amalgamated company shall be eligible for following tax concessions:

1) Expenditure on scientific research [Sec 35(5)] –

Any unabsorbed capital expenditure will be allowed to be carried forward and set off in the hands of the amalgamated company. Further if such asset ceases to be used in a previous year for scientific research related to the business of the amalgamated company and the amalgamated company sells such assets, the sale price to the extent of the cost of the asset shall be treated as business income of the amalgamated company. The excess of the sale price over the cost of the asset shall be subject to the provisions of the capital gains.

2) Expenditure for obtaining licence to operate telecommunication services [Sec 35 ABB (6)]

Where in a scheme of amalgamation, the amalgamating company sells or otherwise transfers its licence to the amalgamated company (being an Indian company) the provisions of section 35ABB become applicable in the same manner to the amalgamated company and consequently the expenditure on acquisition of licence not yet written off shall be allowed to the amalgamated company in the same number of balance instalments and where such licence is sold by the amalgamated company, the treatment of the deficiency / surplus will be same as would have been in the case of amalgamating company.

3) Treatment of preliminary expenses [Sec 35D (5)] –

The amount of preliminary expenses of the amalgamating company to the extent not written off shall be allowed as a deduction to the amalgamated company.

4) Amortization of expenses in case of amalgamation [Sec 35DD] -
One-fifth of the expenditure on amalgamation shall be allowed for each of the 5 successive previous years beginning with the previous year in which the amalgamation or de-merger takes place. No deduction shall be allowed for this expenditure under any other provisions of the Act. This is subject to the rider that the expenditure is incurred in the process of running the business or remaining in business.

5) Treatment of expenditure on prospecting, etc of certain minerals [Sec 35E (7A)] –

The amount of expenditure on prospecting, etc of certain minerals of the amalgamating company, which is not yet written off, shall be allowed as deduction to the amalgamated company as it would have been to the amalgamating company.

6) Treatment of capital expenditure on family planning [Sec 36(1) (ix)] –

Where in a scheme of amalgamation a capital expenditure is transferred to an amalgamated company, such transfer shall not be regarded as transfer and the capital expenditure on family planning not yet written off shall be allowed to the amalgamated company in the same number of balance instalments and where such assets are sold by the amalgamated company, the treatment of the deficiency / surplus will be the same as would have been in the case of the amalgamated company.

7) Treatment of bad debts [Sec 36(1) (vii)] –

The debt of the company taken over by the amalgamated company in a scheme of amalgamation shall be allowed to be written off as bad debts of the amalgamated company if it turns bad [CIT Vs T Veerabhadra Rao, K. Koteswara Rao & Co. 155 ITR 152 (SC)].

8) Carry forward and set off of business losses unabsorbed depreciation –

The amalgamated company shall be allowed to carry forward and set off the business losses and unabsorbed depreciation of the amalgamating company if all the conditions laid u/s 72A are satisfied.

9) In case of no depreciable assets transferred by an amalgamating company to an Indian amalgamated company, the cost of acquisition of the asset shall be taken at the same value as it was to the original owner duly adjusted for any cost of improvement [Sec 45]. In the case of depreciable assets, it would be transferred at WDV of the assets in the case of amalgamating company for the immediately preceding previous year as reduced by the amount of depreciation actually allowed in relation to the said preceding previous year. The provisions of section 50 regarding computation of capital gains would apply.



- 10)** The benefit of tax concession is allowed to the amalgamating company and the amalgamated company only when the conditions laid down in section 2 (1B) of the Act. 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-fourths 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.
- 11)** As per section 72A, the amalgamated company can carry forward the business loss and unabsorbed depreciation of the amalgamating company subject to certain conditions. Where it is not possible to satisfy such conditions, the companies may opt for a reverse merger i.e. instead of the loss making company merging with the profit making company, the profit making company may merge with loss making company. In this case the amalgamated company which was the loss making company will be able to carry forward its own business loss and unabsorbed depreciation and set it off against the profits of the business which has merged in the scheme of amalgamation.
- 12)** The benefit u / s 47(vii) shall be allowed only when the shareholders of the amalgamating company are allowed shares of the Indian amalgamated company in lieu of shares held by them in the amalgamating company. If the shareholders are allotted something more than the shares in the amalgamated company i.e. bonds, debenture, etc no benefit will be available u / s 47 (vii).

Slump Sale

According to Section 2(42C) defines Slump Sale as slump sale means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales. The determination of the value of an asset or liability for the sole purpose of payment of stamp duty, registration fees, etc, shall not be regarded as assignment of values of individual assets and liabilities.

Any profits or gains arising from the slump sale affected 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.

Provided that any profits or gains arising from the transfer under the slump sale of any capital asset being one or more undertakings owned and held by an assessee for not more than thirty-six months immediately preceding the date of its transfer shall be deemed to be the capital gains arising from the transfer of short-term capital assets. The “net worth” of the undertaking or division so transferred shall be deemed to be the cost of acquisition and the cost of improvement in computing the capital gain. However, indexation benefit shall not be allowed.

“Net worth” shall be 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 its books of accounts. Any change in the value of assets on account of revaluation of assets shall be ignored for the purposes of computing the net worth.

For computing the net worth, the aggregate value of total assets shall be –

- (a) in the case of depreciable assets, the written down value of the block of assets determined in accordance with the provisions contained in section 43 (6); and
- (b) in the case of other assets, the book value of such assets.

A report of a Chartered Accountant indicating the computation of the net worth and certifying the correctness of net worth is required to be enclosed along with the return of income.

The following are the advantages u/s 50B-

- i. If the undertaking is in existence for more than 36 months, the gain arising on slump sale is treated as long term even though some of the assets comprised in the undertaking may be held only for few months.
- ii. If the gain is long term it will suffer only 20% tax rate u/s 112.
- iii. No distinction is made between depreciable and non- depreciable assets.
- iv. It is possible to plan for exemption under the various applicable sections such as 54EC, 54ED or 54F if the undertaking is long term capital asset.



The only disadvantage u/s 50B appears to be the denial of indexation benefit respect of non-depreciable long term capital assets comprised in the business.

An assessee may have to weigh the options of selling a business as a going concern by way of slump sale or alternatively, selling the assets independently and decide about the advantageous mode of transferring the business keeping in view the above aspects discussed.

EXEMPTIONS, DEDUCTIONS AND REBATES

Exclusions/Exemptions

Income not included in Total Income of any person (Section 10)

A. By Character of Income:

1. Agricultural income is totally exempt provided it falls within the definition of 'agricultural income' [section 2(1A)]. However the agricultural income is to be aggregated in the case of certain assesseees for the purpose of determining the rate of tax on non-agricultural income.
2. Any subsidy received from or through the Tea Board under any such scheme for re-plantation or replacement of tea bushes or for rejuvenation or consolidation of areas used for tea cultivation as the Central Government may notify.[Section 10(30)]
3. Any subsidy received from or through the concerned board under any such scheme for re-plantation or replacement of rubber plants, coffee plants, cardamom plants or plants for the growing of such other commodity or for rejuvenation or consolidation of areas used for cultivation of rubber, coffee, cardamom, or such other commodity as the Central Government may notify. [Section 10(31)].

B. By Character of receipt:

1. Any payment made in cash or in kind as an award instituted in the public interest by Central or State Government or any other body and approved by the Central Government or as a reward by the Central Government or any State Government for such purposes as may be approved by the Central Government in the public interest. [Section 10(17A)]
2. Any payments made under Bhopal gas leak disaster (processing of claims) Act, 1985 to the extent that it has not been allowed as deduction on account of any loss or damage caused to him by such disaster. [Section 10(10BB)]
3. The tax on income earned in the business of leasing operation of aircrafts by a Government of a foreign state or foreign enterprise through an Indian company. [Section 10(6BB)]
4. Any income by way of fees for technical services under an approved agreement in projects connected with security of India for providing services in or outside India.
5. Any allowance or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering services outside India. [Section 10(7)]

6. The remuneration received by an individual from the Government of a foreign state for carrying out assigned duties in India under any cooperative technical assistance programme or in projects in accordance with approved agreements or any other income which accrues or arises outside India and is not deemed to accrue or arise in India in respect of which such individual is required to pay any income or social security tax to the Government of that foreign state. [section 10(6)(xi)]
7. Any remuneration or fees received by a consultant out of the funds made available to an international organization under a technical assistance grant agreement between such international organization and the Government of the foreign state or any other income which accrues or arises outside India and is not deemed to accrue or arise in India in respect of which such individual is required to pay any income or social security tax to the Government of that foreign state.[Section 10(8A)]
8. Any remuneration received by him as an employee of a foreign enterprise for services rendered by him during his stay in India, under section 10(6)(vi), provided the following conditions are fulfilled –
 - (a) the foreign enterprise is not engaged in any trade or business in India.
 - (b) his stay in India does not exceed in the aggregate a period of ninety days in such previous year.
 - (c) such remuneration is not liable to be deducted from the income of the employer chargeable under the Income Tax Act.

C. By Category of Assessee

1. Salaried Employees

A. General

1. Scholarship granted to meet the cost of education is exempt. [Section 10(16)]
2. Any special allowance or benefit, not being in the nature of a perquisite within the meaning of clause (2) of section 17, specifically granted to meet expenses wholly, necessarily and exclusively incurred in the performance of the duties of an office or employment of profit to the extent to which such expenses are actually incurred for that purpose. [Section 10(14)(i)]
3. Any prescribed allowance 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 is exempt upto the prescribed extent. [Section 10(14)(ii)]
4. 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 dependants.[Section 10(23AA)]



5. Where the contract of employment provides for encashment of unutilized leave at the time of retirement, exemption is available to the extent of the least of the following:
 - (a) 30 days for every year of actual service rendered for the employer from whose service the employee has retired.
 - (b) 10 months average salary.
 - (c) Actual leave encashment at the time of retirement.[Section 10(AA)]
6. Retrenchment compensation to the extent of the least of the following:[10(10B)]
 - (a) 15 days average pay for every completed year or part thereof of continuous service.
 - (b) Rs.5,00,000.
 - (c) Actual retrenchment compensation.
7. Commuted pension, where the employee has received gratuity, commuted value of one-third of the pension and in other cases. One-half of such pension is exempt. Any amount received in excess will be included in gross salary.
8. Any payment in computation of pension received by an individual from a fund set up by Life Insurance Corporation (LIC). [Section 10(23AAB)]
9. Any allowance granted for encouraging the academic research and training pursuits in educational and research institutions.
10. Any lumpsum payments received at the time of voluntary retirement from service, provided the employees fall under the prescribed categories and the payments were received under scheme evolved by the employers, which satisfied the prescribed guidelines
11. Gratuity received on the retirement or on incapacitation or on termination of his employment or on his death to the extent of the least of:
 - (a) Actual amount of gratuity.
 - (b) Half month's average salary for every completed year of service.
 - (c) Rs.3, 50,000. [Section 10(10)]

Any amount in excess of the above received by an employee shall be included in his gross salary and received by the legal heirs under the head 'income from other sources'.

12. Lumpsum payment made gratuitously or by way of compensation or otherwise to the widow or other legal heirs of an employee, who dies while in service.
13. Any payment from a provident fund to which the Provident Funds Act 1925 applies or from any other provident fund set up by the Central Government under notification. Public provident fund scheme 1968 has been notified for the purpose.[Section 10(11)]



14. The accumulated balance due and becoming payable to an employee participating in a recognized provident fund to the extent provided in Rule 8 of Part A of the fourth schedule. [Section 10(12)]
15. Any payment from an approved superannuation fund made on the death of a beneficiary or paid in lieu of or in computation of an annuity on his retirement at or after a specified age or on his becoming incapacitated prior to such retirement or by way of refund of contribution to or on the death of a beneficiary or by way of refund of contribution to an employee on his leaving the service in connection with which the funds is established otherwise than by retirement to the extent to which such payment does not exceed the contributions made prior to the commencement of this Act and the interest thereon. [Section 10(13)]
16. Any sum received under a life insurance policy including the sum allocated by way of bonus on such policies, other than-
 - (a) any sum received under sub-section (3) of section 80DD or sub-section (3) of section 80DDA; or
 - (b) any sum received under a Keyman insurance policy; or
 - (c) any sum received under an insurance policy issued on or after the 1st day of April, 2003 in respect of which the premium payable for any of the years during the term of the policy exceeds twenty per cent of the actual capital sum assured [Section 10(10D)]
17. Provision of refreshments during office hours in the office premises.
18. Tea or other non-alcoholic beverages and light snacks during working hours
19. Free supply of gas, electric energy or water for household consumption by the employer without purchasing them from any other outside agency.
20. Any free educational facilities to the employees or their children.
21. Allowance given to an employee to meet the expenses in connection with rent of the accommodation which the employee might have to take to the extent of the least of the following:
 - (a) Actual house rent allowance paid in respect of the period during which the rented accommodation is occupied during the previous year.
 - (b) Excess of rent paid over 10% of the salary for the relevant period
 - (c) 50% of the salary in case the accommodation is in Mumbai, Kolkata, Delhi or Chennai and 40% in other cases. [Section 10(13A)]
22. Transport facility provided by a transport undertaking engaged in the carriage of goods or passengers to its employees and dependent family members.

**B. Foreigner/non-residents:**

1. The remuneration received by him as an official, by whatever name called, of an embassy, high commission, legation, commission, consulate or the trade representation of a Foreign State, or as a member of the staff of any of these officials, for service in such capacity. [Section 10(6)(ii)]
2. Remuneration received from a foreign enterprise for services rendered during his stay in India provided the stay does not extend beyond 90 days and such remuneration is not liable to be deducted from the income of the employer chargeable under Income Tax Act.[Section 10(6)(vi)]
3. Salary received by an individual, being a non-resident employed on a foreign ship provided the stay does not extend beyond 90 days.
4. Any tax paid by the employer to the Central Government on the salaries paid for a period not exceeding 48 months from the date of his arrival in India provided that he is on the service of Government or Local Authority or any corporation set up in India under any special law or any such institution or body established in India for carrying on scientific research as is approved for the purpose or in any business carried on in India. This exemption is also applicable to an individual who is a non resident Indian citizen.

C. Government employees and employees of Local Authority

1. The entire amount of death cum retirement gratuity paid under the revised pension rules of the Central Government or the Central Civil Services (Pension) Rules, 1972 or any other similar scheme applicable to members of the civil services of the Union or the holders of posts connected with defence or of civil post under the Union or the members of all India services or the members of the civil services of the State or the holders of civil post under a State or the employees of a Local Authority or the pension code or regulations applicable to the members of the defence services.
2. Commuted pension received under civil pensions commutation rules of the Central Government or under any similar scheme applicable. Judges of the Supreme Court and High Court will be entitled to exemption of the commuted portion under section 10(10A)(i).

2. Partnership Firms

In the case of a partner, the share in the total income of the firm shall be exempt, if the firm were to be assessed to tax separately. [Section 10(2A)]

3. Hindu Undivided Family

Any sum received by an individual as a member of a HUF shall be exempt in the hands of the member provided such sum has been received out of the income of the family or in the case of any impartible estate such sum has been paid out of the income of the estate belonging to the family. [Section 10(2)]

The exemption is restricted to the members of the family who have an interest in the joint income of the property and does not extend to their heirs. A daughter's son who as a prospective heir to the estate receives an allowance from the income of the estate does not receive it as a member of the joint family. A widow who is a member of HUF and receives maintenance allowance out of the joint income of the family shall get exemption but if such allowance were to be paid not out of the income of the family, the same would not be exempt under section 10(2).

A married daughter is not a member of the family of her father or mother and any income received by such daughter or married widowed daughter staying with her parents is not entitled to exemption.

D. By Class of Organizations

1. Any income of a corporation established by a central / state / provincial Act or of any other body, institution or association wholly financed by the Government where such institution has been established or formed for promoting the interest of the members of the scheduled caste or scheduled tribes or backward classes or of any two or all of them. [Section 10(26B)]
2. Any income of a corporation established by the Central Government or any State Government for promoting the interests of the members of notified minority communities. The Central Government has since notified Muslims, Christians, Sikh Buddhists, Zoroastrians and Parsis as minority communities for the purpose of this section. [Section 10(26BB)]
3. Any income of a cooperative society formed for promoting the interest of the members of either the scheduled caste or the scheduled tribes or both referred in clause 26B on the condition that the membership of the cooperative society consists of only other cooperative societies formed for similar purposes and the finances of the society are provided by the Government and such other societies. [Section 10(27)]
4. Any income accruing or arising to the following boards / authorities:
 - (a) The coffee board [section 4 of the Coffee Act, 1942].
 - (b) The rubber board [section 4(1) of the Rubber Board Act, 1947]. \
 - (c) The tea board [section 4 of the Tea Act, 1953].
 - (d) The tobacco board [section 4 of the Tobacco Board Act, 1975].
 - (e) The marine products export development authority [section 4 of the Marine Products Export Development Act, 1985].
 - (f) The agricultural and processed food products export development authority [section 4 of the Agricultural and Processed Food Products Export Development Act, 1985].
 - (g) The spice board [section 3(1) of the Spice Board Act, 1986]. [Section 10(29A)]



5. Any income of the employee's state insurance fund set up under the provisions of the Employees State Insurance Act, 1948. [Section 10(25A)]
6. Any income received by the trustees on behalf of a recognized provident fund or an approved superannuation fund or an approved gratuity fund. [Section 10(25)]
7. Interest on securities belonging to any provident fund (Covered by the Provident Funds Act, 1925) and any capital gains of the fund arising from the sale, exchange or transfer of such securities.
8. Any income received by the board of trustees constituted under the Coal Mines Provident Fund and Miscellaneous Provisions Act, 1948 on behalf of the deposit linked insurance fund constituted under that Act. [Section 10(25)]
9. Any income received by the board of trustees constituted under the Employees Provident Funds and Miscellaneous Provisions Act, 1952 on behalf of the deposit linked insurance fund constituted under the Act. [Section 10(25)]
10. The income from house property and income from other sources of a registered trade union within the meaning of the Indian Trade Unions Act, 1926 or an association of such trade unions formed primarily for the purpose of regulating the relations between workmen and the employers and / or between workmen inter Se. [Section 10(24)]
11. Income from dividends, interests, and long-term capital gains of an infrastructure capital fund or an infrastructure capital company or a cooperative bank provided:
 - (a) Such income is on account of the investment made on or after 01-06-1998.
 - (b) Investment is by way of shares or long-term finance in any enterprise wholly engaged in the business referred to in section 80-1A (4) or a housing project referred to in section 80-1B (10) and such enterprise is approved by the Central Government.
12. Income of a venture capital company or a venture capital fund registered under Securities and Exchange Board of India Act, 1992 (SEBI) from any investments made in a venture capital undertaking.
13. Any income of investor protection fund set up by the recognized stock exchanges in India either jointly or separately as the Central Government by notification in the official gazette specifies. [Section 10(23EA)]
14. Any income of Exchange Risk Administration Fund set up by public financial institutions either jointly or separately as the Central Government may by notification in the Official Gazette specify in this behalf. The fund set up by IDBI, IFCI, ICICI, PFCI and IREDA are exempt.
15. Any income received by any person on behalf of the following funds:
 - (a) The Prime Minister's National Relief Fund.

- (b) The Prime Minister's Fund (promotion of folk art) or
 - (c) The Prime Minister's Aid to Students Fund or
 - (d) The National foundation for communal harmony or
 - (e) Any university or other educational institution existing solely by / for educational purposes and not for purpose of profit or
 - (f) Any hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or during convalescence or requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for purpose of profit. [Section 10(23C)]
16. Income of the Insurance Regulatory and Development Authority (IRDA) established under section 3(1) of the Insurance regulatory and development authority Act, 1999. [Section 10(23BBE)]
 17. Any income of the European Economic Community (EEC) derived in India by way of interests, dividends or capital gains from investments made out of its funds under such schemes as may be notified by the Central Government. The European Community International Institutional Partners (ECIIP) scheme 1993 has since been notified. [Section 10(23BBB)]
 18. Any income of any body or authority established, constituted or appointed by or under any Central or Provincial Act to provide for the administration of any public, religious, charitable trust or endowments (including mutts), temples, gurudwaras, wakfs, churches or other places of public religious worship or societies for religious or charitable purposes. [Section 10(23BBA)]
 19. Income of Khadi and Village Industries Board established in a State by or under a State or provincial Act for the development of khadi or village industries in the state. [Section 10(23B)]
 20. Any income received by any person on behalf of a fund established for the welfare of employees or their dependents as may be notified in the Official Gazette and of which such employees are members subject to certain conditions. [Section 10(23AAA)]
 21. Any income received by the 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 the present members of such forces or their dependents. [Section 10(23AA)]
 22. Income of the notified sports associations or institutions established in India with their object of controlling, supervising, regulating or encouragement of the games of cricket, hockey, football, tennis or other such games or sports specified by the Government.
 23. Any income of such news agency set up in India solely for collection and distribution of news as the Central Government may notify in this behalf. Press Trust of India Limited, New Delhi and United News Agency of India have since been notified.



24. Income of a local authority falling under the heads 'income from house property', 'capital gains', 'income from other sources' or 'income from a trade or business' carried on by it which accrues or arises from the supply of a commodity or service (not being water or electricity) within its jurisdictional area or income from the supply of water or electricity within or outside its jurisdictional area. [Section 10(20)]
25. Any income of an 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. A state industrial corporation is entitled to exemption in the same way as a state housing board, development boards and similar authorities.
26. Income of a scientific research association, which is approved for the purpose of section 35(1)(ii), subject to the fulfillment of conditions. The property and income of a State shall be exempt from Indian taxation [Article 289(1)]. 35. The RBI is not liable to pay Income-tax as per section 48(1) of the Reserve Bank of India Act, 1934. [Section 10(21)]
27. UTI is not liable to pay Income-tax as per section 32(1)(a) of the Unit Trust of India Act, 1963.
28. The Oil industry development board is not liable to pay any Income-tax on its income, profits or gains as per section 22 of the Oil industry development Act, 1974.
29. The salaries, pension, etc of the officials of the United Nations are exempt from tax by virtue of section 2 of the United Nations (Privileges and immunities) Act, 1947 read with section 18(b) of Article 5 of the Schedule thereto. Pension received by the erstwhile employee of the WHO shall also be exempt.
30. The income of the banking service commission is exempt under section 27 of the Banking Service Commission Act, 1984.
31. The income of the IDBI is exempt under section 35 of the IDBI Act.
32. The income of SEBI is exempt under section 25 of the SEBI Act, 1992.
33. Income of IFCI is exempt under section 6(1) of the Industrial Financial Corporation (Transfer of undertakings and repeal) Act, 1993.
34. The income of the Telecom Regulatory Authority of India (TRAI) is exempt under section 22 of the Telecom Regulatory Authority of India Limited Act, 1997.

E. By Character of Receipt

1. Any income, by way of interest on such securities or bonds as the Central Government may notify, earned by an assessee, who is non-resident in India. [Section 10(4)(i)]

2. Any income by way of premium on the redemption of bonds in respect of securities mentioned in (1) above. [Section 10(4)(i)]
3. Any interest earned on NRE deposits from banks in India.
4. The daily allowances to Members of Parliament or Legislative Assembly or any committee thereof and any allowance paid to Member of Parliament under Members of Parliament (Constituency allowance) Rules, 1986 and any allowance not exceeding Rs. 2000 per month in the aggregate received by any member of the Legislative Assembly or any committee thereof, which the Central Government may notify. [Section 10(17)]
5. Income of a minor child upto Rs. 1500 per child will be exempt in full. [Section 10(32)]

Relief when salary, etc., is paid in arrears or in advance (section 89).

Where an assessee is in receipt of a sum in the nature of salary, being paid in arrears or in advance or is in receipt, in any one financial year, of salary for more than twelve months or a payment which under the provisions of clause (3) of section 17 is a profit in lieu of salary, or is in receipt of a sum in the nature of family pension as defined in the Explanation to clause (iia) of section 57, being paid in arrears, due to which his total 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 may be prescribed.

Share of member of an association of persons or body of individuals in the income of the association or body.

Where the assessee is a member of an association of persons or body of individuals being other than a company or any society registered under any law in force in any part of India, income-tax shall not be payable by the assessee in respect of his share in the income of the association or body computed in the manner provided in section 67A (Section 86)

Rebate in respect of securities transaction tax.

Where the total income of an assessee in a previous year includes any income, chargeable under the head “Profits and gains of business or profession”, arising from taxable securities transactions, he shall be entitled to a deduction, from the amount of income-tax on such income arising from such transactions, computed in the prescribed manner, of an amount equal to the securities transaction tax paid by him in respect of the taxable securities transactions entered into in the course of his business.

However, from A.Y. 2009-10, this rebate is withdrawn and instead, deduction for the securities transaction tax paid is allowed.

**Carry forward set off of losses**

Every dark cloud has a silver edge! Well, even sustaining a loss. Because, the Act allows set off of loss against other income either of the same year or for the succeeding years. The Act has made detailed provisions for the law governing carry forward and set off of losses and certain allowances.

The law in this behalf should be carefully studied while tax planning, as set off of loss saves tax and if opportunity is lost, it costs to the enterprise, in a sense that opportunity of tax saving is forfeited.

LAW RELATING TO IS DISCUSSED IN THE FOLLOWING TOPICS:

1. Set off of Loss in the Same Year
2. Carry forward and Set off of Loss in Subsequent Years
 - (i) Basic Conditions for carry forward of loss.
 - (ii) Conditions applicable to each head

As stated in section 14 of the Act computation of total income is made under certain heads viz.-

- (i) Salaries
- (ii) Income from House Property
- (iii) Profits and gains of Business or Profession
- (iv) Capital gains and
- (v) Income from other sources.

In a case computation results in to a positive figure, it is income. Likewise, if the computation results into a negative figure, it is 'Loss'. Therefore, there cannot be loss from the head 'Salary'. Loss can occasion from all the remaining heads.

SET OFF OF LOSS IN THE SAME YEAR

For the purpose of computing total income and charging tax thereon, income from various sources is classified under the following heads -

- A. Salaries
- B. Income from House Property
- C. Profits and gains of Business or Profession
- D. Capital gains
- E. Income from other sources

These five heads of income are mutually exclusive. If any income falls under one head, it can-

not be considered under any other head. Income under each head has to be computed as per provisions under that head. Then, subject to provisions of Set off of Losses (Sec. 70 to Sec. 80) between the heads of income, the income under various heads has to be added to arrive at a gross total income. From this gross total income, deductions under chapter VIA are to be allowed to arrive at the total income.

In this part, the provisions relating to set off, carry forward and set off of losses are categorized as under-

SECTION 70

Where the net result for any Assessment Year in respect of any source falling under any head of income is a loss, the assessee shall be entitled to have the amount of such loss set off against his income from any other source under the same head.

- (1) Save as otherwise provided in this Act, where the net result for any assessment year in respect of any source falling under any head of income, other than “Capital gains”, is a loss, the assessee shall be entitled to have the amount of such loss set off against his income from any other source under the same head.
- (2) Where the result of the computation made for any assessment year under sections 48 to 55 in respect of any short-term capital asset is a loss, the assessee shall be entitled to have the amount of such loss set off against the income, if any, as arrived at under a similar computation made for the assessment year in respect of any other capital asset.
- (3) Where the result of the computation made for any assessment year under sections 48 to 55 in respect of any capital asset (other than a short-term capital asset) is a loss, the assessee shall be entitled to have the amount of such loss set off against the income, if any, as arrived at under a similar computation made for the assessment year in respect of any other capital asset not being a short-term capital asset.

Though the profits of each distinct business may have to be computed separately, the tax is chargeable, not on the separate income of each distinct business but on the aggregate of the profits of all the business carried on by the assessee. It follows from this that where the assessee carries on several businesses; he is entitled under section 70 to set off of losses in one business against profits in another - CIT v. P.M. Muthuraman Chettiar 44 ITR 710.

SECTION 71

Where the net result of the computation under any head of income in respect of any Assessment Year is a loss, the assessee shall be entitled to have such amount of loss set off against his income assessable for that Assessment Year under any other head of income.

Exceptions to provisions of sections 70 and 71 are as follows-

- a) **Loss from speculation business:** “Speculation transaction” means a transaction in which a contract for the purchase or sale of any commodity including stocks and shares is periodically or ultimately settled otherwise than by actual delivery or transfer of the commodity or scripts. [Sec. 43(5)] Loss from speculative transaction, if it is in the nature of business, can be set off only against income of another speculative business.



- b) **Loss under the head long term capital gains:** Loss under the head long term capital gains arising from transfer of long-term capital assets will be allowed to be set off only against long term capital gains.

Note: 1. Loss can be set off against deemed income.

2. Inter head adjustment is made only when the net income computed under a head is a loss.

3. The scheme of inter source and inter head adjustment is mandatory.

- c) **Loss from owning and maintaining race horses** can be set off only against income of that activity.
- d) No expenditure or allowance is allowed from winning from lotteries, crossword puzzles, card games etc. similarly, no loss from any lottery, card games, races, etc. is allowed to be set off from the income of such sources. [Sec. 58(4)].
- e) Loss incurred by an assessee from a source, income from which is exempt cannot be set off against income from a taxable source.
- f) Where the net result of the computation under the head “Profits and gains of business or profession” is a loss and the assessee has income assessable under the head “Salaries”, the assessee shall not be entitled to have such loss set off against such income.

CARRY FORWARD AND SET OFF OF LOSS IN SUBSEQUENT YEARS

BASIC CONDITIONS FOR CARRY FORWARD OF LOSS.

SECTION 80: LOSS RETURNS.

In order to carry forward loss under section 72, 73, 74 and 74A, the due date is prescribed in section 139(1). No loss which has not been determined in pursuance of a return filed within the date in accordance with the provisions of section 139(3) shall be carried forward under the provisions of sec

The condition for filing of return in accordance with the provisions of sec. 139(3) shall not apply to loss from House Property carried forward u/s. 71B and unabsorbed depreciation u/s. 32(2).

Brought forward loss of earlier assessment Year in accordance with Ss. 72, 73, 74, 74A can be set off against the income of that Assessment Year and can be carried forward further, even if the return is not filed within the due date specified in section 139(1) of the Act.

CONDITIONS APPLICABLE TO EACH HEAD

71B. Carry forward and set off of loss from house property

Where for any assessment year the net result of computation under the head “Income from house property” is a loss to the assessee and such loss cannot be or is not wholly set off against income from any other head of income in accordance with the provisions of section 71 so much of the loss as has not been so set-off or where he has no income under any other head, the

whole loss shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year and –

- (i) be set off against the income from house property assessable for that assessment year; and
- (ii) the loss, if any, which has not been set off wholly, the amount of loss not so set off, shall be carried forward to the following assessment year, not being more than eight assessment years immediately succeeding the assessment year for which the loss was first computed.

Carry forward and set off of business losses (section 72)-

- (1) Where for any assessment year, the net result of the computation under the head “Profits and gains of business or profession” is a loss to the assessee, not being a loss sustained in a speculation business, and such loss cannot be or is not wholly set off against income under any head of income in accordance with the provisions of section 71, so much of the loss as has not been so set off or, where he has no income under any other head, the whole loss shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year, and-
 - (i) it shall be set off against the profits and gains, if any, of any business or profession carried on by him and assessable for that assessment year;
 - (ii) if the loss cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the following assessment year and so on.

Provided that where the whole or any part of such loss is sustained in any such business as is referred to in section 33B which is discontinued in the circumstances specified in that section, and, thereafter, at any time before the expiry of the period of three years referred to in that section, such business is re-established, reconstructed or revived by the assessee, so much of the loss as is attributable to such business shall be carried forward to the assessment year relevant to the previous year in which the business is so re-established, reconstructed or revived, and –

- a) it shall be set off against the profits and gains, if any, of that business or any other business carried on by him and assessable for that assessment year; and
 - b) if the loss cannot be wholly so set off, the amount of loss not so set off shall, in case the business so re-established, reconstructed or revived continues to be carried on by the assessee, be carried forward to the following assessment year and so on for seven assessment years immediately succeeding.
- (2) Where any allowance or part thereof is, under sub-section (2) of section 32 or sub-section (4) of section 35, to be carried forward, effect shall first be given to the provisions of this section.
- (3) No loss [(other than the loss referred to in the proviso to sub-section (1) of this section)] shall be carried forward under this section for more than eight assessment years immediately succeeding the assessment year for which the loss was first computed.

**Losses in speculation business (section 73):-**

- (1) Any loss, computed in respect of a speculation business carried on by the assessee, shall not be set off except against profits and gains, if any, of another speculation business.
- (2) Where for any assessment year any loss computed in respect of a speculation business has not been wholly set off under sub-section (1), so much of the loss as is not so set off or the whole loss where the assessee had no income from any other speculation business, shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year, and –
 - (i) it shall be set off against the profits and gains, if any, of any speculation business carried on by him assessable for that assessment year ; and
 - (ii) if the loss cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the following assessment year and so on.
- (3) In respect of allowance on account of depreciation or capital expenditure on scientific research, the provisions of sub-section (2) of section 72 shall apply in relation to speculation business as they apply in relation to any other business.
- (4) No loss shall be carried forward under this section for more than four assessment years immediately succeeding the assessment year for which the loss was first computed.

Where any part of the business of a company other than a company whose gross total income consists mainly of income which is chargeable under the heads “Interest on securities”, “Income from house property”, “Capital gains” and “Income from other sources”, or a company the principal business of which is the business of banking or the granting of loans and advances consists in the purchase and sale of shares of other companies, such company shall, for the purposes of this section, be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.

Losses under the head “Capital gains” (section 74)

- (1) Where in respect of any assessment year, the net result of the computation under the head “Capital gains” is a loss to the assessee, the whole loss shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year, and –
 - (a) in so far as such loss relates to a short-term capital asset, it shall be set off against income, if any, under the head “Capital gains” assessable for that assessment year in respect of any other capital asset;
 - (b) in so far as such loss relates to a long-term capital asset, it shall be set off against income, if any, under the head “Capital gains” assessable for that assessment year in respect of any other capital asset not being a short-term capital asset;
 - (c) if the loss cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the following assessment year and so on.

- (2) No loss shall be carried forward under this section for more than eight assessment years immediately succeeding the assessment year for which the loss was first computed.

PROVISIONS RELATING TO CARRY FORWARD OF LOSSES

Carry forward of losses

Section	Nature of Loss	No. of Yeas	To be set off against
71B	Loss from house property	8 years	Income from house
72	Business loss unabsorbed	8 years	Income from business or profession
72A(1)	Accumulated loss and unabsorbed depreciation of an amalgamating company.	8 years from the expiry of amalgamation (set off in the year of amalgamation and carry forward for 8 years)	Business income of amalgamated company
72A(4)	Accumulated loss and unabsorbed depreciation of a demerged company.	Unexpired period out of total permissible period of 8 years.	Business income of resulting company.
72A(6)	Accumulated loss and unabsorbed depreciation or a proprietary concern.	8 years from the expiry of conversion of the firm or proprietary concern into a company.	Business income of successor company.
73	Speculation business loss.	4 years	Income from speculation business.
74	Loss under the head “Capital Gains”	8 years	Capital Gains.
74A	Loss under the activity of owing and maintaining racehorses.	4 years	Income from same activity.

Note: Under sub-section (1) of Section 72A, the loss and depreciation remaining unabsorbed in the case of amalgamating company shall be deemed as the loss or depreciation of the amalgamated company for the previous year in which the amalgamation is effected. Same analogy applies when a reorganization of the business is made where by a firm or proprietary concern is succeeded by a company as a contemplated under clause (xiii) or (xiv) of section 47. Consequently, apart from availing set off benefit in the year of amalgamation or reorganization, a fresh period of 8 years there after is available for carry forward and set off of unabsorbed loss / depreciation incase amalgamation or successor company. However, in case of demerger the



resulting company will get the benefit of carry forward and set off only for the remaining no. of years out of the total allowable 8 years.

SPECIAL PROVISIONS

Section 78(1):

Where a change has occurred in the constitution of the firm, the firm shall not be entitled to carry forward and set off 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. These restrictions shall not apply to unabsorbed depreciation.

Change in constitution of the firm takes place-

- (i) If one or more of the partners cease to be partners or one or more new partners are admitted, in such circumstances that one or more of the persons who were partners of the firm before the change continue as partner or partners after the change (provided the firm is not dissolved on the death of any of its partners).
- (ii) Where all the partners continue with a change in their respective shares or in the shares or in the shares of some of them.

Section 78(2):

Where any person carrying on any Business or Profession has been succeeded in such capacity by another person otherwise than by inheritance, then the successor cannot have the loss of predecessor carried forward and set off against his income.

Section 79:

Losses (other than unabsorbed depreciation) in case of closely held company

In case of a company in which public are not substantially interested (defined in sec. 2(18) of the Act), the unabsorbed business loss relating to any Assessment Year can be carried forward and set off against the income in a subsequent Assessment Year only (if the shares of the company carrying not less than 51% of the voting power were beneficially held by the same persons) both on the last day of the Previous Year(s) in which the loss, claimed to be set off and on the last day of the Previous Year in which loss was incurred.

Exceptions

The provisions stated supra shall not apply if the change in the voting power takes place due to the following reasons-

- a) the death of a shareholder; or
- b) transfer of shares by way of gifts to any relative of the shareholder making such gift.
- c) w.e.f. AY 2000-01, this section shall not apply to any change in the shareholding of an

Indian company which is subsidiary of a foreign company arising as a result of amalgamation or demerger of a foreign company subject to the condition that 51% of the shareholders of the amalgamating or demerged foreign company continue to remain the shareholders of the amalgamated or the resulting foreign company.

NOTES:

Unabsorbed business losses can be carried forward and set off against profits from any business from A.Y. 2000-01. There is no need to continue the same business in which the loss was incurred.

Depreciation can be carried forward and set off against the profits from any business in the succeeding assessment year. The business in which the loss was incurred need not be continued in that year.

The effect of depreciation, business loss and investment allowance should be given in the following order:

- Current year's Depreciation
- Unabsorbed Business loss
- Unabsorbed Depreciation
- Unabsorbed Investment Allowance.

A return of loss is required to be furnished for determining the carry forward of such losses, by the due date prescribed for different assesses under section 139(1) of the Act. (S. 80).

Summary:

Set-off in the same year:

- (i) Loss relating to the speculative business shall be set-off against the profits from speculative business.
- (ii) Long term capital loss can be set-off against long term capital gain only.
- (iii) Loss from owning & maintaining of horses can be set-off against the income of that activity.
- (iv) Business loss can not be set-off against the income from salary.
- (v) Loss from house property can be set-off against any head of income

Carry forward & set-off:

- (i) No loss can be carried forward under section 72, 73, 74 & 74A if the return relating to such loss is not filled before due date.
- (ii) Loss from house property can be carried forward & set-off against income from house property.



- (iii) Business loss can be carried forward & set-off against the income from same business or income from any other business in subsequent year provided speculative loss can be set-off against speculative profit.
- (iv) Short term capital loss can be carried forward & set-off against capital gain but long term capital loss can be carried forward & set-off against only long term capital gain.

Loss from the owning & maintaining of race horses can be carried forward & set-off against the income from such activity.

CHANGE IN CONSTITUTION AND SUCCESSION

(1) Where a change has occurred in the constitution of firm the loss attributable to the share of a retired or deceased partner remaining unabsorbed shall not be allowed to be carried forward by the firm. The restriction shall not apply to unabsorbed depreciation.

(2) Where any person carrying on business or profession has been succeeded in such capacity by another person otherwise than by inheritance, then the successor can not have the loss of predecessor carried forward and set off against his income.

Where the business is succeeded by inheritance, the legal heirs (assessable as BOI) are entitled to the benefit of the loss of the predecessor. Even if the legal heirs constitute themselves as a partnership firm, the benefit of predecessor's loss should be made available to the firm CIT Vs. Madhukant M. Mehta, 247 ITR 805 (SC).

Losses in case of closely held company

In the case of company in which public are not substantially interested, the unabsorbed business loss relating to any assessment year can be carried forward and set off against the income in a subsequent assessment year only if the following requirement is fulfilled:

On the last day of the previous year in which the loss is sought to be set off, the shares of the company carrying not less than 51% of voting power are beneficially held by the persons who beneficially held the shares of the company carrying not less than 51% of the voting power on the last day of the previous year in which the loss was incurred.

Exceptions

The above restrictions do not apply to a case if the change in the said voting power takes place due to the following reasons:

- i) Death of the shareholder.
- ii) Gift by a shareholder to his relative.

The restriction placed under section 79 shall not apply to any change in the shareholding of an Indian Company, which is a subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company. However, 51% of the shareholders of the amalgamating or demerged foreign company should continue to be the shareholders of the amalgamated or the resulting foreign company.

The provisions of Sec. 79 are applicable only in the case of carry forward of losses. As carry forward of unabsorbed depreciation is covered by Sec. 32(2), its carry forward and set off is not affected by sec. 79 [CIT Vs. Shree Subhulaxami Mills Ltd. 249 ITR 795 (SC)].

Loss returns

No loss which has been determined in pursuance of a return filed in accordance with the provision of section 139(3) shall be carried forward under the provisions of section 72, 73, 74 and 74A. this condition does not apply to loss from house property carried forward under section 71B and unabsorbed depreciation carried forward u/s 32(2).

Under section 119(2) (b), the CBDT can condone the delay in cases having claim of carry forward of losses – associated Electro – ceramic Vs. Chairman CBDT, 201 ITR 501 (Kar). CBDT has subsequently issued circular no. 8 of 2001 dated 16-05-2001 clarifying and delegating that the commissioners shall have power to condone cases where the claim for loss does not exceed Rs.10000 in an assessment year, Chief Commissioners / Director Generals upto Rs. 1 lakh and beyond CBDI shall exercise the power. These norms equally apply for condoning delay in claim for refund.

Relief from Capital Gains Tax

Under certain circumstances, exemption is provided from capital gains tax in case of succession under section 47.

TAX CREDITS

Although Income-Tax is leviable on the previous year in the relevant assessment year, but Income-Tax is being recovered from the assessee in the previous year itself in the following manner:

- a) Tax is deducted or collected at sources by the payer at the time of credit or actual payment of certain incomes to the payee.
- b) Advanced payment of Income-tax - the assessee in certain cases is under an obligation to pay tax in advance.
- c) Self-assessment tax - the assessee has to compute a tax liability in case of his income and remit the tax voluntarily through approved collection centres.
- d) In case of employee Tax on non-minatory perquisites paid by employer u/s 192(1A), if any.

The taxes collected under the above systems of recovery of tax in the previous year itself are known as prepaid taxes and tax credits are deductible from the total tax due from the assessee.

In the case of income in respect of which provision is not made for deducting Income-tax at the time of payment and in any case where Income-tax has not been deducted in accordance with the TDS provisions, Income-tax shall be payable by the assessee directly in the form of advance tax or otherwise [section 191].



Where under an agreement or other arrangement, the tax chargeable on any income is to be borne by the person by whom the income is payable, then for the purposes of tax deduction under those provisions, such income shall be increased to such amount as would, after deduction of tax thereon at the rates in force for the financial year for which such income is payable be equal to the net amount payable under such agreement or arrangement [section 195A].

Every person, being a seller shall, at the time of debiting the amount payable by the buyer to the account of the buyer or at the time of receipt of such amount, whichever is earlier, collect Income-tax from the buyer at specified rates as spelt out in section 206C.

Reliefs in respect of double taxation are spelt out in section 90 and 91 and the same has been discussed in detail elsewhere in the study materials.

Where under any of the provisions of this Act, a refund is due to any person, the Assessing Officer, in lieu of payment of the refund, set off the amount to be refunded or any part of that amount, against the sum, if any, remaining payable under this Act by the person to whom the refund is due, after giving an intimation in writing to such person of the action proposed to be taken under this section.

TAX INCENTIVES

In respect of all categories of assessee, who derive any profit and gains from a newly established undertaking in FTZ and engaged in the export of articles or things or computer software, tax holiday has been provided under sections 10A and 10B of the Act. The profits and gains from the exports of such undertaking shall not be included in the total income of the assessee in respect of any ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles, things or computer software. No deduction under this Section shall be allowed to any undertaking for the assessment year beginning on the 1st day of April 2010 (extended to '2011' by the Finance Act, 2008) and subsequent years. Where the undertaking 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 exemption, referred to in this paragraph shall be reckoned from the assessment year relevant to the previous year in which the undertaking was first set up in such FTZ or EPZ. The following allowances or expenditure shall be deemed to have been allowed or absorbed during the course of the relevant assessment years:

- a) Depreciation allowance [section 32].
- b) Expenditure on scientific research [section 35].
- c) Expenditure in relation to family planning [section 36(1)(ix)].
- d) Business losses u/s 72(1).
- e) Capital gains u/s 74(1) or 74(3).

f) Deduction u/s 80HH or 80HHA or 80-I or 80-IA or 80-IB.

The provisions of this relief are entirely at the option of the assessee. 100% of the profits and gains derived from export oriented undertakings can be claimed as a deduction u/s 10B from the export of articles or things or computer software 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 articles or things or computer software as the case may be from the total income of the assessee. This exemption is available to all categories of assessee who derive profits and gains from 100% EOU.

SEZ

Income of developer and unit in SEZ is exempt for a certain period. This is discussed elsewhere.

Special provisions relating to certain income of non-residents:

Definitions

The provisions contained in this chapter applicable to only individuals can be comprehended in proper perspective only if the following definitions given under the relevant sections are elucidated:

- a) The income derived by a non-resident Indian from any foreign exchange asset is called "Investment Income".
- b) "Foreign exchange asset" means the following assets acquired or purchased with or subscribed to in, convertible foreign exchange:
 - i) Shares in an Indian company;
 - ii) Debentures issued by an Indian public company;
 - iii) Deposits with an Indian public company;
 - iv) Securities of the Central Government; and
 - v) Such other assets as may notified by the Central Government.
- c) "Non-resident Indian" means an individual, being a citizen of India or a

person of Indian Origin who is not a resident. A person shall be deemed to be of Indian Origin if he, or either of his parents or any of his grand parents, was born in undivided India.

Note: Since dividend income, except to the extent covered by sec 2(22) (e), is taxable in the distributing company's case and not in the case of shareholders, the provisions of this chapter will not apply in respect of such dividend income with effect from 1-6-1997. This is subject to the change that has been brought about by the Finance Act, 2002.

**Deductions in computation:**

In computing such “investment income” or “Long term capital gains” of a non-resident Indian, no deduction in respect of any expenditure or allowance under any provisions of the Income-tax Act is allowable. Again no deduction under chapter VIA shall be allowed and indexation will not be applicable.

Tax income ‘and’ Long term capital gains”

Where the total income of a non-resident Indian consists only of “investment income” and / or income by way of “long term capital gains” arising from the transfer of any foreign exchange asset, such investment income shall be charged to income-tax at a flat rate of 20% and such long term capital gains shall be charged at 10%.

The investment income and / or long-term capital gains in respect of foreign exchange asset will constitute a separate block of income and charged to income-tax at a flat rate of 20% or 10%, as the case may be. If the non-resident Indian has any other income in India, such other income will constitute an altogether separate block of income and charged to tax as if such other income had been the total income. The aggregate of the income-tax so calculated in respect of the said two blocks of income will be the tax payable for the relevant assessment year.

Return of income need to be filed

A non-resident Indian having only investment income or income by way of long term capital gains arising from the transfer of any foreign exchange asset or both, need not file the return of income u/s 139 if the tax deductible from such income has been correctly deducted at source. However, it is permissible for him to opt u/s 115-I of the Income-tax Act to submit the return of income and claim the refund due to him if any.

Benefits after the assessee becomes resident

A non-resident Indian who becomes a resident in any subsequent year has the option to claim that the special provisions shall continue to apply to him in relation to investment income derived from foreign exchange asset [other than shares in Indian companies] for that assessment year and for every subsequent assessment year until the transfer or conversion of such assets into money. Such option can be exercised by furnishing a declaration in writing to that effect along with his return of income for that assessment year.
Note: Since dividend covered by section 115-0 is exempt in the case of the shareholder under section 10(33) it will not be taxable.

Option to assessee:

A non-resident Indian has the option to claim that in respect of any particular assessment year the special provisions relating to taxation of “investment income” and “long term capital gains” under which the tax on such income is to be charged at a flat rate should not apply to him by furnishing his return of income with such declaration for that assessment year u/s 139. In such a case the whole of the total income of that assessment year will be charged to tax under the general provision of the Income-tax Act.

FOREIGN COLLABORATION AGREEMENT AND TAX IMPLICATIONS

Foreign collaboration in India is encouraged by the Government of India on a selective basis. Instead of encouraging mere financial collaborations, collaboration involving import of know-how, which would contribute to the growth of industry and technology in India is generally preferred. Stipulations are made with regard to the following:

1. Initial lumpsum payment to be paid to the foreign collaborator for importing know how or transfer of rights in any technology; Payments for supply of drawings and designs.
2. Royalty and fees for technical services.
3. Payment for supply of machinery and equipment.
4. Payment of interest on monies due.
5. Dividend in respect of shares allotted.

Tax implications in respect of the above are analysed hereunder. Tax planning can be done keeping in view the provisions of Income-tax Act; aspects relating to Double Taxation Avoidance Agreement and the case laws discussed in order to avail exemption or concessional rate or to avoid taxability.

Recently law on transfer pricing has been overhauled and certain stipulations have been made. Compliance with the transfer pricing law is obligatory.

Strategic Management Decisions – Tax Implications

In business, the decisions are taken with a view of optimize returns to the stakeholders. A dominant aspect to be considered taking in view the tax consequences of the same on the bottom-line so as to share minimum profits with Government without violating any tax or any other laws in force.

It is significant that tax consequences alone need not bind the management to take a decision and it is only a factor which influences the management decisions.

Moreover, in case of taxes, there are both direct as well as indirect taxes and in efforts for planning implications of both category of taxes are required to be considered.

Management decisions, which have a bearing on the bottom-line are analyzed below from the point of view of income-tax implications.

1. Make or Buy

Following are the relevant factors for deciding raw materials or components:

- (a) Desire for specialization.
- (b) Inadequacy of funds to establish new unit for manufacture.



- (c) To guard against the risk of technological obsolescence.
- (d) To conserve monetary and managerial resources.
- (e) Containing risk in case of any new technology.

In making the final decision, the comparison of total cost of manufacture as compared to the buying cost of the product is important.

In computing the costs, care should be taken so as to include all fixed and variable cost applicable to both the alternatives. In considering the option, possibility of utilizing idle capacity needs to be examined and principles of marginal costing should be applied.

While manufacturing the product or component, it will result in levy of taxes like excise duty, while buying the same will result in payment of taxes in form of VAT, Sales Tax, Octroi. Thus statutory levies such as duty payable, Octroi, VAT, Sale tax, cess etc should be taken into consideration wherever they are applicable in both the alternatives. Aspects of set off of duty or any tax should be considered.

Tax concessions available under the provisions on the Income Tax Act for setting a new unit for making the product will have to be taken in to account. Provisions of different benefits available under various Central, state and local Acts for setting up of a unit will have to be considered.

The costs which are to be compared, in both the cases, should be 'post-tax' calculations.

If purchase price is less than the cost of manufacture, the management should decide to buy the product or component and if it is the other way round, the decision should be in favour to manufacture the product or component.

In case of organizations following transfer pricing for transfer of products from one division to another, this comparison is made to evaluate the efficiency of each division. In case of multinationals, which outsource the manufacture, the design and quality control are kept at the head office while products are manufactured at small scale units. In such cases concessions available to the manufacturing unit should be kept in mind. Other industries for example mineral based industries like steel and cement manufacture, the conservation of mineral wealth have to be kept in mind while taking the decision to make or buy.

2. Own or Lease

The factors which influence the decisions of management relating to owing or leasing of fixed asset are as follows:

- (a) Capital outlay – In case of ownership of assets, huge resources are committed on long term basis while case of lease of assets the same is not required. Leasing helps to pay as when we earn. Liquidity and opportunity costs for the amount required which is blocked in acquiring assets weigh a lot in decision making in this regard.

- (b) Depreciation - While depreciation can be claimed in the case of assets owned or acquired on hire purchase basis, depreciation is not allowed in case of leased assets. However the entire lease rentals paid are chargeable to Profit and Loss Account.
- (c) Repairs and renewal - In both cases, current repairs and renewals can be claimed as deduction. Any expenditure incurred for replacement of certain parts of exiting assets can be claimed as revenue – CIT vs. Mahalakshmi Textile Mills Ltd. 66 ITR 710 (SC).
- (d) Hire Charges – Applicable only in the case of lease and fully deductible in computing taxable profits.
- (e) Taxes – Lease of assets, if considered as sale and therefore, Sales Tax may be attracted. Aspects of set off of taxes should be considered. Whereas, in case of purchase excise as well as Sales Tax may be attracted. Similarly, aspects of set off of duty or taxes should be considered.
- (f) Tax Deducted at Source – In payment of lease charges, care must be taken to comply the TDS prescribed under section 194 I of Income Tax Act.
- (g) Technical obsolescence – The risk of obsolescence is avoided when assets are required on lease basis as opposed to ownership basis. If assets, which are bound to become obsolete, are purchased, there may not be any resale value also, for example electronic items such as computers, software.
- (h) Scientific Research – In case of expenditure on scientific research, deduction shall be allowed under section 35 on any capital expenditure on plant, machinery, equipments, etc. In certain circumstances even weighted deduction for expenditure on scientific research is available. In such cases buying of an asset may be advantageous.
- (i) Closure – In the case of any business which is intended to be carried on only for a particular period of term, it may be more feasible to avail the lease option instead of buying the asset.
- (j) Second hand or new – The decision to buy or hire a new or second hand asset depends upon factors like the resources to be committed, condition of the asset and the differential price / rental between the two. In case of a new industrial undertaking, deduction under section 80 IA will not be available if the used plant and machinery account for more than 20% of the total value of the plant and machinery. In some cases where fiscal incentives such as capital subsidy are involved, there is a necessity to restrict the investment up to certain levels only and in such cases trade-offs may have to be exercised and purchases / lease of second hand machinery may be restored to.
- (k) Leased assets are not owned assets and therefore the asset cover to equity comes down due to increased dependence on leaser finance.



- (l) Financial ratios are also distorted due to greater dependence on lease finance.
- (m) Lease rentals generate regular financial commitments whereas owned assets create only one time cash outgo. This would have its own impact on the operating cashflow.
- (n) The asset taken on lease is taken back by the lessor at the expiry of the lease period. To find an alternative asset at the expiry of lease period may pose several problems.

3. Retain or Replace

Repair means to restore to good condition, to renovate, to mend by replacing parts or an asset compensating loss or exhaustion. If repairs are carried out a newly acquired asset to install in the business, such expenditure in capital in nature. Repairs should be distinguished from renewal in as much as renewal means reconstruction of the premises entirely or substantially [CIT vs. Sri Rama Sugar Mills Ltd 21 ITR]

In cases where the assets are maintained in excellent conditions due to the maintenance policies pursued by the company or the sturdiness of the asset, it would be economical to retain the asset as the replacement cost may be uneconomical. This is true in cases where the inflation replacement cost of the concerned machinery building industry is very high.

Further in developing and underdeveloped countries such as ours, due to technology policy pursued, there is a possibility that we might have purchased machinery which have been removed from the manufacturer's current list and in such cases, we are left with no other alternative except to retain the current asset. The replacement in such situations would be prohibitive in terms of costs.

Repairs can result in outflow of cash in form of payment of service tax. Renewals, result in payment of indirect taxes like excise duty, sales tax. In either case, there may be a possibility of set off of such taxes that also needs to be examined.

While in retaining the asset, the full amount of repairs will be allowed as deduction as business expenditure while in case of replacing the asset, depreciation as per prescribed limit will be allowed as deduction.

'Repair' implies the existence of a thing which has malfunctioned and can be set right by effecting repairs which may involve replacement of some parts, thereby making the thing as efficient as it was before or as close to it as possible. Replacement is different from repair. Replacement implies the removal or discarding of the thing that was in use, by a different or new thing capable of performing the same function with the same, lesser or greater efficiency. The replacement of a section in a series of machines which are interconnected in a segment of the production process which together form an integrated whole may, in some circumstances, be regarded as amounting to repair when without such replacement that unit in that segment will not function. The logic cannot be extended to the entire manufacturing facility from the stage of raw material to the delivery of the final finished product - CIT v. Madras Cements Ltd. 255 ITR 243(Mad.).

Total replacement of four cement mills into one cement mill will not constitute 'repair' - Where the assessee replaced the existing four cement mills by a new cement mill at a different location, and the new mill was technologically superior and was far more efficient than the earlier four mills together, and was also capable of delivering a recognizably superior product, the expenditure on such replacement cannot be treated as 'repair' under section 31 - CIT v. Madras Cements Ltd. 255 ITR (Mad.).

Total replacement of damaged equipment is not 'repair' - Where the assessee replaced the electric control panel which was damaged and was beyond repair, by a new control panel, the expenditure on such replacement cannot be treated as 'repair' under section 31. It would be a case of capital investment and would not be a case of repair - Deputy CIT v. S.T.N. Textiles Ltd. 257 ITR (Ker.).

4. Repair/Scrap or Return

The term 'current repairs' means expenditure on buildings, machinery, plant or furniture which is not for the purpose of renewal or restoration but for preserving an already existing asset. Current repairs indicate repairs which are attended to when the need for them arises from the businessman's view and these are not allowed to be in arrears or to be accumulated. Current repairs are allowed as business expenditure in the computation of income.

Sale of scrapped assets will attract VAT, Sales Tax and care should be taken to collect the same.

Sometimes it would be economical feasible to scrap the asset than to spend money in repairing it. However in such cases, the implications of section 50 have to be kept in mind as money realized on scrapped asset sales will have to be reduced from WDV of the block of assets.

In cases where the machineries are obtained under a warranty, the machinery is returned to the manufacturer in case there is substandard performance. In case any repairs are carried out, the same expenditure has to be received from the manufacturer and cannot be treated as business expenditure.

5. Export or Domestic Sale

Indian companies are eligible to claim deductions of profits earned from the business of export of goods or services subject to fulfilment of certain conditions. However, these are available only for 10A [Free Trade Zones], 10AA [Special Economic Zone], 10B [Export-oriented undertakings]

The term 'profits of the business' referred in the above section is different from the term 'profit of business' referred to under the head 'profits and gains of business or profession'. The export turnover means sale proceeds received in, or brought into, India by the assessee in convertible foreign exchange, within a period of six months from the end of the previous year or within such further period where such sale proceeds are credited to a separate account maintained for the purpose by the assessee with any bank outside India with the approval of the Reserve Bank of India. It does not include freight or insurance attributable to the transportation of the goods beyond the customs station of India. The profits of the export business would be computed after claiming the deductions available as under:



Tax concession available in respect of profits and gains from projects outside India (80HNB), export profits (80HNC), services provided to foreign tourists (80HND), export of computer software (80HNE), export or transfer of film software (80HNF) have been withdrawn from 1st April, 2005.

Moreover in case of exports risk of forex loss also exists or there may be gain in realization at times.

6. Shut Down or Continue

The income chargeable as 'profits of the business only' if the assessee carries on the business at anytime during the previous year. It is however not necessary that the business is carried on throughout the previous year or till the end of the previous year – [CIT Vs Bangalore Transport Company (1967) 66 ITR 573 (SC)].

When the assessee does not carry on the business, it therefore implies, section 28 cannot be applied and the amount that he receives cannot bear the character of profits of the business. In case of temporary suspension of business to overcome business crisis without any intention of the assessee to part with the business, it would be better to lease out the business assets and earn revenue so that the income earned is assessable as income from business and not otherwise – [CIT Vs Vikram Cotton Mills Ltd. (1988) 169 ITR 597 (SC)]. In the following cases, even though no business has been carried on by the assessee, the receipts are taxable as income from business in the year of receipt:

- a) Recovery against any loss, expenditure or trading liability earlier allowed as a deduction [section 41(1)]
- b) Balancing charge in the case of electricity companies [section 41(2)]
- c) Sale of capital asset used for scientific research [section 41(3)]
- d) Recovery against bad debts [section 41(4)].
- e) Amount withdrawn from special reserve [Section 41 (4A)]
- f) Receipt of discontinued business under cash system of accounting [S. 176(3A),(4)].
- g) Sec 50

The cessation of business may occur in two ways:

- a) Where the business is no longer in existence.
- b) Where the business is in existence but has been transferred by the assessee as a going concern to another entity,

The succession and discontinuance are mutually exclusive concepts as there cannot be discontinuance where there is succession. Further if a part of the business of an assessee is dropped owing to non-profitable nature either permanently or temporarily, it will not imply that the

business has been discontinued. In the case of dissolution of a firm or a liquidation of a company, sometimes the trade may be carried on even after such dissolution or liquidation. There could be other examples of discontinuance of business as under:

- a) Amalgamation of two separate and independent businesses belonging to distinct owners resulting in discontinuance of those businesses.
- b) Partition of a joint family business and the business is divided amongst the members. In this case there would be discontinuance of the old business even if some or all the members carry on their own business in the same premises and take the advantage of the old business connections.
- c) In case a firm is split up into two different firms and the old business is also divided amongst the different firms, the original firm shall be deemed to have discontinued the business.
- d) If a professional leaves his practice, there would be discontinuance. The question whether the professional discontinued his profession or not depends on the state of his mind at the time of cesser merely because he takes to the profession once again, it cannot be said that there is no discontinuance at the time of cesser.
- e) Spin-off - The common definition of 'spin off' is when a division of a company or organization becomes an independent business. Spin off is feasible when loss making or profit making unit is separated from the main unit. For example if a manufacturing unit is going in losses, while the land property it holds, if separated from the main unit may fetch profits on sale of the same.

In all the above cases, the mischief of section 176 regarding accelerated assessment would come into play.

Profits arising out of sale of fixed assets shall be deemed to be the capital gains arising from the transfer of short-term capital assets.

Sometimes due to change of economic circumstances, the manufacture of a product would become costlier than buying it from the open market. In case this situation continues for a long time, the assessee may have to sell the existing plant and machinery and seek an exit. In this case, there will be short-term capital gain or loss if the entire block of assets is sold or there will be a short-term capital gain if the part of the block is sold for a price more than the written down value of the block.

7. Expand or Contract

The profits and gains of any business follow the business cycle and depending upon the phase in which the particular company is positioned in the industry; there could be either an expansion or contraction of business. Depending upon the macro-economic scenario, an industry may either face an upbeat situation of rising demand for its products not only in the markets in which it is operating but also in newer markets. In case the trend is a continuing one, the



owners may decide to expand the manufacturing facilities or set up manufacturing facility in newer markets. In the case of the latter, the owners may also form joint ventures with local partners. The mergers and acquisitions route may also be followed to meet the sudden upsurge in demand or to gain monopolistic status. In some other cases, outsourcing through contract manufacture may also be resorted to.

In case of recession in the industry, there will be slack in the demand for the product and the management may either take any of following alternatives:

- a) Pull out of a market by closing down the local unit.
- b) Cut down the production by reducing the number of shifts or number of working days.
- c) Discontinue the business, where there is no hope of revival of product demand

The tax implications of the above managerial alternatives are:

- a) To claim tax relief in respect of profits from new undertakings.
- b) To claim depreciation on new investments.
- c) To claim depreciation on R&D activities.
- d) To claim deduction in respect of additional manpower employed.
- e) To claim necessary relief for export of products, goods or services.
- f) To claim necessary relief in respect of location of the industry.
- g) To prepare for accelerated assessment u/s 176 in the eventuality of closing down of the unit.

8. Mergers And Acquisitions

Merger is a combination of two or more companies into one company and it may involve either absorption or consolidation. A merger, in which one of the companies loses its identity and assets and liabilities of the company are taken over by the acquiring company is termed as absorption, e.g. TOMCO with HLL, Reliance Petrochemicals with Reliance Industries, Renusagar Power Supply with Hindalco Industries Ltd. A merger, in which all the participating companies go out of existence to form a new company, is referred to as amalgamations, e.g. Tetra Pack and Alfa Laval into TetraLaval, Forbes Campbell with Gokak Patel Volkart to form Forbes Gokak, Oriental Carpets, Digvijay Woolen Mills and Universal Electric to form VXL India Ltd, Mudra Communications, Interact Communication and Vision Advertising to form Interact Vision.

Acquisition / takeover involve the transfer of controlling interests in a company from one management group to another. Typically it involves the bidding company making a tender offer directly to the shareholders of the target company. The tender offer is an offer to purchase the share of the target company at a fixed price per share from shareholders who tender their shares. To induce the shareholder of the target company to sell the shares, the tender price is

usually set significantly above the current market price. Use of tender offer allows the acquiring company to bypass the management of the target company it wishes to acquire. The term 'takeover' is also used to refer to this project e.g. acquisition of controlling interest in –

- a) Chloride India by the S K Birla Group,
- b) Harrison Malayalam Plantation by the R P Goenka Group,
- c) Rallis India by Tata Tea,
- d) Consolidated Coffee by Tata Tea, etc.

In merger transactions, the consideration is paid for and received in shares and both the merging partners receive money in future in the form of dividends. No money transaction is usually implied at the time of entering into a merger agreement. Whether the share capital is pooled or assets are pooled, so long as a share for share exchange takes place between the contracted parties, the transaction is a merger. In an acquisition, the consideration is in the form of cash. The person or the corporation intending to control another corporation buys the controlling interest in the share capital through open market operations. The seller if the shares receives money in the current period of the transaction and the buyer of the share settles the same based on market prices.

Under section 394 of the Companies Act, amalgamation includes absorption and the amalgamation under the company law may be by order of the court or by the Central Government, if it is in public interest. The memorandum of association of both the companies must provide for amalgamation and under section 391 and 394 of the Companies Act, 1956 the Central Government's approval of the merger proposal is necessary for filing petition before the FERA, 1973 (Section 6 of FEMA, 1999) for transfer of share involving NRIs or foreign nationals.

The Income-Tax Act has defined 'amalgamation' under 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 -

- a) 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.
- b) 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.
- c) shareholders holding not less than three-fourths 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,

If the amalgamated company wishes to set off the losses and unabsorbed depreciation of the amalgamating company with its profits, the conditions mentioned in section 72 A should be fulfilled.

Thus under section 72A where there has been an amalgamation then, the accumulated loss and the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or, as the case may be, allowance for unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected, and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly

For example where the property of company A, which merges is sold to the other company B and the amalgamation comes about by virtue of transaction of sale. This is to exclude from amalgamation the cases where the scheme of amalgamation is not approved by the High Court. Where the company A, which merges is wound up in liquidation and the liquidator distributes the property of company A to the company B and the amalgamated company B receives the property of company A from the liquidator, there is no amalgamation. Sometimes it would be advantageous to look at reverse merger option.

Under section 47 (vi)(a) any transfer, in a scheme of amalgamation, of a capital asset being a share or shares held in an Indian company, by the amalgamating foreign company to the amalgamated foreign company, if –

- a) at least twenty-five per cent of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company, and
- b) such transfer does not attract tax on capital gains in the country, in which the amalgamating company is incorporated.

9. Demerger

As per 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 undertakings to any resulting company in such a manner that -

- a) 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.
- b) 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.
- c) 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.

- d) The resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis.
- e) 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.
- f) 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.
- g) The transfer of the undertaking is on a going concern basis.
- h) 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.

With a view to recognize the demerger slump sale and to rationalize the provisions of amalgamation a number of amendments have been made in the Income Tax Act should be considered. The effect of these provisions is that demerger would now be taxed neutral and would not attract any additional liability to tax. Further, in demerger, the tax benefit and the concession available to any undertaking would be available to the said undertaking on its transfer to the resulting company.

Under section 47(vi)(c) any transfer in a demerger, of a capital asset, being a share or shares held in an Indian company, by the demerged foreign company to the resulting foreign company, if -

- a) the shareholders holding not less than three-fourths in value of the shares] of the demerged foreign company continue to remain shareholders of the resulting foreign company; and
- b) such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated

Under section 72 A in the case of a demerger, the accumulated loss and the allowance for unabsorbed depreciation of the demerged company shall

- a) where such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting company, be allowed to be carried forward and set off in the hands of the resulting company.
- b) where such loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting company, be apportioned between the demerged company



and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company, and be allowed to be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be.

The above provisions should be borne in mind in case of demergers

10. New Capital Investments

In the case of any fresh investments in business arising out of expansion or diversification or takeover of a business, the tax consequences of such managerial decisions are weighed. In such cases the assessee is entitled to:

- a) Claim normal depreciation allowances.
- b) Claim additional depreciation allowances.
- c) Tax incentives in respect of export turnover.
- d) Incentives for employing additional manpower.
- e) Carry forward of unabsorbed depreciation and business losses.
- f) Tax holiday on the profits and gains of the new undertaking.

11. Accounting Standards for Taxes on Income

The Institute of Chartered Accountants of India has issued Accounting Standards in respect of accounting periods commencing on or after 01-04-2001. This Accounting Standard will be mandatory in nature. It is known as Accounting Standard (AS 22) on 'Accounting for Taxes on Income'. The various matters covered in this Accounting Standards relate to the following, inter alia, matters:

- a) Accounting for Taxes on Income.
- b) Definitions of Accounting profit (loss), taxable profit (tax loss), Tax expense provision for taxes payable, Timing differences, Permanent differences, etc.
- c) Effect of permanent and Timing Differences on Taxable profit and Accounting profit.
- d) Taxes Payable Method.
- e) Tax Effect Accounting Method, and its application.
- f) Consideration of prudence.
- g) Calculation of Deferred Tax Adjustments.
- h) Amalgamation

- i) Transitional Provisions
- j) Disclosure
- k) Examples of Timing Differences
- l) Illustration regarding Taxes payable and Tax Effect Accounting Methods.
- m) Illustration regarding Application of Tax Effect Accounting Method in case of Loss.
- n) Full Provision Method.
- o) Liability Method.

12. Tax audit of certain persons carrying on business or profession

It is provided in Section 44AB that in the following cases tax audit will be compulsory:

- a) Where the total sales, turnover or gross receipts, as the case may be in business exceed or exceeds Rs.40 lakh in any previous year; or
- b) Where the gross receipt in profession exceed Rs. 10 lakh in any previous year; or
- c) Where a person carrying on the business, if the profits and gains from the business are deemed to be the profits and gains of such person u/s. 44AD / 44AE / 44AF as the case may be and has claimed his income to be lower than the profits or gains so deemed in any previous year.

Different forms to be prescribed by Rule 6G for Tax Audit Reports, which are as under:

- a) Form 3CA: Tax audit report in the case of a person who carries on business and who is required to get his accounts audited under any other law.
- b) Form 3CB: Tax audit report in the case of a person who carries on business and who is not required to get his accounts audited under any other law.
- c) Form 3CC: Tax audit report in the case of professionals.
- d) Form 3CD: Prescribed particulars in the case of (i) and (ii) above.
- e) Form 3CE: Prescribed particulars in the case of (iii) above.

The last date for furnishing of Tax Audit Report is 30th September of the Assessment year concerned for companies.

Modification of provisions regarding compulsory audit of accounts — Section 44AB:

The Finance Act, 2001 has, with effect from the assessment year 200 1-02, amended Section 44AB to provide that in the case where the amounts are required to be audited by or under any other law, it would be sufficient compliance with the provisions of the said section if the person gets the accounts audited under such law before the specified date and furnishes by that date,



the report of the audit under such other law, and a further report from a Chartered Accountant in the prescribed form under Section 44AB.

13. Accounting for International Transactions

Under section 92D following provisions should be followed in maintenance and keeping of information and document by persons entering into an international transaction.

- a) Every person who has entered into an international transaction shall keep and maintain such information and document in respect thereof, as may be prescribed.
- b) Without prejudice to the provisions contained in sub-section (1), the Board may prescribe the period for which the information and document shall be kept and maintained under that sub-section.

The Assessing Officer or the Commissioner (Appeals) may, in the course of any proceeding under this Act, require any person who has entered into an international transaction to furnish any information or document in respect thereof, as may be prescribed under sub-section (1), within a period of thirty days from the date of receipt of a notice issued in this regard.

Noncompliance attracts penalty.

14. Allowances vs. Perquisites

As per section 17 allowances and perquisites are part of salaries and are taxable in the hands of employee.

However, certain perquisites are taxable in the hands employer in the form of Fringe Benefit Tax.

Therefore, the employer should figure out what is beneficial for the company but not at the cost of additional burden to the employees and should find a suitable policy for payment of salary.

15. Preference Capital vs. Debentures

Preference capital represents a hybrid form of financing. It partakes of some characteristics of equity and some attributes of debentures. It resembles equity in the way that preference dividend is payable only out of distributable profits.

Payment of dividend to preference shareholders results in payment of Dividend Distribution Tax by the Company, but receipt of tax-free income by the shareholders.

Debentures are instruments for raising long-term debt capital. Debenture holders are the creditors of the company. The obligation of the company towards its debenture holders is similar to that of a borrower who promises to pay interest and capital at specified times. The specific cost of debt capital, represented by debentures, is much lower than the cost of preference or equity capital. This is because the interest on debentures is allowed as deduction, and the effective cost of debentures is much less.

Payment of interest does not call for any additional liability on the Company, and receipt of taxable income by the debenture holders. Interest also attracts TDS.

Evolving Capital Structure

Before setting up a new project, decision regarding the capital structure has to be taken. While opting for a particular capital structure, the following consideration are borne in mind:-

- a) Servicing the capital base with consistent dividend / yield policy,
- b) Cost of capital to be raised from the market.
- c) Chargeability or otherwise of taxes i.e. direct and indirect taxes.
- d) Policy on plough back of profits for future plan towards diversification, expansion modernization and other development aspects.
- e) Cost of servicing the capital e.g. for bank finance monthly / quarterly statements are required to be furnished, in case of public issue quarterly accounts are required to be published, etc; for which costs are required to be incurred.

Generally the means of finance selected under India conditions for a new project comprises of:-

- 1) Equity share capital.
- 2) Preference share capital
- 3) Borrowings from financial institutions / bank-Loans.
- 4) External Commercial Borrowing.
- 5) Borrowings from the capital markets through debentures and debt instruments.
- 6) Lease financing.

In making capital structure decision, the financial leverage plays an important role. The percentage increase in Earnings Before Tax (EBT) in relationship to percentage increase in Earnings Before Interest and Taxes (EBIT) expressed as a percentage is the financial leverage of the structure opted. This can be explained in the form of an example.

EBIT	1000
Less: Interest on securities	500
EBT	500

$$\text{Financial Leverage} = 1000 / 500 = 2$$

This would mean that any increase in EBIT would have two fold increase in EBT. So if EBIT were 1500, EBT would be 1000. Therefore it is clear that 50% increase in EBIT has resulted into 100% increase in EBT.



As a corollary to the above, a high financial leverage would result in a very high return when there is high profitability. But in case of depression, this would be counter productive as the residual net income available to shareholders may be considerably reduced and may sometimes end up in loss. The fluctuations in operating profits and debt-equity mix would indicate the safety parameters and get reflected in the financial leverage.

A capital structure is said to be optimum when it has a mixed bag of debt and equity stocks and it has the lowest weighted average cost of capital. The advantage of having an optimum capital structure is to maximise the value of assets of the company and the wealth of its owners and minimizes the cost of capital, which in turn, raises its ability to have inbuilt additional investment opportunities. At the same time a high debt equity ratio is also not prudent. A high debt equity ratio has its own advantages and disadvantages. Problem of planning capital structure is of crucial importance and has long term implications. The tax planner should properly balance risks, costs, control and tax considerations. In capital structure decisions, the cost of capital is an important consideration along with the risk factor. One of the main reasons for raising finance through borrowings (in preference over equity shares) is to increase earnings on equity share capital. But excessive use of debt capital, increase the risk of the company as is witnessed in the country.

While the interest paid on debt instruments is tax deductible [section 36(1)(iii)], the dividend paid would be construed as apportionment of profits. The interest received by the shareholder is taxable in the hands of the recipient and any ROI calculations would be on net of tax basis. The cost of raising finance through debts is deductible in the year in which it is incurred (except where it is incurred during the pre-commencement period in which case, it has to be capitalised). The cost of issue of shares is allowed as a deduction in 10 years under section 35D of Income Tax Act. Because of aforesaid provisions, corporate taxation plays an important role in determining the choice between different sources of financing.

Moreover, in case pf capital – equity or preference – the Company is liable to pay dividend distribution tax and on the other hand shareholders receive tax free dividend.

In case of ECB, possibility of forex - loss or gain – needs to be taken into account.

AMORTIZATIONS

Any Indian company or a person other than a company, who is resident in India, can claim deduction u/s 35D read with rule 6AB of any expenditure incurred on the following:

- 1) Expenditure incurred before the commencement of business i.e. setting up of a new industrial unit.
- 2) Expenditure incurred in connection with existing industrial undertaking i.e. business expansion.

The expenses that qualify for deduction are:

- 1) Preparation of a feasibility report.
- 2) Preparation of a project report.
- 3) Conducting market survey or any other survey necessary for the business of the assessee.
- 4) Engineering services relating to the business of the assessee.
- 5) Legal charges for:
 - i) Drafting any agreement between the assessee and any other person relating to the setting up or conduct of business of the assessee.
 - ii) Drafting Memorandum and articles of Association.
- 6) Printing of Memorandum and Articles of association.
- 7) Fees for registering the company under the provisions of the Companies Act, 1956.
- 8) In connection with the issue for public subscription of shares or debentures of the company such as underwriting commission, brokerage, charges for drafting, typing, printing of prospectus and advertisement.
- 9) Any other expenditure not allowable under the provisions of the Act.

The expenditure on items (a) to (d) can be incurred either by the client or by engaging an approved consultant.

The aggregate of the expenditure shall not exceed 5% of the cost of the project or capital employed in the business whichever is beneficial to the company. The amounts qualifying as per the limits specified above shall be allowed as a deduction in five equal instalments beginning with the previous year of the commencement of the business or the period in which the extension of the industrial undertaking is completed and the new unit commences production or operations.

In the case of amalgamation / de-merger, the provision of this section shall as far as may be applied to the amalgamated company as they would have applied to the amalgamated company as if the amalgamation had not taken place.

Where an assessee, being an Indian company, incurs any expenditure wholly or exclusively for the purpose of amalgamation or de-merger of an undertaking, the assessee shall be allowed a deduction of an amount equal to one fifth of such expenditure for each of 5 successive previous years beginning with the previous year in which the amalgamation or de-merger takes place (section 35DD). No deduction shall be allowed in respect of the expenditure under other provisions of the Act.

If the expenditure on amalgamation were incurred by the amalgamating company, it would be able to claim one-fifth expenditure in the year of amalgamation but the balance four-fifth ex-



penditure will not be allowed as deduction to the amalgamating company as it ceased to exist. On the other hand if such expenditure were incurred by the amalgamated company, it would be eligible to deduction over a period of five years as it continues to exist. However, in the case of de-merger, both the companies continue to exist hence the problem does not arise.

Where an assessee incurs any expenditure in any previous year by way of payment of any sum to an employee at time of his voluntary retirement, in accordance with any schemes of voluntary retirement, one fifth of the amounts so paid shall be deducted in computing profits and gains of the business for that previous year and the balance shall be deducted in equal instalments for each of the four immediately succeeding previous years. No deduction shall be allowed in respect of such expenditure under any other provisions of the Act. The deduction is allowed u/s 35 DDA so as to provide that where the undertaking is transferred before the expiry of the period specified to another Indian company in a scheme of amalgamation or de-merger, the deduction shall continue to be available to the amalgamated or the resulting company, as if the amalgamation or de-merger had not taken place. In case of recognition of certain forms of business whereby a firm or a proprietary concern is succeeded by a company, the deduction shall be available to the successor company. Further in the year of transfer, no deduction shall be available to the amalgamated company, demerged company, the firm or proprietary concern as the case may be.

SHORT TERM BORROWINGS

It is normal for any business to borrow money for the purpose of business and in the case of companies; the borrowings can be in the form of loans and public deposits in the short to medium term and term loans in the medium to long term. The amount of interest paid in respect of capital borrowed for the purpose of business or profession is allowed as deduction [Section 36(1) (iii)]. The basic requirements are:-

The money must have been borrowed by the assessee.

It must have been borrowed for the purposes of business, profession, or vocation.

The interest must have been paid and claimed as an allowance. In case accrual method is followed, the amount of interest due would also be allowed.

However, any amount of the interest paid, in respect of capital borrowed for acquisition of an 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, shall not be allowed as deduction. It can be included in cost of the asset.

Few important principles in respect of allowability of interest expenditure are as under:

Even where the assessee has surplus funds, it was held that the Department has no right to question the need of the borrowings- CIT Vs Bombay Samachar Ltd. (1969) 74 ITR 723 (Bom).

In the case of genuine borrowing, the Assessing Officer cannot object to the interest rates-CIT Vs Tarai Development Corporation Ltd. (1994) 205 ITR 421 (All).

Interest is allowable irrespective of the facts whether the borrowings is utilised for working capital or for acquisition of a capital asset- CIT Vs India Cements Ltd. (1966) 60 ITR 52 (SC).

It is not necessary that the investments made out of borrowed funds should yield any profit in the year – Calico Dyeing & Printing Works Vs CIT (1958) 34 ITR 265 (Bom).

The claim for interest paid by a firm to its partner cannot exceed 12% per annum.

Interest on money borrowed prior to commencement of business has to be capitalized.

Interest on money borrowed for meeting personal obligations of the assessee or its partners or directors will not be allowed.

Interest on money borrowed for meeting any income - tax liability is not allowed.

Interest paid on purchase of debentures will not be allowable u/s 36(1)(iii), but may be allowed u/s 37(1).

Assessee carrying on jewellery business commencing exhibition of cinematographic films. Capital borrowed for constructing cinema theatre, which was run for several years and then transferred. Loan has been obtained for business purposes. Business of jewellery and that of exhibition of films being composite one, interest on capital borrowed held deductible for periods after cinema business discontinued – Veecumsees Vs CIT (1996) 220 ITR 185 (SC).

Where the money is borrowed or used for the purposes of putting up a building in which the assessee had not interest and through diversion of funds, the interest is not deductible – CIT Vs Indian Express Newspapers (Madurai) Pvt. Ltd. (1999) 104 Taxman 578 (Mad).

Interest on money borrowed for expansion of the old business is allowable as a deduction whether the expanded unit has gone into production or not – CIT Vs Bhilai Iron Foundry Ltd. (1998) 234 ITR 661 (MP).

Where the borrowed money has been initially invested in business and subsequent diversion of funds take place, such diversion must be clearly established and not matter of mere speculation. If the amount diverted were subsequently brought back into business and utilised into business, the interest is allowable but not so long as the diversion continues – K Somasundaram & Bros. Vs CIT (1999) 153 CTR 153 (Mad).

The onus is on the assessee to prove that the interest is deductible – CIT Vs Mir Mohd. Ali (1964) 53 ITR 165 (SC). Where however if the Assessing Officer disallows part of interest on account of diversion of funds, the onus shall be on the Assessing Officer to prove such diversion – Modipon Ltd. Vs ITO (1985) 22 TTJ 108 (Del).

Interest on money borrowed for payment of dividends is an allowable deduction.

Interest paid outside India is not allowable as deduction unless tax has been paid / deducted at source.

Interest under the residuary provisions of sections 37(1) has to be explode where the interest is deductible u/s 36(1)(iii). However only one deduction will be allowed.



PROFIT DISTRIBUTION

While interest is paid as the yield on investments to the lenders, the return on investment to the equity / preference shareholders takes the form of dividends or bonus shares or rights issue.

Company is required to pay dividend distribution tax on dividends paid to shareholders, who get it tax free. This is discussed elsewhere.

The word 'dividend' in its ordinary connotation means the sum paid to or received by a shareholder proportionate to his shareholding in a company out of the total sum distributed. Section 2(22) of the Income-tax Act has given an inclusive definition.

Dividend from a foreign company including deemed dividend shall be taxed under the head 'income from other sources.'

Any distribution by a company to the extent of accumulated profits whether capitalized or not, if such a distribution entails the release of all or any part of the assets of the company to its shareholders shall be declared as dividend under the Act [section 2(22)(a)]. The main ingredients of taxation of dividend are —

- (a) the company should possess accumulated profits and
- (b) such accumulated profits are distributed in cash or in kind.

Where the distribution is in kind, the market value of the asset (not the book value) shall be deemed dividend in the hands of the shareholders. The provisions of section 2(22) (a) are not attracted in case where a company merges into another company in a scheme of amalgamation.

Any distribution to its shareholders (equity or preference) by a company of debentures, debenture stock or deposit certificates in any form whether with or without interest to the extent of accumulated profits whether capitalized or not shall also be deemed as dividend. Similarly any distribution to its preference shareholders of shares by way of bonus to the extent to which the company possesses accumulated profits whether capitalized or not shall be deemed as dividend. However mere capitalization of accumulated profits by issue of bonus shares to equity shareholders does not entail the release of the assets of the company and hence shall not be deemed to be dividend.

Any distribution made to the shareholders of a company on its liquidation to the extent to which such distribution is attributable to the accumulated profits immediately before its liquidation whether capitalized or not shall be deemed as dividend. However the shares issued for full consideration, where the holder of the shares is not entitled to participation in the surplus assets in the event of liquidation, is not a deemed dividend. The provisions of section 2(22) (c) are not attracted in case where a company merges into another company in a scheme of amalgamation.

Any distribution to its shareholders by a company on the reduction of its capital to the extent to which the company possesses accumulated profits, whether such accumulated profits have

been capitalized or not, shall be deemed as dividend. For this purpose, profits of the company up to the date of the resolution permitting the reduction of capital shall form part of the accumulated profits. The deemed dividend does not include any distribution to shareholders on liquidation or reduction of capital of the company in respect of any shares issued for full cash consideration where the holder of the shares is not entitled in the event of liquidation to participate in the surplus assets i.e. preference shareholders.

Any payment by a company (other than a company in which the public are substantially interested) of any sum (whether as representing a part of the assets of the company or otherwise) by way of advance or loan to the extent of accumulated profits (excluding capitalized profits) to an equity shareholder who is the beneficial owner of shares holding not less than 10% of the voting power or to any concern in which such shareholder holding not less than 10% of the voting power is a member or a partner and in which he has a substantial interest or any person on behalf of or for the individual benefit of any such shareholder. Even if such loans are advanced against interest, the section 2(22)(e) is applicable. The deemed dividend shall not be exempt u/s 10(33), though the closely held company who made the advance or loan was a domestic company.

The concept of dividends will not cover the following transactions:

1. Any advance or loan to a shareholder or a specified concern by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company.
2. Any dividend paid by the company, which is set off by the company against the whole or any part of the loan or advance paid by it previously and which has been treated as deemed dividend u/s 2(22)(e). In this case, the dividend so set off shall not be treated as dividend in the hands of the shareholder [section 115-0].
3. Any distribution made in accordance with clause (c) or (d) of section 2(22) in respect of any share issued for full consideration to preference shareholders.
4. Any payment made by a company on purchase of its own shares from a shareholder pursuant to section 77A of the Companies Act, 1956.
5. Any distribution of shares pursuant to a de-merger by the resulting company to the shareholder of the demerged company (whether or not there is a reduction in capital of the demerged company).

The following principles are generally applied in the case of treatment of such transactions [section 2(22)(e)]:

1. One should be a shareholder on the date the loan was advanced.
2. If the payment is made by a closely held company to a substantial shareholder by way of advance or loan, etc, it cannot be deemed as dividend u/s 2(22)(e) even if the company were in possession of accumulated profits, which had already been capitalized prior to such payment - Badiani P. K. Vs CIT (1976) 105 ITR 642 (SC).



3. If the accumulated profits possessed by the company at the time of payment exceed the amount of payment made by the company, the whole of the payment should be regarded as payment and not only that part of it, which represented proportionate share of the shareholder in the accumulated profits of the company. However the amount of payment so made is larger than the accumulated profits possessed by the company, only that part of the payment, which is equal to the amount of accumulated profits would be deemed to be dividend [CIT Vs Mayur Madhukant Mehta (1972) 85 ITR 230 (Guj)].
4. The amount of the loan, etc granted to a mere beneficial owner of the shares, who is not a registered shareholder, cannot be deemed as dividend - Rameshwarlal Sanwaram Vs CIT (1980) 122 ITR 1 (SC).
5. An advance or loan made to the corporate entity say to a holding company by its subsidiary can attract the provisions of section 2(22)(e) on fulfillment of all the conditions laid down in that behalf- Sadhana Textile Mills Pvt. Ltd. Vs CIT (1991) 188 ITR 318 (Bom).
6. Sale of goods on credit does not amount to a transaction of loan although a debt is created - Lakhmichand Muchhal Vs CIT (1961) 43 ITR 315 (MP).
7. Temporary advances or loans do not fall within the mischief of section 2(22)(e). The fact that the loan or advance was factually repaid or made good within a short period is no defence to the attraction of the provision - Waichand & Co. Ltd. Vs CIT (1975) 100 ITR 598 (Bom).
8. The word 'advance' means something which is due to a person but paid to him ahead of the time - CIT Vs Srinivasan K (1963) 50 ITR 788 (Mad).
9. Whenever a loan or advance is routed through an employee to the Managing Director, who needs the money, such loans made by the company to the employee fell in the category of benefit to the assessee and were therefore were assessable as deemed dividends in his hands even though he is not a party to the transaction directly - CIT Vs Alagusundaram Chettiar L (1977) 109 ITR 508 (Mad).
10. Payment of shareholder's personal expenses, insurance premia, etc would also be covered within the ambit of section 2(22) (e) to the extent of the accumulated profits of the company - CIT Vs Srinivasan K (1963) 50 ITR 178 (Mad).
11. Accumulated profits mean commercial profits and not assessable income - Badiani P. K. Vs CIT (1976) 105 ITR 642 (SC).
12. Even if the accumulated profits in the hands of the company are derived from agriculture and agricultural income is exempt from tax, the money received by the shareholder is taxable as the character of receipt changes - Kumaraswarni S Vs ITO (1961) 43 ITR 423 (Mad).
13. The accumulated profits include all profits of the company up to the date of distribution of the payment and include all profits of the company till the date of liquidation subject to the exception provided in section 2(22)(c).

14. Accumulated profits include general reserve - CIT Vs Srinivasan K (1963) 50 ITR 178 (Mad).
15. The accumulated profits get reduced by the amount already deemed to be dividend u/s 2(22)(e) even if no adjustments is made in the books of accounts - CIT Vs G Narasimhan (1999) 102 Taxmann 66 (SC).

For payment of dividend distribution tax, dividend under section 2(22)(e) is not covered. Similarly it is not exempt in the hands of a shareholder.

The following expenses can be claimed as deduction from gross dividend income, if such dividend is taxable in the hands of the assessee:

1. **Collection charges** — Any reasonable sum paid by way of commission or remuneration to a banker or any other person for the purpose of realizing the dividend.
2. **Interest on loan** — Interest on money borrowed for purchasing the shares can be claimed as deduction even where no income is earned on such shares.
3. Any other expenditure not being an expenditure of capital nature expended wholly and exclusively for the purpose of making or earning such income can be claimed as a deduction.

In case of equity bonus shares, the tax treatment and the implication for the investor are not difficult to understand. In the case of bonus shares, the bonus shares would be assumed to have been acquired at 'zero cost' and the entire sale consideration on disposal of shares will be subject to capital gains. The investors have no tax effect in the bonus shares are received and the incidence of tax would arise only at the point of sale. The main question thus confronting the investors would be whether the gain should be short-term or long-term in nature. If the shares are sold after a period of 12 months, it will be considered as being long-term in nature, which is beneficial from tax angle for those who fall in the higher tax bracket on account of lower rate of tax. In the case of bonus debentures, the investor receives a debenture free of cost based on equity holdings in the company. This receipt is termed as a deemed dividend under the tax laws and taxable in the hands of the receiver. Thus there will be an element of income and tax when the bonus debentures are issued. The point to note is that when the debentures are redeemed at face value, on its maturity, there will not be any gain or loss for the investor. In addition the interest that will arise on the debenture will be taxable in the hands of the investor as income from other sources. E.g. HLL Bonus debenture issue. Instead of debentures, if the company chooses to issue bonus redeemable preference shares there is also a return of the principal amount after a certain number of years. These shares would not qualify as normal dividend or as deemed dividend in terms of the Income-tax Act, 1961 and therefore would mean no tax effect at the time of the issue of bonus. The incidence of taxation would shift to the time when such preference shares are redeemed. In addition, the fixed rate of dividend, which will be received every year will be considered as normal dividend and there would qualify for deduction u/s 80 L subject to a, maximum of Rs.9000, E.g. Marico Industries bonus preference share issue.

The companies resort to resource mobilization by way of issue of equity capital and the companies have to follow necessarily the provisions of section 81 of the Companies Act, 1956. In such



an event the shareholders may or may not avail the rights given to them for subscribing to the additional capital. Further in pricing the issue of shares, the shares can be issued at par or at a premium. Since these shares are subscribed with receipt of cash consideration in mind, they cannot be deemed as dividend even though it may confer some pecuniary advantage to the shareholders in terms of the ruling market prices. Since the renunciation right is there, the amount pecuniary advantage cannot be taxed. Therefore the rights issue offers an excellent scope for tax planning by the shareholders. In case the rights are renounced in favour of one of the family members and such family member takes up the share, the pecuniary advantage is passed on to the member of the family. In case such transferee is a minor the clubbing provision can also be avoided.

Tax Credit for tax paid on 'Book Profits'.

Under section 115JB in the case of a company, the income-tax, payable on the total income as computed under this Act in respect of any assessment year, is less than ten per cent of its 'book profit', such book profit is deemed to be the total income of the company and the tax is payable by the company on such 'book profit' shall be the amount of income-tax at the rate of ten per cent.

Tax credit in respect of tax paid on deemed income relating to certain companies.

Section 115JAA provides that when any tax is paid under section 115JB by any company for the assessment year commencing on the 1st day of April, 2006 and any subsequent assessment year, then, credit in respect of tax so paid shall be allowed to him in accordance with the provisions of this section.

The tax credit to be allowed is the difference of the tax paid for any assessment year under section 115JB and the amount of tax payable by the assessee on his total income computed in accordance with the other provisions of this Act.

The tax credit shall be allowed set-off in a year when tax becomes payable on the total income computed in accordance with the provisions of this Act other than on 'book profits'.

Set off in respect of brought forward tax credit shall be allowed for any assessment year to the extent of the difference between the tax on his total income and the tax which would have been payable under the provisions of section 115 JB.

The amount of tax credit determined under section 115JAA can not be carried forward and set off beyond the seventh assessment year immediately succeeding the assessment year in which tax credit becomes allowable under section.

However, no interest shall be payable on the tax credit allowed under section 115 JAA.

When any company becomes liable for payment of tax on book profits', it should be ensured that an amount of tax credit should be ascertained and credit should be availed in terms of these provisions.

TAX ON DISTRIBUTED PROFITS OF A COMPANY

The amount declared, distribution or paid by a domestic company way of dividends (DDT) would be charged to additional income-tax at a flat rate of 15% (increased by surcharge @2% on I.T, 2% education cess and 1% secondary education cess on I.T. plus S.C..) in addition to normal income tax chargeable on the income of the company.

As per provisions of section 115-O a domestic company is liable to pay tax on any amount declared, distributed or paid by such company by way of dividends, whether interim or otherwise.

Notwithstanding that no income-tax is payable by a domestic company on its total income computed in accordance with the provisions of this Act, the tax on distributed profits must be paid.

The principal officer of the company and the company would be liable to pay income tax to the credit of Central Government within 14 days from the declaration, distribution, or payment of dividends whichever is the earliest. If the principal officer and the company fail to so pay the income-tax to the credit of the Central Government, he or it will be liable to pay simple interest at the rate of 1%, for every month or part of thereof on the amount of tax payable and such principal officer and the company would also be deemed to be assessee in default in respect of the amount of tax payable.

It has been clarified that no deduction under any of the provisions of the IT Act would be allowed to the company or shareholders in respect of the tax on distributed profits. The additional income-tax so paid by the company would be treated as the final payment of tax in respect of the amount distributed and no further credit for such tax would be claimed either by the company or by any other assessee. The provision is logical as the entire amount of such dividends would completely exempt from the income-tax in the hands of shareholders, under section 10(33).

TAX ON DISTRIBUTED INCOME TO UNIT-HOLDER

Chapter XII-D includes three Sections 115R , 115S and 115T which provide for

Tax on distributed income to unit holders is applicable under section 115T. Any amount of income distributed by UTI or a Mutual Fund to its unit holders shall be chargeable to tax and such UTI or Mutual Fund shall be liable to pay additional income-tax on such distributed income at the rate of—

- (i) twenty-five per cent on income distributed by a money market mutual fund or a liquid fund;
- (ii) twelve and one-half per cent on income distributed to any person being an individual or a Hindu undivided family by a fund other than a money market mutual fund or a liquid fund; and



- (iii) twenty per cent on income distributed to any other person by a fund other than a money market mutual fund or a liquid fund:

Such Tax shall not apply to shall apply to any income distributed,—

- (a) by the Administrator of the specified undertaking, to the unit holders; or
- (b) to a unit holder of equity oriented funds in respect of any distribution made from such funds

Interest and penalty applies to any default in tax payment.

INCENTIVE TO VENTURE CAPITAL AND TAX TREATMENT OF INCOME OF A VENTURE CAPITAL COMPANY OR A VENTURE CAPITAL FUND

Section 10 (23FA) of the Act exempts any income by way of dividends, other than dividends referred to in section 115-O, or long-term capital gains of a venture capital fund or a venture capital company from investments made by way of equity shares in a venture capital undertaking in respect of any investment made after the 31st day of March, 2000.

In order to claim exemption the conditions should be fulfilled. Important provisions are as under :

- i) such venture capital fund or venture capital company is approved, for the purposes of this clause, by the Central Government on an application made to it in accordance with the rules made in this behalf and which satisfies the prescribed conditions.
- ii) any approval by the Central Government shall, at any one time, have effect for such assessment year or years, not exceeding three assessment years, as may be specified in the order of approval.
- iii) “venture capital fund” means such fund, operating under a trust deed registered under the provisions of the Registration Act, 1908 (16 of 1908), established to raise monies by the trustees for investments mainly by way of acquiring equity shares of a venture capital undertaking in accordance with the prescribed guidelines;
- iv) “venture capital company” means such company as has made investments by way of acquiring equity shares of venture capital undertakings in accordance with the prescribed guidelines;
- v) “venture capital undertaking” means such domestic company whose shares are not listed in a recognised stock exchange in India and which is engaged in the—
 - (i) business of—
 - (A) software;

- (B) information technology;
- (C) production of basic drugs in the pharmaceutical sector;
- (D) bio-technology;
- (E) agriculture and allied sectors; or
- (F) such other sectors as may be notified by the Central Government in this behalf; or
- (ii) production or manufacture of any article or substance for which patent has been granted to the National Research Laboratory or any other scientific research institution approved by the Department of Science and Technology;

Section 10 (23FB) of the Act 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 claim exemption the conditions should be fulfilled. Important provisions are as under :

- (a) “venture capital company” means such company—
 - (i) which has been granted a certificate of registration under the Securities and Exchange Board of India Act, 1992
 - (ii) which fulfils the conditions as may be specified, with the approval of the Central Government, by the Securities and Exchange Board of India, by notification in the Official Gazette, in this behalf;
- (b) “venture capital fund” means such fund—
 - (i) operating under a trust deed registered under the provisions of the Registration Act, 1908 or operating as a venture capital scheme made by the Unit Trust of India established under the Unit Trust of India Act, 1963
 - (ii) which has been granted a certificate of registration under the Securities and Exchange Board of India Act, 1992
 - (iii) which fulfils the conditions as may be specified, with the approval of the Central Government, by the Securities and Exchange Board of India, by notification in the Official Gazette, in this behalf; and
- (c) “venture capital undertaking” means such domestic company whose shares are not listed in a recognised stock exchange in India and which is engaged in the—
 - (i) **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; or*
- (ii) *dairy or poultry industry;*

WEALTH TAX

CHARGEABILITY

The wealth tax Act, 1957 extends to the whole of India and came into force on the 1st day of April 1957. The act was extended to the state of Sikkim with effect from the assessment year 1990-1991. Every individual, HUF or company shall be charged wealth tax at 1% on the net wealth in excess of Rs. 15 Lakhs determined on the basis of nationality and residential status on the corresponding valuation date.

“Net wealth includes assets/ deemed assets irrespective of their location minus debt owed in respect of acquiring such assets. According to section 6, the value of the assets and debts located outside India shall not be included in the computation of net wealth of the assessee in certain cases dependant upon the nationality and residential status in the case of individuals and residential status in India in respect of HUF and companies.

● **CERTAIN IMPORTANT DEFINITIONS**

Under the Wealth Tax Act, 1957 certain terms have been defined for the purpose of computation of wealth and payment of tax, while certain have terms have evolved. Meaning of selected terms is as follows:

“Individual” means and includes trustees, trade unions, Hindu deities, holder of an impartible estate, and heirs of an individual who died intestate, association of persons where the shares are indeterminate. However club is not an individual.

“Hindu undivided family (HUF)” - the word has not been defined under the Act. This would mean that the word has to be construed in the same sense in which it is understood under the Hindu Law. Jain and Sikh families are not governed by Hindu Law even though they are treated as HUF under the Act. If the Karta of HUF dies, the HUF does not cease to exist. The share of the Karta devolves on the heirs and will be assessed in their individual hands. The remaining property will continue to be assessed in the hands of HUF.

“Company” shall have the meaning assigned to it in section 2 (17) of the Income-tax Act, 1961.

“Valuation date” in relation to any year for which an assessment is to be made under this Act means the last day of the previous year as defined u/s 3 of the Income-tax Act i.e. 31st March. Only the net wealth at the last moment of the last date should be considered for the purpose.

“Assessment year” means a period of twelve months commencing on the 1st day of April every year.

“Assessee” means a person by whom wealth tax or any other sum of money is payable under this Act and includes every person in respect of whom any proceeding under this Act has been taken for the determination of wealth tax payable by him or by any other person or the amount of refund due to him or such other person, every person who is deemed to be an assessee or assessee in default under this Act.

“Valuation Officer” means a person appointed as a Valuation Officer under section 12A, and includes a Regional Valuation Officer, a District Valuation Officer, and an Assistant Valuation Officer;

“Net wealth” means the amount by which the aggregate value computed in accordance with the provisions of this Act of all the assets, wherever located, belonging to the assessee on the valuation date, including assets required to be included in his net wealth as on that date under this Act, is in excess of the aggregate value of all the debts owed by the assessee on the valuation date which have been incurred in relation to the said assets;

“Location of the assets” is essentially one of fact and will have to be decided in the light of evidence. The following instructions have been issued:

1. Tangible immovable property is located in India if the property is in India.
2. Rights or interests in or over immovable property are located in India in respect of immovable properties located in India.



3. Rights or interests in or over tangible movable security are located in India if such property is located in India. Goods on high seas cannot be said to be located in India.
4. Debts, secured or unsecured, are located in India if they are contracted to be repaid in India or if the debtor is residing in India.
5. Aircraft or motorcar is located in India if they are registered in India.

The above list is only illustrative and not exhaustive and generally the location has to be decided having regard to the nature of the assets.

“Assets”, means the following -

1. House including farmhouse means any building or land appurtenant thereto whether used for residential or commercial purposes or for the purpose of maintaining a guest house or otherwise including a farm house situated within twenty-five kilometers from local limits of any municipality or a Cantonment Board, but does not include—
 - a) a house meant exclusively for residential purposes and which is allotted by a company to an employee or an officer or a director who is in whole-time employment, having a gross annual salary of less than five lakh rupees;
 - b) any house for residential or commercial purposes which forms part of stock-in-trade;
 - c) any house which the assessee may occupy for the purposes of any business or profession carried on by him;
 - d) any residential property that has been let-out for a minimum period of three hundred days in the previous year;
 - e) any property in the nature of commercial establishments or complexes;
2. Motor car – All motorcars, Indian or Foreign except cars used by the assessee in the business of running them on hire or as stock-in-trade;
3. Jewellery, bullion, furniture, utensils or any other article made wholly or partly of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals :(other than stock-in-trade)
4. Yachts, boats and aircrafts (other than those used by the assessee for commercial purposes);

5. Urban land;
6. Cash in hand, in excess of fifty thousand rupees, of individuals and Hindu undivided families and in the case of other persons any amount not recorded in the books of account.

Explanation [1] - for the purposes of this clause -

(a) “Jewellery” includes-

- (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, utensils or other article or worked or sewn into any wearing apparel ;

(b) “Urban land” means land situate-

- (i) in any area which is comprised within the jurisdiction of a municipality or a cantonment board and which has a population of not less than ten thousand according to the last preceding census of which the relevant figures have been published before the valuation date; or
- (ii) in any area within such distance, not being more than eight kilometres from the local limits of any municipality or cantonment board, as the Central Government may, having regard to the extent of, and scope for, urbanisation of that area and other relevant considerations, specify in this behalf by notification in the Official Gazette.

The following land shall not be treated as urban land and not included as assets:

- a) Land on which construction of a building is not permissible under any law for the time being in force in the area in which such land is situated or
- b) The land occupied by any building which has been constructed with the approval of the appropriate authority or
- c) Any unused land held by the assessee for industrial purposes for a period of two years from the date of its acquisition by him or
- d) Any land held by the assessee as stock-in-trade for a period of ten years from the date of its acquisition by him.

Explanation 2 - For the removal of doubts, it is hereby declared that “jewellery” does not include the Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 notified by the Central Government;



COMPUTATION LOGIC

Confirm that the assessee is an assessee liable for wealth tax under the Act i.e.

- (i) individual,
- (ii) HUF or
- (iii) company.

The 'Net wealth' means the amount by which the aggregate value computed in accordance with the provisions of this Act all the assets, within the meaning of the Act, wherever located owned by the assessee on the valuation date, including assets required to be included in his net wealth as on the date of valuation date, is in excess of the aggregate value of all debts owed by the assessee on the valuation date owed by the assessee on the valuation date, which have been incurred in relation to the aforesaid assets. The same can be described as under:

Computation of the net wealth on the valuation date:

Sr. No.	Particulars	Rupees	Remarks
1	Value of the assets owned by the assessee	XXXX	Refer section 2 (e) for definition of 'asset' and Valuation Rules
2	Add : Share in Assets of Partnership, AOP, BOI, etc	XXX	
3	Add: Assets to be Clubbed	XX	Refer section 4 for assets of other persons to be included in wealth of a person
4	Sub- total	XXXXXXXXXX	
5	Less: Assets exempt from Wealth Tax	XXX	Refer section 5
6	Sub total	XXXXXXX	
7	Less: Debts incurred	XX	Refer section 2 (m) for definition of
8	Net Wealth	XXXXXX	Refer section 44C rounding off ('00)

It, therefore, follows that wealth tax is chargeable only in the case of three categories of persons i.e. individuals, HUF and companies and in the case of individual on the basis of his nationality and residential status of previous year ending on the valuation date and in the case of HUF and company, on the basis of its residential status of the previous year ending on the valuation date.

DEEMED WEALTH : SECTION 4

The following assets even though owned by others shall be included in computation of net wealth of an individual.

1. Transfer to spouse/ son's wife – Sec. 4 (1)(a)

- i) Asset held by the spouse of such individual to whom such assets have been transferred by the individual, directly or indirectly, otherwise than for adequate consideration or in connection with an agreement to live apart, or
- ii) Asset held by a person or association of persons to whom such assets have been transferred by the individual directly or indirectly otherwise than for adequate consideration for the immediate or deferred benefit of the individual, his or her spouse or
- iii) Asset held by the son's wife, of such individual, to whom such assets have been transferred by the individual, directly or indirectly, on or after the 1st day of June, 1973, otherwise than for adequate consideration, or
- iv) Asset held by a person or association of persons to whom such assets have been transferred by the individual, directly or indirectly, on or after the 1st day of June, 1973, otherwise than for adequate consideration for the immediate or deferred benefit of the son's wife, of such individual or both.

2. Clubbing of minor's wealth – Sec. 4 (1)(a)

Asset held by a minor child, not being a minor child suffering from any disability of the nature specified in section 80U of the Income-tax Act or a married daughter, will be clubbed in the hands of the parent as indicated below:

- a) Where the marriage of his parents subsists, in the hands of the person whose net wealth (excluding the minor's assets) is greater.
- b) Where the marriage does not subsists, in the hands of the parents who maintains the child.

However, assets acquired by the minor out of his income referred to in the proviso to sec. 64 (1A) of the Income - tax Act and which are held by him on the valuation date cannot be clubbed.



3. Interest in the assets of Firm or AOP – Sec. 4 (1)(b)

Where the assessee is a partner in a firm or a member of an association of persons (not being a co-operative housing society) the value of his (interest in the assets of the firm) or association is included in the net wealth of the assessee.

Provided that where a minor is admitted to the benefits of partnership in a firm, the value of the interest of such minor in the firm, determined in the manner specified above, shall be included in the net wealth of the parent of the minor in the manner stated above.

4. Transfer or conversion by member of HUF – Section 4 (1A)

Where, in the case of an individual being a member of a Hindu undivided family, any property having been the separate property of the individual has, at any time after the 31st day of December, 1969, been converted by the individual into property belonging to the family directly or indirectly, to the family otherwise than for adequate consideration, then, for the purpose of computing the net wealth of the individual under this Act for any assessment year commencing on or after the 1st day of April, 1972, it shall be included in the net wealth of such individual.

However, any property, on being included in the net wealth of the individual, it will be excluded from the net wealth of the family,

5. Assets transferred under a revocable transfer – Sec. 4 (5)

The value of any assets transferred under an irrevocable transfer shall be liable to be included in computing the net wealth of the transferor as and when the power to revoke arises to him. This implies that the value of any asset transferred under a revocable transfer shall be liable to be included in computing the net wealth.

Revocable transfer means the following transfers in accordance with explanations to Sec. 4

- a) Transfers revocable within a period of 6 years.
- b) Transfers revocable during the lifetime of the transferee.
- c) Transfers where the assessee continues to derive the benefit from the asset directly or indirectly.

- d) Transfer of an asset where the transfer deed provided for the retransfer of either the income or the asset to the assessee.
- e) Transfer of an asset where the transfer deed gives the transferor assessee a right to reassume power over the asset or the income.

6. Gift by book entries - Sec. 4 [5A]

Gift of money by book entries made in the books maintained by the assessee to any other person with whom he has business relationship or any other relationship it shall be deemed to be his asset unless the Assessing Officer is satisfied that money has actually been delivered to the other person at the time the entries were made.

7. Impartible Estate - Sec. 4[6]

Holder of an impartible estate shall be deemed to be the individual owner of all the properties comprised in the estate.

8. Building allotted by Housing Society- sec. 4[7]

Where the assessee is a member of a cooperative housing society or a company or any association of persons to whom a building or part thereof is allotted or leased to him under a house-building scheme, the assessee is deemed to be the owner of such building or part thereof. In determining the value of such building any outstanding installments payable by the assessee to the society towards the cost of such building or part thereof shall be deductible as debts owed by the assessee.

9. Possession of building by a contract u/s 53A of Transfer of Property Act - S.4[8]

Any person who is allowed to take or retain 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, 1882, shall be deemed to be the owner of that building or part thereof and the value of such building or part shall be included in computing net wealth of such person.

10. Rights acquired under clause iii of S. 269UA of the Income-tax Act - S. 4[8]

Any person who acquires any rights (excluding any rights by way of a lease from month to month or for period not exceeding 1 year) in or with respect to any building or part thereof by virtue of any such transaction as is referred to in clause (f) of sec. 269 UA of the Income-tax Act, 1961, shall be deemed to be the owner of that building or part thereof and the value of such building or part shall be included in computing net wealth of such person.

EXEMPTIONS IN RESPECT OF CERTAIN ASSETS

Wealth-tax shall not be payable by a non-resident assessee in respect of the assets situated outside India.

Wealth-tax shall not be payable by virtue of provisions contained in section 5 of the Act, by an assessee in respect of the following assets, and such assets shall not be included in the net wealth of the assessee –



- (i) any property held by him under trust or other legal obligation for any public purpose of a charitable or religious nature in India i.e. excluding assts of business, other than business referred to in sub-section 10 (22), 10 (22A), (23B) and (23C) and 11(4A)(a) / (b);
- (ii) the interest of the assessee in the coparcenary property of any Hindu undivided family of which he is a member ;
- (iii) Any one Building used as official residence in the case of a ruler;
- (iv) Jewellery in the possession of a ruler recognised as his heirloom at the time of his first assessment to wealth-tax under this Act :

Provided that in the case of jewellery recognised by the Central Government as aforesaid, such recognition shall be subject to the following conditions, namely:-

- a) that the jewellery shall be permanently kept in India and shall not be removed outside India except for a purpose and period approved by the Board ;
 - b) that reasonable steps shall be taken for keeping the jewellery substantially in its original shape ;
 - c) that reasonable facilities shall be allowed to any officer of Government authorised by the Board in this behalf to examine the jewellery as and when necessary ; and
 - d) that if any of the conditions hereinbefore specified is not being duly fulfilled, the Board may, for reasons to be recorded in writing, withdraw the recognition retrospectively
- (v) In the case of an assessee, being a person of Indian origin or a citizen of India who was ordinarily residing in a foreign country and who, on leaving such country, has returned to India with the intention of permanently residing therein, moneys and the value of assets brought by him into India and the value of the assets acquired by him out of such moneys within one year immediately preceding the date of his return and at any time thereafter:

This exemption shall apply only for a period of seven successive assessment years commencing with the assessment year next following the date on which such person returned to India.

- (vi) one house or part of a house or a plot of land belonging to an individual or a Hindu undivided family:

Provided that wealth-tax shall not be payable by an assessee in respect of an asset being a plot of land comprising an area of five hundred square metres or less

Even where a building consists of more than one dwelling unit, if there is unity of structure exemption can be claimed for the entire building by treating it as one house. The fact that such self-contained dwelling units are occupied by different persons will not make any difference- Shiv Narain Chaudhari Vs CWT 108 ITR 104 (All).

If part of the house is used as a godown and the remaining part is used for residence even then the exemption can be claimed for the entire house including the godown – CWT Vs M Appuswamy 233 ITR 460 (Mad).

In order to avail exemption u/s 5 (1), it is not necessary that the property must be held in India but it is necessary that the public purpose of charitable or religious nature should be in India. If

property is held in India but it is held for any public purpose of a charitable or religious nature outside India, the trust does not qualify for exemption – Trustees of H.E.H. The Nizam's pilgrimage money Trust Vs CIT 243 ITR 676 (SC)

Under a trust deed the purpose for which the trust property would be put to use were not confined to religious or charitable use; the property could be used for social, cultural and other allied purpose at the sole discretion of the trustee. Such a trust was held to be not entitled to exemption under section 5 (1) of the Wealth Tax Act- Ganga Bai Charities Vs CWT 2501 ITR 666 (SC).

EXCLUSIONS

In the case of a foreign citizen, foreign company and an individual or HUF not ordinarily resident in India / NRI, the following assets shall not be considered :

- (i) Value of assets and debts located outside India.
- (ii) Value of assets in India represented by loans or debts owed by the assessee the interest whereon is exempt Ws 10 of the Income-tax Act. The nature of the assets under this category is: NRE deposits, FCNR deposits and bonds / debentures / deposits, the interest on which is exempt u/s 10(4)/(4B) and 10(15). Since deposits / bonds and debentures are not treated as taxable assets with effect from assessment year 1993-94, this provision is only of academic interest.

The net wealth of the following entities shall not be taxed under the Act:

- 1) Companies registered u/s 25 of the Companies Act.
- 2) Any cooperative society.
- 3) Any social club.
- 4) Any political party.
- 5) Any mutual fund [Covered by section 10(23D)].

Partnership firms, AOP, BOI are not liable for wealth tax on their net wealth. However, their net wealth is computed as per provisions of the act and the share of partner being individual, HUF or company is included in the net wealth of the said person.

SCOPE OF NET WEALTH

The scope of Net Wealth in the case of the three assesseees is as under -

	Whether to be included		Whether to be deducted	
	Assets located in India	Assets located outside India	Debts located in India	Debts located outside India
<i>In case of Indian National</i>				
- Resident & ordinarily resident	Yes	Yes	Yes	Yes
- Resident but not ordinarily resident	Yes	No	Yes	No
- Non-resident	Yes	No	Yes	No
<i>In case of Foreign National</i>				
<i>In case of Foreign National</i>	Yes	No	Yes	No
<i>In the case of HUF</i>				
- Resident & ordinarily resident	Yes	Yes	Yes	Yes
- Non-resident or resident but not ordinarily resident	Yes	No	Yes	No
<i>In the case of Company</i>				
- Resident	Yes	Yes	Yes	Yes
- Non-Resident	Yes	No	Yes	No

VALUATION OF ASSETS SECTION

The value of any asset, other than cash, for the purposes of this Act, shall be determined in the manner laid down in these rules. Section 7 prescribes that the valuation should be in accordance with Schedule III to the Act.

Valuation of immovable property

Subject to the provisions of rules 4, 5, 6, 7 and 8, for the purposes of sub-section (1) of section 7, the value of any immovable property, being a building or land appurtenant thereto, or part thereof, shall be the amount arrived at by multiplying the net maintainable rent by the figure 12.5 :

In relation to any such property which is constructed on leasehold land, this rule shall have effect as if for the figure 12.5,—

- (a) where the unexpired period of the lease of such land is fifty years or more, the figure 10.0 had been substituted ; and
- (b) where the unexpired period of the lease of such land is less than fifty years, the figure 8.0 had been substituted :

Net maintainable rent how to be computed.

For the purposes of rule 3, “net maintainable rent” in relation to an immovable property referred to in that rule, shall be the amount of gross maintainable rent as reduced by—

- (i) the amount of taxes levied by any local authority in respect of the property ; and
- (ii) a sum equal to fifteen per cent of the gross maintainable rent.

Gross maintainable rent how to be computed.

For the purposes of rule 4, “gross maintainable rent”, in relation to any immovable property referred to in rule 3, means—

- (i) where the property is let, the amount received or receivable by the owner as annual rent or the annual value assessed by the local authority in whose area the property is situated for the purposes of levy of property tax or any other tax on the basis of such assessment, whichever is higher;
- (ii) where the property is not let, the amount of annual rent assessed by the local authority in whose area the property is situated for the purpose of levy of property tax or any other tax on the basis of such assessment, or, if there is no such assessment or the property is situated outside the area of any local authority the amount which the owner can reasonably be expected to receive as annual rent had such property been let.

The computation logic for the valuation of the building is as under:

Annual rent or annual value assessed		
Actual rent received / receivable	XX	
Gross maintainable rent		XXX
Less: Amount of Tax levied	XX	
15% of the gross maintainable rent	XX	
Net Maintainable rent (NMR)		XXX
Valuation by capitalization:		
A. Property on freehold land: $NMR \times 12.50$		XXX
B. Property on leasehold land:		
Unexpired lease period 50 years or more: $NMR \times 10$		XXX
Unexpired lease period less than 50 years: $NMR \times 8$		XXX
Value adjustments:		
Add:		
(a) If the un-built area of the plot of land exceeds a specified area		
(i) Above 5% up to 10% — 20% of the above value		
(ii) Above 10% up to 15% — 30% of the above value		XXX
(iii) Above 15% up to 20% — 40% of the above value		
Less: Deduction towards claim and recovery of specified part of the unearned increase in the value of the land at the time of transfer of the property or 50% of Schedule III value, whichever is less (In the case of property constructed on leasehold land).		XXX
Valuation of property for Wealth Tax		XXX

Notes:

1. Aggregate area means the aggregate of area on which the property is constructed and the unbuilt area.
2. The unbuilt area means that part of such aggregate area on which no building has been erected.
3. Specified area in relation to properties located in:
 - i) Mumbai, Kolkata, Delhi or Chennai — 60% of the aggregate area
 - ii) Agra, Ahmedabad, Allahabad,
Amritsar, Bangalore, Bhopal, Cochin,
Hyderabad, Indore, Jabalpur, Jamshedpur,
Kanpur, Lucknow, Ludhiana, Madurai,
Nagpur, Patna, Pune, Salem, Sholapur,
Srinagar, Surat, Tiruchirapalli, Trivandrum,
Vadodara or Varanasi — 65% of the aggregate area
 - iii) Any other place — 75% of the aggregate area
4. Unearned increase means the difference between the value of the land on the valuation date (determined by the Government or other authority) and the amount of the premium paid / payable to the Government for the lease of the land.
5. Where the difference between unbuilt area and specified area exceeds 20% of the aggregate area and where the lease period expires within 15 years, rule 20 will apply.

Valuation of assets of business

In case of accounts of the business are maintained regularly, value of assets as disclosed in the balance sheet shall be taken as follows:

- (a) the value of any asset as disclosed in the balance-sheet shall be taken to be,—
 - (i) in the case of an asset on which depreciation is admissible, its written-down value;
 - (ii) in the case of an asset on which no depreciation is admissible, its book value;
 - (iii) in the case of closing stock its value adopted for the purposes of assessment under the Income-tax Act for the previous year relevant to the corresponding assessment year;

Net value of the assets as per the Balance Sheet		XXX
Add. Value of assets not disclosed in the Balance Sheet		XXX
Less:		
1. Advance Tax paid	XX	
2. Bad Debts allowed as deduction	XX	
3. Assets on which wealth tax is not payable	XX	
4. Debit balance of P&L account	XX	
5. Non-business assets	XX	
6. Capital employed other than borrowed fu	XX	
7. Reserves	XX	
8. Any provision for meeting future <i>I</i> contingent liability	XX	
9. Non-business liabilities	XX	
10. Liability for financing exempt assets	XX	
		XXX
Value of business		XXX

Where it is not possible to calculate the amount of debt so utilised, it shall be taken as the amount which bears the same proportion to the total of the debts owed by the assessee as the value of that asset bears to the total value of the assets of the business.

Valuation of Interest in firms and Association of Persons

The value of the interest of a person in a firm of which he is a partner or in an association of persons of which he is a member shall be determined in the manner:

Computation of net wealth of the firm or association and its allocation amongst the partners or members

STEP I : Compute the net wealth of the firm / AOP (Rule 14).

STEP 2 : The net wealth determined in step 1 shall be without considering exemptions u/s 5(1) / 5(1A).

STEP 3 : Allocate the net wealth to the extent of capital contribution amongst the partners in proportion to their capital contribution.

STEP 4 : Allocate the residual wealth in line with agreement for distribution of assets in the event of dissolution / profit sharing ratio.

STEP 5 : Include the value of interest of the partner *I* member in respect of assets eligible for exemption u/s 5(1) / 5(1A) in the profit sharing ratio.

Valuation of Personal Assets — Jewellery

The value of the jewellery shall be the open market price on the valuation date. **The return of net wealth furnished by the assessee shall be supported by,—**

- i) a statement in the prescribed form, where the value of the jewellery on the valuation date does not exceed rupees five lakhs;
- ii) a report of a registered valuer in the prescribed form, where the value of the jewellery on the valuation date exceeds rupees five lakhs.

Notwithstanding anything mentioned in sub-rule (2), the Assessing Officer may, if he is of opinion, that the value of the jewellery declared in the return,—

- (a) is less than its fair market value by such percentage or such amount as is prescribed under sub-clause (i) of clause (b) of sub-section (1) of section 16A;
- (b) is less than its fair market value as referred to in clause (a) of sub-section (1) of section 16A,

he may refer the valuation of such jewellery to a Valuation Officer under sub-section (1) of the said section and the value of such jewellery shall be the fair market value as estimated by the Valuation Officer.

Where the jewellery includes gold or silver or any alloy of these, then the value of these metals as on the valuation date shall be substituted for the value determined by the officer. Where any jewellery is sold or disposed off or where jewellery is acquired, the value of jewellery as determined shall be reduced or increased to the extent of such deletions or additions to the jewellery.

Valuation of Life Interest

- STEP 1 : Compute the average of the annual gross income in the last three years.
- STEP 2 : Reduce the average of the collection expenses incurred in each of those three years subject to a maximum of 5% of the average of the annual gross income.
- STEP 3 : Multiply the annual average income arrived in step 2 with the value factor given in the table against the age of the assessee, which will give the value of life interest on the valuation date.
- STEP 4 : The value factors arrived at on the basis of formula based on annual premium for whole life insurance without profits.
- STEP 5 : Where the life tenant has to be insured at higher premium rates, the Assessing Officer may vary the valuation suitably.
- STEP 6 : The value of life interest shall be limited to the market value of the trust corpus on the valuation date.
- STEP 7 : Where the life tenant is 80 years or above, treat the value as NIL.



Valuation of Residuary Assets

The value of any asset not covered above shall be the estimated price, which it would fetch in the open market on the valuation date. This is irrespective of any documents available showing the cost of acquisition (Rule 20 & 21).

Tax Planning Aspects

The following are not considered as 'assets' for computation of net worth

1. In the case of any person only cash in hand is treated as an asset. Balance in Bank account will not be treated as assets. Therefore, the cash in hand should be deposited in bank before the valuation date and can be withdrawn after the valuation date.
2. In the case of ownership of yatches, boats and air crafts, they are included in the net wealth. Ships are kept out side purview.
3. The land on which construction of building is not permissible under any law for the time being in force in the area in which such land is situated.
4. The land occupied by a building, which has been constructed with the approval of the appropriate authority
5. One residential house is exempt. In case of two or more houses, possibility of its gift / sale to any family member may be considered.
6. Any unused land by the assessee for industrial purposes for period of more than 2 years from the date of acquisition.
7. Any land held as stock in trade for a period of more than 10 years from the date of its acquisition.
8. Jewellery shall not include gold deposit bonds issued under the Gold deposit scheme.
9. Any residential property that has been let out for a minimum period of 300 days in the previous year.
10. Any property in the nature of commercial establishments or complexes.
11. Cars used by the assessee in the business of running them on hire shall be excluded.
12. Cars held as stock in trade by the manufacture or dealer.
13. In case of non-residents assets outside India are not liable to wealth tax.

Avoidance of tax by certain transactions in securities

Provisions are made for arresting avoidance of tax from certain transactions in securities. Care should be taken that the company avoids such transactions. However, if these transactions are entered into; then proper computation from such transactions should be reported. Important transactions are as under:

Transactions in securities:

1. Where the owner of any securities sells or transfers those securities and buys back or reacquires the securities, then, if the result of the transaction is that any interest becoming payable in respect of the securities is receivable otherwise than by the owner, the interest payable as aforesaid shall, whether it would or would not have been chargeable to income-tax apart from the provisions of this sub-section, be deemed, for all the purposes of this Act, to be the income of the owner and not to be the income of any other person.
2. Where any person has had at any time during any previous year any beneficial interest in any securities, and the result of any transaction relating to such securities or the income thereof is that, in respect of such securities within such year, either no income is received by him or the income received by him is less than the sum to which the income would have amounted if the income from such securities had accrued from day to day and been apportioned accordingly, then the income from such securities for such year shall be deemed to be the income of such person.
3. The provisions stated in para 1 or 2, above shall not apply if the owner, or the person who has had a beneficial interest in the securities, as the case may be, proves to the satisfaction of the Assessing Officer that
 - (a) there has been no avoidance of income-tax, or
 - (b) the avoidance of income-tax was exceptional and not systematic and that there was not in his case in any of the three preceding years any avoidance of income-tax by a transaction of the nature referred to in para 1 or 2.
4. Where any person carrying on a business which consists wholly or partly in dealing in securities, buys or acquires any securities and sells back or retransfers the securities, then, if the result of the transaction is that interest becoming payable in respect of the securities is receivable by him but is not deemed to be his income by reason of the provisions contained in sub-section (1), no account shall be taken of the transaction in computing for any of the purposes of this Act the profits arising from or loss sustained in the business.

Dividend Stripping:

Where—

- (a) any person buys or acquires any securities or unit within a period of three months prior to the record date;
- (b) such person sells or transfers—
 - (i) such securities within a period of three months after such date; or
 - (ii) such unit within a period of nine months after such date;



- (c) the dividend or income on such securities or unit received or receivable by such person is exempt, then, the loss, if any, arising to him on account of such purchase and sale of securities or unit, to the extent such loss does not exceed the amount of dividend or income received or receivable on such securities or unit, shall be ignored for the purposes of computing his income chargeable to tax.

Bonus Stripping:

Where—

- (a) any person buys or acquires any units within a period of three months prior to the record date;
- (b) such person is allotted additional units without any payment on the basis of holding of such units on such date;
- (c) such person sells or transfers all or any of the units referred to in clause (a) within a period of nine months after such date, while continuing to hold all or any of the additional units referred to in clause (b), then, the loss, if any, arising to him on account of such purchase and sale of all or any of such units shall be ignored for the purposes of computing his income chargeable to tax and notwithstanding anything contained in any other provision of this Act, the amount of loss so ignored shall be deemed to be the cost of purchase or acquisition of such additional units referred to in clause (b) as are held by him on the date of such sale or transfer.

CLUBBING PROVISIONS :

INCOME OF OTHER PERSONS INCLUDED IN ASSESSEE'S TOTAL INCOME

Under the Income-tax Act, 1961, an assessee is generally liable to tax in respect of the income he earns. The anxiety of saving tax renders assessee to take up such transactions that his income is reduced and that to his family members increases, However, in order to arrest such a tax planning, provisions are made for inclusion of family members income in the income of an assessee under certain circumstances.

The provisions have also been made to counteract the tendency on the part of the tax-payers to dispose of the property or transfer income in such a way that their tax liability can be avoided or reduced. These are popularly called as clubbing provisions. Important provisions are as under:

Section	Person whose income to be clubbed	Nature of income to be clubbed	Person in whose hands to be clubbed
64(1)(ii)	Spouse	Salary, commission, fees, remuneration from concern where individual has substantial interest. If spouse possesses technical/ professional qualification and income is solely attributable to the application of such knowledge, it is not to be clubbed.	Spouse having substantial interest in the concern
64(1)(iv)	Spouse	From assets transferred to spouse for inadequate consideration other than (i) transfer under an agreement to live apart, or (ii) an income from house property includible u/s. 27(i), interest on capital contributed in the firm out of the transferred funds will however, be clubbed.	Transferor
64(1)(vi)	Son's wife	From assets transferred (after 1-6-1973) to son's wife for inadequate consideration. Interest on capital contributed in the firm out of the transferred funds will however be clubbed.	Transferor
64(1)(vii)	Spouse	Income for immediate or deferred benefit of spouse from assets transferred for inadequate consideration to an AOP or a person.	Transferor

4(1)(viii)	Son's wife	Income for immediate or deferred benefit of son's wife from assets transferred for inadequate consideration (after 1-6-1973) to an AOP or a person.	Transferor
4(1A)	Minor child (except a minor child suffering from any disability mentioned in S. 80U)	Any income accruing / arising to a minor, except income from: a) manual work, or b) application of his skill, or talent, or specialised knowledge and experience (for deduction refer note below)	1st year: that parent whose income is higher. Subsequent years; the same parent — unless the AO is satisfied that it should be clubbed with the other parent. where marriage does not subsist, in the hands of the custodian parent.
4(2)	HUF	Income from property converted to HUF property or transferred to HUF by an individual (after 31-12-1969) for inadequate consideration. If converted property is partitioned, income from partitioned property received by spouse, is clubbed in the hands of the individual.	Transferor

Note :Deduction of income up to Rs. 1,500 per minor is available [S. 10(32)]

Therefore, it needs to be ascertained that tax planning exercise is beyond the clubbing provisions. In case these provisions are attracted, it must be ensured that income of the other person is included in the assessee's income for tax calculations.

DOUBLE TAXATION RELIEF

Some of the taxpayers having transactions with outside countries resort to dubious methods for evading their liability under the tax laws. Tax evasion is thus closely linked with transactions involving over-invoicing and under-invoicing in import and export business operations through secret foreign bank accounts and smuggling of valuable articles into and out of India. With a view to enabling the tax administration to tackle the problem of tax evasion having international ramifications, in order to empower the Central Government to enter into agreements with foreign countries not only for purposes of avoidance of double taxation of income but also for enabling the tax authorities to exchange information for the prevention of evasion or avoidance of taxes on income or for investigation of cases involving tax evasion or avoidance or for recovery of taxes in foreign countries on a reciprocal basis.



It is, therefore, necessary to examine such an agreement in case of cross-border transactions as relief is afforded by the Double Taxation Avoidance Agreement (DTAA). It provides a useful inputs for cross border tax planning.

Agreement with foreign countries [Sec 90]

- (1) Where the Central Government may enter into an agreement with the Government of any country outside India for the granting of relief in respect of—
 - (i) Income on which have been paid both income-tax under this Act and income-tax in that country; or
 - (ii) income-tax chargeable under this Act and under the corresponding law in force in that country to promote mutual economic relations, trade and investment,

Advantage of such relief should be availed.

It should be noted that an agreement with any country for granting relief has been entered into, then, in relation to the assessee to whom such agreement applies, the provisions of the Income Tax Act apply to the extent they are more beneficial to that assessee.

Examples :

1. Rate of tax on say, Royalty is 10% as per the Act as well as the DTAA. In such a case surcharge and education cess is not applicable for rates prescribed in DTAA. Therefore, DTAA route should be selected.
2. Under India – Mauritius DTAA:

In respect of Capital Gains:

- i. gains from the alienation of ships and aircraft operated in international traffic and movable property pertaining to the operation of such ships and aircraft, is be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.
 - ii. Gains derived by a resident of a Contracting State from the alienation of any property other than those specifically mentioned in the other paragraphs, is be taxable only in that State.
3. Under India – USA DTAA
 - i) In case of 'salary' income of a Non-resident from USA, it is taxable in India if services are rendered in India. However, if period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned, it is not taxable in India when certain further conditions are fulfilled.



- ii) Income from Royalties or fees for technical services arising in India and paid to a beneficial owner of USA, the tax so charged in India shall not exceed 10 per cent of the gross amount of the royalties or fees for technical services.

Countries with which no agreement exists [Sec. 91]

If any person who is resident in India in any previous year proves that, in respect of his income he has paid tax in any other country with which there is no DTAA under section 90 for the relief or avoidance of double taxation, he shall be entitled to the deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said country, whichever is the lower, or at the Indian rate of tax if both the rates are equal.

In the other words, where section 90 does not apply, unilateral relief will be available, which should be availed'

Conditions for such relief should be followed.

Income deemed to accrue or arise in India

Section 9 of the Income Tax Act, 1961 provides that certain incomes are presumed to accrue or arise in India irrespective of actual place of accrual or arising. Therefore, income tax is attracted and is payable on such incomes even by non-residents.

In case recipient of income is a non-resident, provisions of deduction of tax at source from such incomes (section 195) are attracted. However, if there is an agreement for avoidance of double taxation with the country of which the said non-resident recipient is a resident, concession stated in the DTAA becomes applicable. Concession can be sparing the income from tax in India or the foreign country, lower rate of tax, etc.

In view of these provisions, at times non-resident recipients demand payment on 'net' basis i.e. exclusive of Indian taxes. While undertaking such transactions care should be taken to measure correct cost of the outgo, else planning may fail.

The following incomes shall be deemed to accrue or arise in India :—

- (i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.
- (ii) income which falls under the head "Salaries", if it is earned in India. However, any pension payable outside India to a person residing permanently outside India shall not be deemed to accrue or arise in India, if the pension is payable to a person referred to in article 314 of the Constitution or to a person who, having been appointed before the 15th day of August, 1947, to be a Judge of the Federal Court or of a High Court within the meaning of the Government of India Act, 1935, continues to serve on or after the commencement of the Constitution as a Judge in India.

- (iii) income chargeable under the head “Salaries” payable by the Government to a citizen of India for service outside India ;
- (iv) a dividend paid by an Indian company outside India ; however, under section 10(34) any corporate dividend referred to in section 115O is exempt from tax.
- (v) income by way of interest payable by—
 - (a) the Government ; or
 - (b) a person who is a resident (Exception : where the interest is payable 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)
 - (c) a person who is a non-resident, where the interest is payable for the purposes of a business or profession carried on by such person in India ;
- (vi) income by way of royalty payable by—
 - (a) the Government ; or
 - (b) a person who is a resident, or
 - (c) a person who is a non-resident;
- (vii) income by way of fees for technical services payable by—
 - (a) the Government ; or
 - (b) a person who is a resident, or
 - (c) a person who is a non-resident;

Note : in case of (v) interest, (vi) royalty and (vii) fees for technical services, stated above:

In case of (b) a person who is a resident the exception is where the interest is payable 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, income is not deemed to accrue or arise in India.

and

In case of (b) a person who is a non-resident, where the interest is payable for the purposes of a business or profession carried on by such person in India ; income is not deemed to accrue or arise in India.



Income from property held for charitable or religious purposes

Income of charitable and religious trusts is exempt from tax under sections 11, 12 and 13. However, there are certain conditions, compliance of which is necessary for availing exemption. While planning affairs of trust, these provisions should be complied with.

1. The exemption provisions of section 11 and 12 do not apply to any trust or institution unless an application for registration of the trust or institution is made to the Commissioner before the expiry of a period of one year from the date of the creation of the trust or the establishment of the institution'
2. The following income shall not be included in the total income of the previous year of the person in receipt of the income—
 - i) Income is exempt to the extent to which such income is applied to such purposes in India; and, where any such income is accumulated for application to such purposes in India. However, the income so accumulated or set apart should not be in excess of fifteen per cent of the income; in case of
 - (a) income derived from property held under trust wholly for charitable or religious purposes,
 - (b) If the trust is created before the commencement of the Income Tax Act, 1961, income derived from property held under trust in part only for such purposes,
 - ii) Income derived from property held under trust—
 - (i) created on or after the 1st day of April, 1952, for a charitable purpose which tends to promote international welfare in which India is interested, to the extent to which such income is applied to such purposes outside India, and
 - (ii) for charitable or religious purposes, created before the 1st day of April, 1952, to the extent to which such income is applied to such purposes outside India:
However, the CBDT approval is necessary
 - iii) 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.

Where eighty-five per cent of the income referred to in clause (a) or clause (b) of (i) above is not applied, to charitable or religious purposes during the previous year, it can be accumulated or set apart, either in whole or in part, for application to such purposes and tax can be avoided. Rules for such accumulation are :

- (a) by notice in writing given to the Assessing Officer, the purpose and the period (not exceeding 5 years) for which the income is being accumulated.
- (b) the money so accumulated is invested or deposited in the forms or modes specified for the purpose.

Exemption of charitable and religious trusts is forfeited if attendant conditions are not complied with. Important cases where, also, exemption is forfeited :

- (a) Income is applied or ceases to be accumulated to purposes other than charitable or religious

- (b) Income ceases to remain invested in any of the forms specified
- (c) Income is not utilised for the purpose for which it is so accumulated
- (d) any part of the income for private religious purposes which does not enure for the benefit of the public;
- (e) in the case of a trust for charitable purposes or a charitable institution created or established after the commencement of this Act, any income thereof if the trust or institution is created or established for the benefit of any particular religious community or caste;
- (f) if any part of such income or any property of the trust is used or applied directly or indirectly for the benefit of any trustee, his relatives, etc.

Care should be taken to avoid withdrawal of exemption.

INTEREST, PENALTY AND PROSECUTION

Interest and penalties are charged for non compliance of tax obligations and procedural formalities. Where there is substantial non compliance from assessee he is subjected to prosecution which can result into fine, imprisonment or both. In any case, these are extra levies which the assessee has to pay. Moreover no deduction is available from taxable income for such levies; therefore, it cost an extra burden on assessee. Therefore, care needs to be taken that organization is not exposed to any such levies.

Brief information about this is here under furnished –

INTEREST

It should be noted that rate of interest, in all the cases, is 1% for each month or part thereof. This interest is not deductible expenditure; therefore, the effective rate is much more, which depends upon the applicable tax rate.

Sections 234A, 234B and 234C provide for charging of mandatory interest since word ‘shall’ is used in the said sections. (CIT v. Anjum M.H. Ghaswala)

Interest For failure to deduct or pay any TDS [Sec. 201(A)]:

Where a person responsible for deducting tax at source does not deduct a source under Chapter XVII or after deducting tax fails to pay the same as required by Act, he is liable to pay interest on the amount of such tax from the date on which tax deductible till the date it is actually paid.

Interest For failure to collect any tax or pay TCS [Sec. 206C(7)] :

Where a person responsible for collecting tax at source under section 206C does not collect or after collecting tax fails to pay the same as required by Act, he is liable to pay interest on the amount of such tax from the date on which tax should have been collected till the date it is actually paid.

**Interest On Delayed Payment Of Tax Other Than Advance Tax [Sec. 220(2)]**

Where an assessee fails to pay any tax, penalty, etc. within 30 days from the date of the Notice of Demand issued under section.156, he shall be liable to pay interest on the outstanding demands for the period of default.

Interests for default in furnishing return [Sec. 234A]:

Under the Income-tax Act, interest is payable by the assessee in respect of non filing or delayed filing of return in certain cases, on outstanding self assessment tax.

For default in paying advance tax [Sec. 234B]:

Where an assessee who has failed to pay advance tax, interest is payable on assessed tax. Such interest is payable from April 1 of the assessment year to the date of determination of income under section 143(1) or on regular assessment.

Where an assessee who had paid advance tax but the amount of advance tax paid by him less than 90% of assessed tax, interest is payable on the assessed tax minus advance tax is paid. Such interest is payable from April 1 of assessment year upto the date of determination of income u/s/ 143(1) or on regular assessment.

Interest for Deferment Of Advance Tax [Sec. 234C]

An advance tax is said to have been deferred, if any one or more of the installments are not paid or tax paid is less than prescribed under the law interest is attracted.

INTEREST IS PAYABLE TO ASSESSEE ON REFUND [SEC. 244A]

Interest on excess payment of advance tax, tax deducted or collected at source and any other tax or penalty becoming refundable shall be paid @ 1/2% for every month or part of a month.

ROUNDING OFF OF MONTH [Rule 119A]

The interest is to be calculated, any fraction of a month deemed to be full month and the interest shall be so calculated.

ROUNDING OFF OF AMOUNT [Rule 119A]

The amount of tax, penalty or other sum in respect of which interest is to be calculated is to be rounded off to the nearest multiple of Rs. 100 and for this purpose any fraction of Rs. 100 is to be ignored.

PENALTIES & PROSECUTION

PENALTIES

Section	Nature of Default	Minimum Penalty	Maximum Penalty
158BFA	Undisclosed income determined by the Assessing Officer u/s.158BC(c)	100% of the tax on undisclosed income	300% of the tax on undisclosed income
221(1)	Default in making a payment of tax within prescribed time	Such amount as the Assessing Officer may impose	Tax in arrears
271(1)(b)	Failure to comply with a notice u/s. 142(1) or 143(2) or with a direction issued u/s.142(2A).	Rs.10000 for each failure	Rs. 25,000 for each failure. (upto 31.5.2001)
271(1)(c)	Concealment of the particulars of income or furnishing inaccurate particulars of income.	100% of Tax sought to be evaded.	300% of Tax sought to be evaded.
271A	Failure to keep or maintain books of A/c, document as required u/s.44AA.	Rs.25000	Rs.1,00,000
271AA	Failure to keep and maintain information and document in respect of international transaction.	a sum equal to two per cent of the value of each international transaction entered into by such person.	a sum equal to two per cent of the value of each international transaction entered into by such person.
271AAA	Penalty where search has been initiated	a sum computed at the rate of ten per cent of the undisclosed income of the specified previous year.	a sum computed at the rate of ten per cent of the undisclosed income of the specified previous year.

271B	Failure to get accounts audited u/s.44AB or to furnish such report along with return of income by due date	1 / 2% of Total Sales, Turnover or Gross receipts.	Rs.1,00,000
271C	Failure to deduct the whole or any part of tax u/s.192 to 195 or (w.e.f. 1.6.97) failure to pay the whole or any part of tax u/s.115 O(2) or 2nd proviso to sec. 194B.	Amount of Tax required to be deducted at source.	—
271CA	Penalty for failure to collect tax at source	a sum equal to the amount of tax	a sum equal to the amount of tax
271D	Taking or accepting any loan or deposit in contravention of the provisions of S.269 SS	Amt. of Loan / Deposit so taken or accepted	—
	Repaying of any deposit otherwise than in accordance with the provisions of Sec. 269 T	Amount of deposit so repaid.	—
271F	i) Failure to furnish return of income u/s.139(1) before the end of the relevant assessment year(w.e.f. 1.4.99)	Rs.5000	—
	ii) Failure to furnish return of income as per proviso to Sec.139(1) by the end of relevant assessment year .	Rs. 5000 for each default.	Rs. 10,000 for each default
271FB	Penalty for failure to furnish return of fringe benefits	a sum of one hundred rupees for every day during which the failure continues.	a sum of one hundred rupees for every day during which the failure continues.

272A(1)(a)	Refuses to answer any question put to a person regarding his assessment by an I.T. Authority.	Rs.10,000 for each default	Rs. 10,000 for each default
272A(1)(b)	Refuses to sign any statement made by a person in course of I.T. Proceeding.	Rs.10,000 for each default	Rs. 10,000 for each default
272A(1)(c)	Failure to comply with summons issued u/s.131(1)	Rs.10,000 for each default	Rs. 10,000 for each default
272AA	Failure to comply with provisions of Sec. 133B.	Any amount upto	Rs. 1000
272B	Failure to comply with the provisions of section 139A or for quoting or intimating a PAN which is false. [w.e.f. 1.6.2002]	Rs. 10,000	Rs. 10,000
272BB	Failure to comply with the provisions of section 203A (i.e. failure to obtain TAN or after obtaining failure to quote TAN in all challans, certificates and returns etc.)	Rs. 10,000	Rs. 10,000
272BBB	Failure to comply with the provisions of of sec. 206CA (i.e. failure to obtain TCAN or after obtaining failure to quote TCAN in all challans, certificates and returns etc.) (w.e.f. 1.6.2002)	Rs. 10,000	Rs. 10,000

276BB	Failure to pay to the credit of Central Government tax collected u/s. 206	3 months and fine	7 years and fine
276C(1)	Wilful attempt to evade tax penalty or interest imposable under the Act (non-cognizable as per sec. 279A)	If tax evaded exceeds Rs. 1,000, 6 months; otherwise 3 months and fine.	If tax evaded exceeds Rs. 1,00,000, 7 years; otherwise 3 years and fine.
276C(2)	Wilful attempt to evade the payment of any tax, penalty or interest (non-cognizable as per sec. 279A).	3 months and fine	3 years and fine
276CC	Wilful failure to file return of income in time u/s. 139(1), or in response to notice u/s. 142(1) or sec. 148(Non-cognizable as per sec. 279A)	If tax evaded exceeds Rs. 1,00,000; 6 months and fine In any other case, 3 months and fine. Note: No prosecution if : (i) the return is filed before the expiry of the assessment year ; or (ii) the tax payable on regular assessment, as reduced by TDS and advance tax does not exceed Rs. 3,000	If tax evaded exceeds Rs. 1,00,000, 7 years; otherwise 3 years and fine

276CCC	Wilful failure to furnish in due time the return of total income which is required to be furnished u/s. 158BC.	3 months and fine	3 months and fine
276D	Wilful failure to produce books of account and documents u/s. 142(1) or wilful failure to comply with a direction to get the accounts audited u/s. 142(2A)	Any period upto 1 year and fine of Rs. 4 for every day during which default continues.	1 year and fine of Rs. 10 every day during which default continues.
277..	Making a false statement in verification or delivering a false account or statement(non-cognizable as per sec.279A)	If tax evaded exceeds Rs. 1,00,000; 6 months; otherwise 3 months and fine.	If tax evaded exceedsRs. 1,00,000, 7 years; otherwise 3 years and fine.
278..	Abetment to make a false statement or declaration. (non- cognizable as per,sec. 279A)	If tax evaded exceeds Rs. 1,00,000; 6 months; otherwise 3 months and fine.	If tax evaded exceedsRs. 1,00,000, 7 years; otherwise 3 years and fine.
278A	Punishment for second and subsequent offences u/ss. 276B, 276C(1), 276CC, 277 or 278.	6 months for every offence	7 years for every offence
278B and 278C	Offences committed by companies/firms or HUFs- Criminal liability of managing director managing partner, karta or any such officer, who wilfully committed the offence for the company/firm or HUF.	Same as in the case of the company/firm/HUF	Same as in the case of the company/firm/HUF
280(1)	Disclosure of particulars by public servants in contravention of sec. 138(2) (prosecution to be instituted	6 months and fine.	6 months and fine.



280(1)	servants in contravention of sec. 138(2) (prosecution to be instituted with the approval of Central Government)	6 months and fine.	6 months and fine.
--------	--	--------------------	--------------------

If there is a reasonable cause, it can be offered as a defense against penalty, prosecution, etc.

Reasonable cause can be reasonably said to be a cause which prevents a man of average intelligence and ordinary prudence, acting under normal circumstances, without negligence or inaction or want of *bona fides* - *Azadi Bachao Andolan v. Union of India* 252 ITR 471 (Delhi).

‘Reasonable cause’ as applied to human action is that which would constrain a person of average intelligence and ordinary prudence. It means an honest belief founded upon reasonable grounds, of the existence of a state of circumstances, which, assuming them to be true, would reasonably lead any ordinary prudent and cautious man, placed in the position of the person concerned, to come to the conclusion that the same was the right thing to do - *Woodward Governors India (P.) Ltd. v. CIT* 118 Taxman 433 (Delhi).

The words “reasonable cause” in the section must necessarily have a relation to the failure on the part of the assessee to comply with the requirement of the law which he had failed to comply with. *Kalakrithi v. ITO* 125 Taxman 97 (Mad.).

Liability of directors of private company in liquidation.

Under certain circumstances directors of private company in liquidation are liable to tax liability of the company. Care should be taken to ensure that directors are not exposed to this risk.

Section 179 provides that where any tax due from a private company in respect of any income of any previous year or from any public company of any previous year during which such other company was a private company cannot be recovered, then, every person who was a director of the private company at any time during the relevant previous year shall be jointly and severally liable for the payment of such tax.

No recovery can be made from a director if the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

Section 179 operates without regard to any contrary provision about limited liability, etc. contained in the Companies Act, 1956.

FRINGE BENEFIT TAX

Background:

The rationale for levying a fringe benefit tax on the employer lies in the inherent difficulty in isolating the 'personal element' where there is collective enjoyment of benefits and attributing the same directly to the employee. This is so especially where the expenditure incurred by the employer is ostensibly for purposes of the business but includes, in partial measure, a benefit of a personal nature. Moreover, in cases where the employer directly reimburses the employee for expenses incurred, it becomes difficult to effectively capture the true extent of the perquisite provided because of the problem of cash flow in the hands of the employer.

Planning for FBT can be as follows:

1. FBT is not applicable to individual and HUF therefore small business should be run as individual or HUF instead of partnership firms or small companies.
2. In case of small companies and partnership firms if number of employees is less and if the work is outsourced and there are no employees, as such FBT will not be applicable.
3. In case of charitable or religious trust registration under section 12AA should be obtained which will avoid liability of FBT.
4. Instead of giving perquisites possibility of substituting them by allowances should be considered.
5. No FBT is payable on (i) expenditure on food or beverages provided by the employer to his employees in office or factory; however, reimbursement to employee for this purpose is not exempt from FBT and (ii) expenditure on paid vouchers which are not transferable and usable only at eating joints or outlets. Possibility of exploring these perquisites should be considered.
6. In case company has network of distributors expenditure on traveling, conveyance should be incurred by such distributors and reimbursement should be made by the company, if it is a distributor or proprietary concern then they too are not liable for FBT.
7. Proper bifurcation of traveling and conveyance should be maintained since 5% of the traveling is concerned as FBT and 20% of conveyance expense is concerned as FBT.
8. Out of employees' welfare expenses, separate account should be maintained for (i) expenditure incurred to fulfill any statutory obligation (ii) mitigate occupational hazards (iii) provide first aid facilities in the hospital or dispensary run by the employer, as no FBT is applicable for such expenses.
9. In case conference expenses are incurred amount of participation should be separately amounted as no FBT is payable on such expenses.



PROVISIONS FOR FILING RETURN OF INCOME

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 assesseees 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.

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 10BA 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.

- (5) 'Due date' means -

- (a) 31st 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.

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).

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) 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.

Accordingly all companies are required to file the return of income and also of FBT in electronic form. Further, certain other entities who's accounts are subject to tax audit must file the return of income and also of FBT in electronic form.

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 nonreceipt 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.*

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.

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.

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.

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.

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.

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.

**PERMANENT ACCOUNT NUMBER (PAN) [SECTION 139A]**

- (1) Where the following persons have not been allotted a permanent account number (PAN), they should 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 lakhs in any previous year; or
 - (iii) Every person who is required to furnish a return of income under section 139(4A); or
 - (iv) Every person, being an employer, who is required to furnish a return of fringe benefits under section 115WD [Sub-section (1)].
- (2) 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.
- (3) 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.
- (4) 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.

SCHEME FOR SUBMISSION OF RETURNS THROUGH TAX RETURN PREPARERS [SECTION 139B]

- (1) 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. 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.
- (2) 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’.

(3) 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.

Grievances Redressal Procedure

When the assessment order is passed against the assessee, and if he is not satisfied with any order passed by the assessing officer, he may appeal to higher court. Procedure for appeal is laid down under the act.

The redressal procedure under the act includes the following:

1. Rectification
2. Appeal
3. Revision

1. Rectification:

Sec. 154 : Rectification of mistake.

With a view to rectifying any mistake apparent from the record an income-tax authority referred to in section 116 may, —

- (a) amend any order passed by it under the provisions of this Act;
- (b) amend any intimation or deemed intimation under sub-section (1) of section 143.

Where any matter has been considered and decided in any proceeding by way of appeal or revision relating to an order, the authority passing such order may, notwithstanding anything contained in any law for the time being in force, amend the order under that sub-section in relation to any matter other than the matter which has been so considered and decided.

Subject to the other provisions of this section, the authority concerned-

- (a) may make an amendment of its own motion, and



- (b) shall make such amendment for rectifying any such mistake which has been brought to its notice by the assessee, and where the authority concerned is the Commissioner (Appeals), by the Assessing Officer also.

An amendment, which has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee, shall not be made under this section unless the authority concerned has given notice to the assessee of its intention so to do and has allowed the assessee a reasonable opportunity of being heard.

No amendment under this section can be made after the expiry of 4 years from the end of the financial year in which the order sought to be amended was passed. It may be noted that an amendment is made when the related order is passed. This period of limitation is not applicable in case the provisions of section 155 are applicable. Extension of time limit under certain circumstances is specified under section 155.

However, if a valid application has been made by the assessee for rectification within the statutory time limit but is not disposed of by the concerned authority within the time specified, it may be disposed of even after the expiry of such time limit [Circular No. 73, dated 7th January, 1972]. This relief is, however, not admissible in case rectification proceedings are initiated by the department itself.

APPEAL AND APPELLATE HIERARCHY

Appeal is a complaint to a higher court relating to an injustice done by a lower court. The party complaining is called “appellant” and the other party is known as “respondent”. There are various provisions in the Income-tax Act relating to appeals and revision of orders.

Under the Income-tax Act, the following remedial measures are available to the assessee if he is not satisfied with any order passed by the assessing officer :-

- i) **Appeal** The first shall lie with the Commissioner of Income Tax (Appeals) against the order of the assessing officer (sec. 246A), or
- ii) **Revision** if appeal is not preferred or it could not be filed within the time limit allowed, the assessee can apply u/s. 264 to the Commissioner of Income Tax for revision of orders passed by the assessing officer.

The Commissioner of Income-tax can also take up suo moto the case for revision. Where, however, in the opinion of the Commissioner of Income Tax the order passed by the assessing officer is erroneous and prejudicial to the interest of revenue, the Commissioner of Income Tax can also take up the case for revision u/s. 263.

Appeal to Commissioner of Income Tax (Appeals) [Sec. 246A]

An aggrieved assessee may appeal to the Commissioner of Income Tax (Appeals) against the following orders of Assessing officer. However, the order should be under section that is specified under section 246A e.g. 143(3), 144, 147, 150, 221, 271, 271A, 271B, 271F, 272BB, etc.



Denial of liability to tax under particular circumstances is also covered - The expression 'denial of liability' is comprehensive enough to take in not only the total denial of liability but also the liability to tax under particular circumstances. Thus, an assessee has a right of appeal against the order of the ITO assessing the AOP instead of the members thereof individually - *CIT v. Kanpur Coal Syndicate* 53 ITR 225

Procedure for filing appeal is prescribed. Fees are also required to be paid before filing of the appeal. [Sec. 249 & Rules 45 & 46]

Powers of the [Commissioner (Appeals)].[Sec .251.]

(1) In disposing of an appeal, the [Commissioner (Appeals)] shall have the following powers—

- (a) in an appeal against an order of assessment, he may confirm, reduce, enhance or annul the assessment
- (b) in an appeal against an order imposing a penalty, he may confirm or cancel such order or vary it so as either to enhance or to reduce the penalty;
- (c) in any other case, he may pass such orders in the appeal as he thinks fit.

(2) The [Commissioner (Appeals)] shall not enhance an assessment or a penalty or reduce the amount of refund unless the appellant has had a reasonable opportunity of showing cause against such enhancement or reduction.

Explanation.—In disposing of an appeal, the [Commissioner (Appeals)] may consider and decide any matter arising out of the proceedings in which the order appealed against was passed, notwithstanding that such matter was not raised before the [Commissioner (Appeals)] by the appellant.

Appeal to the Appellate Tribunal [Sec. 253]

The Appellate Tribunal is constituted by the Central Government and has two classes of members – judicial and accountant.

An assessee may file an appeal before the Appellate Tribunal against the following orders u / s. 253, etc.

The Commissioner may also, if he objects to any order passed by the Commissioner (Appeals) u / s. 154/ 250, direct the assessing officer to appeal to the Appellate Tribunal against the order [Sec. 253(2)].

It may be mentioned that the Appellate Tribunal is the fact finding authority and hence the order passed by it on questions of fact are final and conclusive.

he Appellate Tribunal may, after giving both the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit.

**Procedure of Appellate Tribunal [Sec. 255]**

- (1) The powers and functions of the Appellate Tribunal may be exercised and discharged by Benches constituted by the President of the Appellate Tribunal from among the members thereof.
- (2) Subject to the provisions contained in sub-section (3), a Bench shall consist of one judicial member and one accountant member.
- (3) The President or any other member of the Appellate Tribunal authorised in this behalf by the Central Government may, sitting singly, dispose of any case which has been allotted to the Bench of which he is a member and which pertains to an assessee whose total income as computed by the [Assessing] Officer in the case does not exceed [five hundred thousand rupees], and the President may, for the disposal of any particular case, constitute a Special Bench consisting of three or more members, one of whom shall necessarily be a judicial member and one an accountant member.
- (4) If the members of a Bench differ in opinion on any point, the point shall be decided according to the opinion of the majority, if there is a majority, but if the members are equally divided, they shall state the point or points on which they differ, and the case shall be referred by the President of the Appellate Tribunal for hearing on such point or points by one or more of the other members of the Appellate Tribunal, and such point or points shall be decided according to the opinion of the majority of the members of the Appellate Tribunal who have heard the case, including those who first heard it.
- (5) Subject to the provisions of this Act, the Appellate Tribunal shall have power to regulate its own procedure and the procedure of Benches thereof in all matters arising out of the exercise of its powers or of the discharge of its functions, including the places at which the Benches shall hold their sittings.
- (6) The Appellate Tribunal shall, for the purpose of discharging its functions, have all the powers which are vested in the income-tax authorities referred to in section 131, and any proceeding before the Appellate Tribunal shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228 and for the purpose of section 196 of the Indian Penal Code (45 of 1860), and the Appellate Tribunal shall be deemed to be a civil court for all the purposes of section 195 and Chapter XXXV of the Code of Criminal Procedure, 1898 (5 of 1898).

Appeal to the High Court [Sec 260A & 260B]

An appeal shall lie to the High Court from every appellate order passed by the tribunal, if the High Court is satisfied that the case involves a substantial question of law. The appeal may be filed by the Commissioner or the assessee. The Memorandum of Appeal shall precisely state the substantial question of law involving the appeal. An appeal along with a fee (as per Court Fees Act), shall be filed within 120 days of the date of receipt of the order appealed against. The question of law shall be formulated by the High Court, then the appeal shall be heard by a bench of at least two judges and decided by majority opinion. [Secs. 260A and 260B]

Appeal to the Supreme Court [Sec. 261]

An appeal lies before the Supreme Court, against an order of the High Court in a reference, or in an appeal. Such appeal can be filed only if the High Court certifies it to be a fit case for appeal to the Supreme Court. If the High Court refuses to grant such a certificate, the assessee can file a Special Leave Petition before the Supreme Court. If the SLP is granted, the Supreme Court will hear and decide the appeal on merits. [Sec. 261]

Revision

Provisions relating to powers of revision of the Commissioner of Income Tax provides in sections 263 and 264 of the Income-tax Act which are analysed in a tabular form as under :

Section 263	Section 264
I. Scope:	
1 Revision of order erroneous and prejudicial to the interest of revenue passed by the Assessing officer	Revision of other orders by any subordinate authority.
2 Two circumstances must exist to enable the Commissioner to exercise the power of revision viz. (i) the order should be erroneous; and (ii) by virtue of the order being erroneous prejudice must have been caused to the interest of the Revenue. CIT-vs.- Gabriel India Ltd., 203 ITR 108(Bom).	The Commissioner shall not revise any order where the appeal against the order is pending before the first or second appellate authorities (or) where the time for filing the appeal has not lapsed and the assessee has not waived his right of appeal.
II. Procedure :	
3 Commissioner of Income Tax may call for and examine the records and revise the orders after hearing the assessee.	Commissioner of Income-tax either on his own motion or on an application by the assessee can call for the records and revise the order.
4 Record shall include all records relating to any proceeding available at the time of examination of the file by the Commissioner of Income-tax.	Every application for revision should be accompanied by a fee Rs. 500.
III. Nature of order :	
5 An order enhancing, modifying or cancelling the assessment can be passed by the Commissioner.	An order which is not prejudicial to the interest of the assessee can be passed.
6 If the Income-tax Officer makes any mistake in carrying out the directions of the Appellate Assistant Commissioner or the Tribunal, his order can be revised by the Commissioner of Income Tax. Warner Lambert Co.-vs.- CIT, 205 ITR 395(Bom).	Commissioner declining to interfere will not amount to passing of an order prejudicial to the assessee.



- 7 The Commissioner of Income Tax has jurisdiction and powers to initiate proceedings in respect of issues not touched by the CIT(Appeals) in his Appellate Order- CIT-vs.-Jayakumar B. Patil, 236 ITR 469(SC).

Where depreciation was not claimed before the Income-tax Officer or the Appellate Assistant Commissioner but was claimed for the first time before the Commissioner of Income Tax in an application u/s. 264, the Commissioner must allow the claim on merits. *Rashtriya Vikas Ltd. vs. CIT*, 196 ITR 694(All.)

IV. Time limit :

- 8 No order can be passed after the expiry of 2 years from the end of the Financial Year in which the order to be revised was passed.

a) Commissioner cannot revise any order beyond 1 year period, b) Assessee cannot file an application after expiry of 1 year from the date of service of the order. Condonation of delay is possible if sufficient cause is shown.

- 9 An order in revision may be passed at any time in the case of an order which has been passed in consequence of or to give effect to any finding or direction contained in an order of the Appellate Tribunal, the High Court or the supreme court.

Commissioner should pass an order disposing of the revision petition within one year from the end of the Financial Year in which the revision petition was filed by the assessee.

V. Remedy :

- 10 Appeal can be filed to the Appellate Tribunal.

There is no right of appeal.

Special Economic Zones

In respect of tax planning, SEZ now provides substantial relief from tax for business undertakings. It is, therefore, necessary to understand provisions relating to SEZ. The provisions for tax exemption are contained in section 10AA of the Income tax Act, 1961.

Salient features of provisions for exemption are as under:

1. Any entrepreneur as referred to section 2 of the Special Economic Zones Act, 2005, from his Unit, who begins to manufacture or produce articles or things or provide any services during the previous year relevant to any assessment year commencing on or after the 1st day of April, 2006, a deduction of profits and gains derived from the export, of such articles or things or from services, as the case may be:
 - (i) for a period of five 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 - hundred per cent
 - (ii) for further five assessment years - fifty per cent and thereafter;
 - (iii) for the next five consecutive assessment years - so much of the amount not exceeding fifty per cent 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, called the "Special Economic Zone Re-investment Reserve Account" to be created and utilized for the purposes of the business of the assessee.

2. The amount credited to reserve account, called the “Special Economic Zone Re-investment Reserve Account” must comply with the following conditions:

- (a) the amount credited to the Special Economic Zone Re-investment Reserve Account is to be utilised—
 - (i) 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
 - (ii) until the acquisition of the machinery or plant as aforesaid, 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;
- (b) the particulars, as may be specified by the CBDT in this behalf, have been furnished by the assessee in respect of machinery or plant 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.

Where any amount credited to the Special Economic Zone Re-investment Reserve Account—

- (a) has been utilised for any purpose other than those specified, the amount so utilised; or
 - (b) has not been utilised before the expiry of the period specified, the amount not so utilised, shall be deemed to be the profits,—
 - (i) in a case referred to in clause (a), in the year in which the amount was so utilised; or
 - (ii) in a case referred to in clause (b), in the year immediately following the period of three years specified and shall be charged to tax accordingly.
3. The exemption u/s 10AA applies to any undertaking, being the Unit, which fulfils all the following conditions, namely:—
- (i) it has begun or begins to manufacture or produce articles or things or provide services during the previous year relevant to the assessment year commencing on or after the 1st day of April, 2006 in any Special Economic Zone;
 - (ii) it is not formed by the splitting up, or the reconstruction, of a business already in existence (however, this condition shall not apply in respect of any undertaking, being the Unit, which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section;
 - (iii) it is not formed by the transfer to a new business, of machinery or plant previously used for any purpose.



4. Where any undertaking being the Unit which is entitled to the deduction under this section 10AA is 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, being the company for the previous year in which the amalgamation or the demerger takes place; and
 - (b) the provisions of this section shall, as they would have applied to the amalgamating or the demerged Unit being the company as if the amalgamation or demerger had not taken place.
5. Loss referred to in sub-section (1) of section 72 or sub-section (1) or sub-section (3) of section 74, 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.
6. For the purposes of exemption working, the profits derived from the export of articles or things or services shall be the amount which bears to the profits of the business of the undertaking, being the Unit, the same proportion as the export turnover in respect of such articles or things or services bears to the total turnover of the business carried on by the assessee.
7. For the purposes of this section,—
 - (i) “export turnover” means the consideration in respect of export by the undertaking, being the Unit of articles or things or services received in, or brought into, India by the assessee but does not include freight, telecommunication charges or insurance attributable to the delivery of the articles or things outside India or expenses, if any, incurred in foreign exchange in rendering of services, computer software outside India;
 - (ii) “export in relation to the Special Economic Zones” means taking goods or providing services out of India from a Special Economic Zone by land, sea, air, or by any other mode, whether physical or otherwise;
 - (iii) “manufacture” shall have the same meaning as assigned to it in section 2 of the Special Economic Zones Act, 2005
 - (iv) “relevant assessment year” means any assessment year falling within a period of fifteen consecutive assessment years referred to in this section;
 - (v) “Special Economic Zone” and “Unit” shall have the same meanings as assigned to them under clauses (za) and (zc) of section 2 of the Special Economic Zones Act, 2005.

Tax Credit for tax paid on 'Book Profits'.

Under section 15JB in the case of a company, the income-tax, payable on the total income as computed under this Act in respect of any assessment year, is less than ten per cent of its 'book profit', such book profit is deemed to be the total income of the company and the tax is payable by the company on such 'book profit' shall be the amount of income-tax at the rate of ten per cent.

Tax credit in respect of tax paid on deemed income relating to certain companies.

Section 115JAA provides that when any tax is paid under section 115JB by any company for the assessment year commencing on the 1st day of April, 2006 and any subsequent assessment year, then, credit in respect of tax so paid shall be allowed to him in accordance with the provisions of this section.

The tax credit to be allowed is the difference of the tax paid for any assessment year under section 115JB and the amount of tax payable by the assessee on his total income computed in accordance with the other provisions of this Act.

The tax credit shall be allowed set-off in a year when tax becomes payable on the total income computed in accordance with the provisions of this Act other than on 'book profits'.

Set off in respect of brought forward tax credit shall be allowed for any assessment year to the extent of the difference between the tax on his total income and the tax which would have been payable under the provisions of section 115 JB.

The amount of tax credit determined under section 115JAA can not be carried forward and set off beyond the seventh assessment year immediately succeeding the assessment year in which tax credit becomes allowable under section.

However, no interest shall be payable on the tax credit allowed under section 115 JAA.

When any company becomes liable for payment of tax on book profits', it should be ensured that an amount of tax credit should be ascertained and credit should be availed in terms of these provisions.

TAX ADMINISTRATION

INCOME TAX AUTHORITIES [SEC. 116]

In order to discharge executive and administrative functions relating to the Act, the following income-tax authorities have been constituted –

- a) The Central Board of Direct Taxes;
- b) Directors General of Income-tax or Chief Commissioners of Income-tax;
- c) Directors of Income-tax or Commissioners of Income-tax or Commissioners of Income-tax (Appeals);



- d) Additional Directors of Income-tax or Additional Commissioners of Income-tax or Additional Commissioners of Income-tax (Appeals);
- e) Joint Directors of Income-tax or Joint Commissioners of Income-tax;
- f) Deputy Director of Income-tax or Deputy Commissioner of Income-tax or Deputy Commissioner of Income-tax (Appeals);
- g) Assistant Directors of Income-tax or Assistant Commissioners of Income-tax;
- h) Income-tax Officers;
- i) Tax Recovery Officers;
- j) Inspectors of Income-tax.

CENTRAL BOARD OF DIRECT TAXES

The Central Board of Direct Taxes (CBDT) has been constituted under the Central Board of Revenue Act, 1963. It functions under the Ministry of Finance. The important powers of CBDT are:

- i) To make rules for carrying out purposes of the Act [Sec. 295].
- ii) To decide jurisdiction of the Income-tax Authorities [Sec. 120].
- iii) To issue instructions, orders and directions to other Income-tax authorities for proper administration of this Act and all other persons employed in the execution of this Act. However, it cannot issue instructions to the Commissioner of Income-tax (Appeals). It cannot issue a direction to any Income-tax authority to dispose of a case in a particular manner. [Sec. 119],
- iv) To declare an organization as company [Sec. 2(17) (iv)].
- v) To entertain objections in respect of search and seizure under the Act. [Sec.132].
- vi) To relax the provisions of Sections 139, 143, 144, 147, 148, 154, 155, 158BFA, 201(1A), 210, 211, 234A, 234B, 234C, 271 and 273 or otherwise [Section 119(2)(a)].
- vii) Power of relaxing any requirement contained in Chapter IV (provisions for computation of income under various heads) or Chapter VI-A (provisions for deductions from gross total income) [Section 119(2)(c)].
- viii) Issue such general or special orders for relaxation of the provisions of sections relating to FBT viz; 115WD, 115WE, 115WF, 115WG, 115WH, 115WJ and 115WK [Section 119(2)(a)].
- ix) Prescribe categories of transactions and documents pertaining to business or profession, where quoting of PAN is necessary [Sec, 139A].
- x) Frame a scheme in respect of 'Tax Return Preparers' [Sec. 139B].

- xi) Prescribe class of persons by whom return of income [Sec. 139D] and TDS statements [Sec. 200] should be filed electronically.
- xii) Prescribing qualifications for Authorized Representatives [Sec. 288].
- xiii) Condone delay for seeking CBDT's approval, where it is required [Sec. 293B] and authorize any income tax authority not being Commissioner of Income-tax (Appeals), to admit belatedly ant claim for exemption, deduction, refund or relief [Section 119(2)(b)].
- xiv) To prescribe method for computation of arm's length price [Section 92C].and to prescribe record to be kept and the time for which it is to be preserved [Section 92D].

Circulars issued by the CBDT are legally binding on the revenue and this binding character attaches to the circulars even if they are found not in accordance with the correct interpretation of a statutory provision and they depart or deviate from such construction - *K.P. Varghese v. ITO* 131 ITR 597 (SC).

It is well-settled that circulars can bind the ITO but will not bind the appellate authority or the Tribunal or the Court or even the assessee - *CIT v. Hero Cycles (P.) Ltd.* 228 ITR 463 (SC).

CBDT has power, interalia, to tone down the rigor of the laws and ensure fair enforcement of its provision by issuing circular.

Circular contemplated in sec.119 (2)(a) cannot be adverse to the assessee. Power is given for the purpose of just, proper and efficient management of work of assessment. Circular, however are not meant for contradicting or nullifying any provision of the statue. They are meant to mitigate the rigor of application of a particular provision. So long as such a circular is in favour, it would be binding on the departmental authorities in view of the provision of sec. 119 to ensure a uniform and proper administration & application of the IT Act - *UCO Bank V CIT* 237 ITR 899 (SC).

DIRECTOR GENERAL/DIRECTOR

The Central Government has power to appoint Director General and Director [Sec. 117]. The CBDT authorize them to perform such functions as may be assigned to them by [Sec. 120]. The powers enjoyed by them include:

- i) To appoint an Income-tax authority below the rank of Assistant Commissioner / Deputy Commissioner, if authorised by the Board [Sec. 117].
- ii) To direct the Joint Commissioner to function and assume the powers of assessing officer, if so authorised by the Board [Sec. 120].
- iii) To transfer cases from one or more assessing officers to any other assessing officer who is subordinate to him [Sec. 127].
- iv) To enquire or investigate concealed income of any person within his jurisdiction [Sec. 131(1A)].



- v) Authorise any Joint Director / Joint Commissioner, Deputy Director / Deputy Commissioner, Assistant Director / Assistant Commissioner or Assessing Officer to enter, search and seize valuables [Sec. 132(1)].
- vi) To requisition books of accounts, etc.[Sec. 132A].
- vii) To survey [Sec. 133A].
- viii) To make an enquiry [Sec. 135].
- ix) To collect certain information [Sec. 133B]

COMMISSIONERS OF INCOME TAX / CHIEF COMMISSIONERS OF INCOME TAX

The Central Government has power to appoint Director General and Director [Sec. 117]. The CBDT authorize them to perform such functions as may be assigned to them by [Sec. 120]. The powers enjoyed by them include:

- i) To appoint an Income-tax authority below the rank of Assistant Commissioner / Deputy Commissioner, if authorised by the Board – [Sec. 117].
- ii) To direct the Joint Commissioner to function and assume the powers of assessing officer, if so authorised by the Board – [Sec. 120].
- iii) To transfer cases from one or more assessing officers to any other assessing officer who is subordinate to him – [Sec. 127].
- iv) To enquire or investigate conceal income of any person within his jurisdiction – [Sec. 131(1A)].
- v) To authorise any Joint Director / Joint Commissioner, Deputy Director / Deputy Commissioner, Assistant Director / Assistant Commissioner or Assessing Officer to enter, search and seize valuables – [Sec. 132(1)].
- vi) To requisition books of accounts, etc. – [Sec. 132A].
- vii) To survey – [Sec. 133A].
- viii) To make an enquiry – [Sec. 135].
- ix) To collect certain information– [Sec. 133B]

Additional Powers

- i) Power regarding discovery, production of evidence, etc. [Sec. 131].
- ii) To sanction reopening of assessments after the expiry of four years. [Sec.151(1)].
- iii) To direct the Assessing Officer to prefer appeal to the Tribunal against the order of First Appellate Authority. [Sec. 253(2)]

- iv) Request the Tribunal to file Reference to High Court. [Sec. 256].
- v) To revise any order passed by the Assessing Officer that is prejudicial to revenue. [Sec. 263].
- vi) To revise any order passed by a subordinate authority on an application by the assessee or *suo moto* when the revision is in favour of the assessee. [Sec. 264]

COMMISSIONER OF INCOME-TAX (APPEALS)

Appointment is made by the Central Government. The following are important powers:

- i) Power regarding discovery, production of evidence etc. [sec. 131]
- ii) To condone delay in filing of appeal.
- iii) Power to call for information. [sec. 133]
- iv) Power to inspect register of companies. [sec. 134]
- v) To dispose of an appeal and to confirm, reduce, enhance or annul the assessment [sec. 251]
- vi) Power to impose a penalty. [sec. 271]
- vii) Power to set off any refund against arrears of tax. [sec. 245].
- viii) The Commissioner (Appeals) has inherent powers to stay recovery proceedings *Paulsons Litho Works v. ITO* 208 ITR 676 (Mad.).

JOINT COMMISSIONER OF INCOME TAX

They are appointed by the Central Government. They enjoy the following powers :-

- i) Power regarding discovery, production of evidence, etc. [sec. 131]
- ii) Power of search and seizure, if authorised. [sec. 132]
- iii) Power to call for information. [sec. 133]
- iv) Power to survey- [Sec. 133A]
- v) Power to make an enquiry- [Sec. 135]
- vi) Power to collect certain information- [Sec. 133B]
- vii) Power to inspect register of companies. [sec. 134]
- viii) To sanction reopening of assessment after the expiry of 4 years, if the assessment is made under any section other than sections 143(3) and 147.



ASSESSING OFFICER

‘Assessing Officer’ means the Assistant Commissioner or Deputy Commissioner or Assistant Director or Deputy Director or the Income-tax Officer who is vested with the relevant jurisdiction by virtue of directions or orders issued under Section 120 or any other provision of this Act, and the *Additional Commissioner or Additional Director or Joint Commissioner or Joint Director* who is directed under the said section 120 to exercise or perform all or any of the powers and functions conferred on, or assigned to, an Assessing Officer under this Act [sec. 2(7A)]

The following are some of the powers of Income-tax Officers —

- i) Power regarding discovery, production of evidence, etc. [sec. 131]
- ii) Power of search and seizure, if authorised. [sec. 132]
- iii) Power to requisition books of accounts. [sec. 132A]
- iv) To apply the assets seized and retained u/s. 132 in satisfaction of the existing liabilities of the assessee under Direct Taxes Act. [sec. 132B]
- v) Power to call for information. [sec. 133]
- vi) Power to collect certain information- [sec. 133B]
- vii) Power to inspect register of companies. [sec. 134]
- viii) Power to allot permanent account number. [sec. 139A]
- ix) Power to direct an assessee to get his accounts audited. [sec. 142]
- x) Power to make assessment. [sec. 143, 144]
- xi) Power to reassess income which has escaped assessment.[sec. 147]
- xii) Power to rectify mistakes apparent from the records, either on his own or on an application made by the assessee. [sec. 154]
- xiii) Power to grant a certificate to an assessee to receive a payment without deduction of tax at source or deduction of tax at source at a lower rate than prescribed [secs. 194, 195, 197]
- xiv) Power to impose penalty for default in payment of a tax. [sec. 221]
- xv) Power to grant refund. [sec. 237, 240]
- xvi) Power to withhold refund in certain cases [sec. 241]
- xvii) Power to adjust the refund against any demand of tax etc. outstanding against the assessee. [sec. 245].

- xviii) Power to impose penalty for the prescribed defaults under the Act [Chapter XXI]
- xix) Power to initiate prosecution for the prescribed offences under the Act [Chapter XXII]
- xx) Power to determine arm's length price of international transactions [Sec. 92C]

INSPECTORS OF INCOME TAX

Inspectors are appointed by the Commissioner of Income Tax.

They have to perform such functions as are assigned to them by the Commissioner or any other Income-tax authority under which they are appointed to perform their functions.

In case of survey, inspectors have power to inspect books of account and other documents, place marks of identification, to take statements at any function, ceremony or event [Sec. 133A].

Assessment of Various Entities

Assessment of Individuals

Tax incidence on Individuals

While computing taxable Income of an Individual following points should be considered

Nature of Income	Tax Treatment
Income earned by the taxpayer	Except the following all other incomes shall be included a. income exempt under sections 10 to 13A b. incomes to be included in income of others by virtue of section 60 to 64.
Share of Profit from Hindu undivided family	It is exempt under section 10(2)
Share of Profit from a firm assessed as firm	It is exempt under section 10(2A)
Salary and Interest from the aforesaid firm	These are taxable as business Income
Share of profit from an association of persons/body of Individuals	If the association/body is taxable at the maximum marginal rate(or at higher rate),then share of profit is not taxable in hands of recipient.
Income earned by others and included in the income of the taxpayer by virtue of section 60 to 64	Such income shall be included in the income of the taxpayer.



Special Provisions for persons governed by Portuguese Civil law (Section 5 A)

This Section is applicable for the appropriation of income between spouses governed by the Portuguese Civil Code which is in force in the state of Goa and Union territories of Dadra and Nagar Haveli and Daman and Diu. By virtue of this section, income from all other sources, except from salary, should be apportioned equally between husband and wife. The income so apportioned will be included separately in the total income of the husband and of the wife and the remaining provisions of act shall apply accordingly. Salary Income is, however, taxable in the hands of the spouse who has actually earned it.

Even the income from profession will be apportioned equally between the husband and the wife-

CIT v Datta V Gaitonde [2002] 241 ITR 241 / 108 / taxman 533(Bom).

Taxable income- How computed

Taxable income shall be computed as follows:

- Step 1- Income under the different heads of income -First find out income under the five heads of income
- Step 2- Adjustment of losses of the current year and earlier years- Losses should be setoff according to the provisions of sections 70 to 78. The income after adjustment of losses is the gross total income.
- Step 3- Deduction from gross total income- Deductions specified under Chapter VI A should be considered while calculating the gross total income.
- Step 4- Rounding off- The balance should be rounded off to the nearest Rs.10. it is called as net income or taxable income or total income.

Tax liability IS DECIDED BY THE APPLICABLE RATE STRUCTURE.

Special Provisions relating to non-residents [Section 115C to 115I]

The benefit of Special provisions can be claimed by non-resident Indians. The following are non-resident Indians for the purpose:

- a. citizen of India who is a non-resident ;
- b. a person of Indian origin who is a non-resident.

A person shall be deemed to be of Indian origin if he or either of his parents or any of his grandparents, was born in an undivided India.

The Provisions of Section 115C to 115I are applicable only in respect of the following incomes derived a non resident Indian:

- a. investment income derived from a “foreign exchange assets”; and
- b. long term capital gains on sale or transfer of “foreign exchange assets”.

Foreign Exchange Asset- It means those “specified asset” which the assessee has acquired or purchased with, or subscribed to in, convertible foreign exchange;

The following are the “specified assets”:

- a. shares in an Indian Company (public or private)
- b. debentures issued by an Indian Company which is not a private company ;
- c. deposits with an Indian Company which is not a private Company, it may be even deposit with SBI or any other banking company;
- d. any security of the Central Government ; and
- e. such other asset as the Central Government may specify in this behalf by notification in the Official Gazette.

Investment Income

In computing the Investment income of a non-resident Indian, no deduction in respect of any expenditure or allowance shall be allowed under any provision of the Act. Moreover, no deduction under Sections 80C to 80U shall be allowed in respect of investment income of non – resident Indians.

Long term Capital gain

Long term Capital gain on sale or transfer of foreign exchange assets shall be calculated subject to:

1. The benefit of Indexation is not available for the sale or transfer of foreign exchange assets.
2. The non-resident Indian can claim exemption under section 115F by investing sale consideration in another asset.
3. No deduction is permissible under section 80C to 80U in respect of long term capital gain.

Tax treatment on Investment and long term capital Gain:

Non resident Indians are chargeable to tax on investment and long term capital gain at the rate of 20 percent and 10 percent respectively.(plus surcharge and education cess)

Return of Income not to be filled in certain cases:

Where a non-resident Indian has income only from a foreign exchange asset or income by way of long term capital gains arising on transfer of a foreign exchange asset, or both, and tax deductible at source from such income has been deducted, he is not required to file the return of income under section 139(1).



The income from foreign exchange assets and long term capital gains arising on transfer of such assets would be treated as separate block and charged to tax at a flat rate as explained above.

If the non-resident Indian has other Income in India, such other income is treated as an altogether separate block and charged to tax in accordance with other provisions of the Act.

Benefit available even after the assessee becomes resident – These provisions are as follows:

1. A non-resident Indian in any previous year, becomes assessable as resident in India in any subsequent year.
2. He may furnish to the Assessing Officer a declaration in writing (along with his return of income under section 139 for the assessment year for which he is so assessable) to the effect that the special provisions shall continue to apply to him in relation to the investment income derived from any foreign exchange asset.
3. The foreign exchange assets for this purpose are debentures and deposit with an Indian public limited company and Central Government securities.

The special provisions shall continue to apply for that assessment year and for every subsequent assessment year till the transfer or conversion (otherwise than by transfer) into money of such assets.

Special Provisions not to apply if the assessee so chooses (section 115-I)

A non Resident Indian may opt that the special provisions should not apply to him by making a declaration to that effect in his return of income for the relevant assessment year. In such case the whole of his Income (including income from foreign exchange assets and long term capital gains arising on transfer of a foreign exchange asset) is chargeable to tax under the general provisions of the Act.

ASSESSMENT OF HINDU UNDIVIDED FAMILY

U/s. 4 of the Income Tax Act, 1961, Income-tax is payable by 'every person'. 'Person' includes a 'Hindu Undivided Family' as defined in sec. 2(31). The definition of 'Hindu Undivided Family' is not found in the Income-tax Act. Therefore the expression 'Hindu Undivided Family' must be construed in the sense in which it is understood under the 'Hindu Law' [Surjit Lal Chhabda vs. CIT 101 ITR 776(SC)].

According to Hindu Law, 'Hindu Undivided Family' is a family which consists of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters. A 'Hindu Undivided Family' is neither the creation of law nor of a contract but arises from status.

A Hindu coparcenary includes those persons who acquire by birth an interest in joint family property. Only a male member of a family can be a coparcener while the membership of a HUF consists of both males and females. All the coparceners of the family constitute what is called a

‘Coparcenery’. All the coparceners are members of a HUF but all members of a HUF are not coparceners. A coparcener of a joint family, who acquires by birth an interest in the joint property of the family, whether inherited or otherwise acquired by the family, may have a right to enforce partition whereas the members of the family who are not coparceners have no right to enforce partition. When a partition takes place, member (mother or widow) of the joint family may get a share equal to the sons and also it is necessary to provide for maintenance and marriage of the unmarried daughter out of family property.

There are two schools of Hindu Law- 1) Mitakshara and 2) Dayabhaga. Under the Mitakshara school, each son acquires by birth an equal interest with his father in the ancestral property. Under the Dayabhaga School which prevails in West Bengal and Assam, a son does not acquire by birth in ancestral property. He acquires interest only on the death of his father. Father enjoys an absolute right to dispose of the property of the family according to his desire. After the death of father, his son does not, by operation of law, become members of the joint family. The sons remain as co-owners with definite shares in the properties left by father unless they decide to live as a joint family.

Case Laws:

- i) A single person, male or female, cannot constitute a Hindu Undivided Family. An individual, who has obtained a share on partition of a joint family, has potentialities of creating a joint family; but until he marries, he alone cannot be considered as a joint family. *C. Krishna Prasad vs. CIT* 97 ITR 493.
- ii) A joint family may consist of a single male member with his wife and daughter(s) and it is not necessary that there should be two male members to constitute a joint family *Gowli Buddanna vs. CIT* 60 ITR 193.

Jain & Sikh families are not governed by Hindu Law. However, for the purpose of Income tax Act, such families are treated as ‘Hindu Undivided Families’.

The income of a joint Hindu family may be assessed in the status of HUF if the following conditions are satisfied:-

- i) there should be a coparcener ship
- ii) there should be a joint family property which consists of ancestral property, property acquired with the aid of ancestral property and property transferred by its members. It may be pointed out that once a joint family income is assessed as that of Hindu Undivided Family, it will continue to be assessed as such in future years till partition is claimed by its coparceners.

Under the Hindu Law, ancestral property is the property which a person inherits from any of this three immediate male ancestors, i.e. his father, grand father and great grand father. Income of ancestral property is taxable as income of HUF in the following cases:



- i) family of husband and wife without any children;
- ii) family of two widows of deceased brothers;
- iii) family of two or more brothers;
- iv) family of uncle and nephew;
- v) family of mother, son and son's wife;
- vi) family of a person and his late brother's wife;
- vii) family of widow mother and her sons.

While computing income of a Hindu Undivided Family one should give due consideration of the following :

- i) where a member of HUF converts his self acquired property into joint family, income from such property shall not be treated as income of HUF u/s. 64(2). It shall continued to be taxed in the hands of the transferor who is the member of the HUF.
- ii) Income from an impartible estate is taxable in the hands of the holder of the estate and not in the hands of HUF.
- iii) income from Stridhan of a woman is not taxable in the hands of HUF.
- iv) personal income of members cannot be treated as income of HUF.
- v) where the funds of HUF are invested in a company or a firm, fees or remuneration received by the member as a director or a partner in the company or a firm may be treated as income of HUF in case the fees and remuneration is earned essentially as a result of investment funds
- vi) where remuneration is paid by HUF to Karta or any other member for services rendered by him in conducting family's business, the remuneration is deductible provided the remuneration is paid :
 - i) under a valid bonafide agreement;
 - ii) in the interest of, and expedient for the business family, and
 - iii) genuine and not unreasonable.

Case law:

- i) remuneration and commission received by the Karta of HUF on account of his personal qualifications and exertions and not on account of investments of the family funds in the company cannot be treated as income of HUF. Subbiah Pillai (K.S.) vs. CIT 103 Taxman 400/237 ITR 11

PARTITION OF HUF

‘Partition’ may be a (i) total or complete partition (ii) partial partition.

Where all the properties of the family are divided amongst all the members of the family, and the family ceases to exist as an undivided family, it is known as total or complete partition.

On the other hand, where one or more coparceners of the HUF may separate from others and the remaining coparceners may continue to be joint or some of the properties are divided and the balance remain joint it is known as partial partition.

Partial partition is not recognised for tax purposes and as such the joint family shall continue to be liable to be assessed as if no such partial partition had taken place. Each member of such family, immediately before such partial partition and the family shall be jointly and severally liable for any sum payable under the Act. [Sec. 171(9)]

ASSESSMENT OF FIRMS

Partnership firm has been classified for the purpose of computation of income and its assessment as under:

- (a) partnership firm assessed as such (PFAS)
- (b) partnership firm assessed as an association of person.

Provisions relating to assessment of firms and partners are analyzed as under:–

Particulars	Sections
Definition- ‘Firm’, ‘Partner’ & ‘Partnership’	2(23)
Income includes interest and salary to partners refer to Sec. 28(v)	2(24)
Share of profit from PFAS- not forming a part of total income	10(2A)
Salary to a partner of a firm not taxable under the head ‘Salaries’	Expl. to Sec. 15
Charging of interest and salary to partner under the head ‘Profits and gains of Business or Profession’ excluding the amount disallowed u/s.	40(b)28
Conditions and monetary limits for disallowance of interest and salary to partners	40(b)
Capital gains on transfer of capital asset by a partner to a firm	45(3)
Capital gains on distribution of capital assets to partners on dissolution or otherwise of a firm	45(4)



Restriction to firm on carry forward loss attributable to the retired or deceased partner	78(1)
Amendments of order in case of a partner if any remuneration assessed in his case has been disallowed in the assessment of the firm	155(1A)
Charge of tax on income (other than long term capital gain) in case of a firm	167A
Charge of tax on long term capital gain in case of a firm	112
Conditions to assess the firm as such or as an association of person	184, 185
Change of constitution of firm	187
Assessment in case of a succession of firm	188
Joint and several liability of a partners	188A
Status of the firm and liability of the partners on dissolution or discontinuance of the business of the firm	189

Specific provisions to firm assessed as an AOP

<i>Particulars</i>	<i>Sections</i>
Disallowance of salary and interest to partner	40(ba)
Method of computing partner's share in the income of PFAOP	67A
Rate of tax in respect of income of AOP / BOI	167B
Taxability of partner's share of income	86, 110

Assessment of firms and conditions to be fulfilled to avail the status of PFAS [Sec. 184]

Where a firm wants to avail the status of PFAS, it has to satisfy the following conditions:-

- The firm shall be evidenced by an instrument and the individual shares of the partner shall be specified therein. [Sec. 184(1)]
- A certified copy of the instrument of partnership shall accompany the return of income of the previous year relevant to the assessment year 1993-94 or subsequent year in respect of which assessment of the firm is first sought. [Sec.184(2)]
- Wherever during a previous year a change takes place in the constitution of the firm or in the sharing ratio of partners, a certified copy of the revised instrument of partnership be submitted along with the return of income of the concerned year of assessment. [Sec. 184(4)]

- iv) There should not be any failure on the part of the firm as is specified in Sec. 144 [Sec. 184(5)]

It may be mentioned that once a firm is assessed as PFAS after fulfillment of the above conditions, it will be assessed as PFAS, for every subsequent year provided there is no change in either firm's constitution or partner's profit sharing ratio. However, there should not be any failure mentioned in sec. 144. [Sec. 184(3)]

A partnership deed shall be certified in writing by all the major partners. Where, however, the firm is dissolved and the return is filed after its dissolution, then the copy of deed may be certified by all the major partners in the firm immediately before its dissolution. Where a partner is dead, then it will have to be certified by his legal representative. [Sec. 184(2) Expl.]

Computation of Income

The following provisions should be given due consideration while computing income of a firm-

- i) Provision relating to deductibility of remuneration paid to partners by firm.
- ii) Provision relating to deductibility of interest paid to partners by firm.

ASSESSMENT OF ASSOCIATION OF PERSONS / BODY OF INDIVIDUALS

Association of Persons:

Where two or more persons voluntarily joint together in a common purpose or action with the object of producing income, Profits and gains they are said to have formed an Association of Persons.

Body of Individuals:

It is a conglomerate of individuals who happen to have come together to carry on sum activity with a view to earn income i.e. co-heirs inheriting shares or securities.

Distinction between AOP & BOI:

- i) AOP may consist of non-individuals but BOI has to consist of individuals only
- ii) An AOP is a voluntary combination of persons in a joint enterprise or common action to produce income whereas in case of BOI will only consist of two or more persons, may or may not have any common object.
- iii) A BOI may become an AOP, but not *vice versa*.

Share of members of AOP / BOI shall be deemed to be indeterminate or unknown, if such shares (in relation to the whole or any part of the income) are indeterminate or unknown on the date of formation of such AOP / BOI or any time thereafter.

Any payment of interest, salary, bonus, commission or remuneration by the AOP/BOI to a member is not allowable as deduction. Where interest is paid by AOP/BOI to a member who has also paid interest to the AOP/BOI, the amount of interest to be disallowed will be limited to the net amount of interest paid by the AOP/BOI. [Sec. 40(ba)]

Tax Rates :

Tax Rates :

	Where shares of members are determinate and known	Where shares of members are indeterminate or unknown
1. None of the members having taxable income	At the rates applicable to individual	At the maximum marginal rate.
2. Any member having taxable income.	At the maximum marginal rate	At the maximum marginal rate.
3. Any member having total Income chargeable to tax	a) Income to the extent of shares of such member or members, b) Balance income of AOP/BOI	At such higher on rate higher than the maximum marginal rate. taxable at the maximum marginal rate.

Maximum marginal rate means the rate of tax (including surcharge, if any) applicable to the highest slab of income in case of individuals. [Sec.2(29C)]

Ascertainment of member's share in AOP/BOI where shares are determinate and its taxability [Sec. 67A, 86 & 110]

<i>i)Ascertainment of share in AOP/BOI [Sec. 67A]</i>	<i>Rs.</i>
Total income of the AOP /BOI	***
<i>Less:</i> Interest, salary, commission or other remuneration paid to any member	***
Balance apportionable to the members in proportion to their shares	***
Share of income allotted to a member	***
<i>Add:</i> Salary, interest, commission or other remuneration received by the member of the AOP or BOI	***
Total share	***
<i>Less:</i> Interest paid on capital borrowed for the purpose of investment in the AOP /BOI	***
Net assessable share income	***

ii)Tax treatment of share income of members [Sec. 86 and Sec. 110]

In computing total income of an assessee, there shall be included share income of a member of an AOP or BOI subject to sec. 86 and 110 of the I.T. Act.

Taxation of AOP/BOI [Sec 167B] hands of members of AOP/BOI	Tax treatment of share income in the [Sec. 86 & 110]
1 AOP or BOI is taxed at maximum marginal rate higher rate.	Share income of the member is not or at a taxable.
2 AOP or BOI is taxed at normal rates applicable	Share income computed u/s. 67A is included into an Individual. the total income of the member but rebate u/s. 110 at the average of tax in respect of such share income has to be allowed.
3 AOP or BOI is not taxed at all.	Share income will be included in the total income of the member and taxed at the rates applicable to him.

“Average rate of Income-tax” is defined u/s. 2(10) to mean the rate arrived at by dividing the amount of Income-tax calculated on the total income, by such total income.

ASSESSMENT OF COMPANIES

In computing tax incidence companies are classified as follows :

- i) Domestic Company
- ii) Foreign Company

‘Company’ means —

- i) any Indian company; or
- ii) body corporate incorporated outside India under the laws of a foreign country; or
- iii) any institution, association or a body which is assessed or was assessable/ assessed as a company for any assessment year commencing on or before 1.4.1970; or
- iv) any institution, association or body whether incorporated or not and whether Indian or non-Indian which is declared by general or special order of the Central Board of Direct Taxes to be a company. [Sec. 2(17)]

‘Domestic Company’ means —

- i) an Indian company; or
- ii) any other company which, in respect of its income liable to tax under the Act, has made the following prescribed arrangements for the declaration and payment of dividends within India in accordance with Sec. 194 read with Rule 27 of the Rules:



- a) The share register of the company for all shareholders should be regularly maintained at its principal place of business in India, in respect of any assessment year, from 1st April of the relevant assessment year.
- b) The general meeting for passing of accounts of the relevant previous year and for declaring dividends in respect thereof should be held only at a place within India.
- c) The dividends declared, if any, should be payable only within India to all shareholders. [Sec. 2(22A)]

‘Foreign Company’ means company which is not a domestic company. [Sec. 2(23A)]

‘Indian Company’ means a company formed and registered under the Companies Act, 1956. Besides, it includes the following:-

- a) a company formed and registered under any law relating to companies formerly in force in any part of India;
- b) a corporation established by or under a Central, State or Provincial Act;
- c) any institution, association or body which is declared by the Board to be a company u/s. 2(17).
- d) a company formed and registered under any law in force in the State of Jammu and Kashmir;
- e) a company formed and registered under any law for the time being in force in the Union territories of Dadra and Nagar Haveli, Daman and Diu, Pondicherry and State of Goa.

In the aforesaid cases, a company, corporation, institution, association or body will be treated as an Indian company only if its registered or principal office is in India. [Sec. 2(26)]

“Company’ in which the public are substantially interested” –

a company is said to be a company in which the public are substantially interested, if-

- a) a company owned by Government or Reserve Bank of India or in which not less than 40% shares are held singly or taken together by the Government or the Reserve Bank or a corporation owned by the Reserve Bank; or
- b) it is a company registered u/s. 25 of the Companies Act, 1956, i.e., companies incorporated for promotion of Commerce, Arts, Science, Religion, Charity and prohibiting the payment of any dividends to its members; or
- c) it is a company having no share capital and it is declared by the CBDT to be a company in which the public are substantially interested; or
- d) it is a company which carries on, as its principal business, the business of acceptance

of deposits from its members and which is declared by the Central Government u / s. 620A of the Companies Act to be a Nidhi or Mutual Benefit Society; or

- e) it is a company which is not a private company and its equity shares are, as on the last day of previous year, listed in a recognised stock exchange in India; or
- f) it is a company which is not a private company and its shares carrying not less than 50% of the voting power (40% in the case of Indian companies whose business consists mainly in the construction of ships or in the manufacture or processing of goods or in mining or in the generation or distribution of electricity or any other form of power) have been allotted unconditionally to or acquired unconditionally to, or acquired unconditionally by, and were through out the relevant previous year beneficially held by-
 - i) the Government; or
 - ii) a statutory corporation; or
 - iii) a company in which the public are substantially interested or any wholly owned subsidiary of such company.
- g) it is a company, wherein equity shares carrying not less than 50% of the voting power have been unconditionally allotted to or acquired by and were through out the relevant previous year beneficially held by, one or more cooperative societies. [Sec. 2(18)]

Taxation of Trust

A.Public Trust u/s. 164(2) —

- i) If income is not exempt u/s. 11 or 12, income of Trust is taxable at the rates applicable to an Association of Person.
- ii) If the exemption is forfeited due to contravention of sec. 13(1)(c) or 13(1)(d), such income of trust is taxable at minimum marginal rate.

B.Private Trust (shares of beneficiaries are determinate or known) —

- i) If income does not include business Profits, the trustee is assessable at the rates applicable to each beneficiary. [Sec. 161(1)]
- ii) If income includes profits from business, the whole income is taxable at maximum marginal rate. [Sec. 161(1A)]

C.Private Trust (share of beneficiaries in determinate or unknown) [S. 164(i)] —

- i) If income does not include business profits, income is taxable at the rates applicable to an AOP if –
 - » none of the beneficiaries has taxable income or is a beneficiary in any other trust.
 - » the trust is non-testamentary trust created before 1.3.1970.
 - » exclusively for the relative dependents of the settle; or



- » it is the only trust declared by a WILL exclusively for the benefit of any dependent relative. In any other case, income is taxable of minimum marginal rate.
- ii) If income includes business profits, the whole income is taxable at maximum marginal rate.

D.Oral Trust [Sec. 160(1)(v), Sec. 164A] : “Oral Trust” means a trust which is not declared by a duly executed instrument in writing including any wakf deed which is valid under the Mussalman wakf validating Act, 1913 and which is not deemed to be trust by virtue of explanation I to Sec. 160.

- i) Income of Oral trust is taxable at maximum marginal rate.
- ii) If Oral trust is declared to be a trust by furnishing a statement in writing containing purposes, particulars and details of trust, beneficiaries and property to the assessing officer within 3 months from the date of declaration of the trust, indicating the share of beneficiaries, the income of the trust is assessable in the hands of trustee at the rates applicable to beneficiaries.

Income from property held under Trust Partly for religious purposes and partly for other purposes [Sec. 164(3)]

Where property is held under trust partly for religious purposes and partly for other purposes and the individual share of the beneficiaries in the income applicable to purposes other than charitable purposes, is not known, the income-tax liability will be aggregated as follows :

- i) the tax which would be chargeable on the part of the relevant income which is applicable to charitable or religious purposes (as reduced by the income which is exempt u / s. 11 as if such part were the total income of an association of persons; and
- ii) the tax on that part of income attributable to purposes other than charitable or religious and in respect of which shares of beneficiaries are indeterminate or unknown, at the maximum marginal rate.

Where any part of income is not exempt u/s. 11 or 12 by virtue of sec. 13(1)(c) or (d), tax is charged on the relevant income at the maximum marginal rate.

Taxation of non-resident Indian

i)Who is non-resident individual — Sec. 6 [refer to Study Note 1 of study material]

ii)Who is non-resident Indian — An individual who is a citizen of India or a person of Indian origin not resident in India, is called non-resident Indian.

iii)Taxation of non-resident assesseees

- » Provisions as applicable to resident assesseees.
- » Special provisions as provided in Sec. 115C to 115I.

The non-resident has an option to be assessed or not to be assessed under special provision for any assessment year. The option is to be exercised by a declaration in his return of Income for

the Assessment Year. [Sec. 115-1]

iv) General Provisions —

Rate of tax Similar to resident assessees.

Special rates of tax on Dividends, interest income from units of Mutual Fund. UTI, bonds or shares purchased in foreign currency and capital gains arising from their transfer.

- » 20% of the dividends [which have not been subjected to additional Income Tax u/s 115-O] [other than dividends mentioned in clause (iv) below];
- » 20% of the interest received from Government or an Indian concern on monies borrowed or debt incurred in foreign currency;
- » 20% of the income received in respect of units purchased in foreign currency, of a Mutual Fund specified u/s 10(23D) or of the Unit Trust India;
- » 10% of the interest or dividends [which have not been subjected to additional income tax u/s 115-O], in respect of bonds or Global Depository Receipts in an Indian company purchased in foreign currency and issued under the Foreign Currency Convertible Bonds and Ordinary shares (Through Depository Receipt Mechanism) Scheme, 1993 (commonly known as Euro Issues / Euro Bonds) or in respect of bonds or Global Depository Receipts issued against shares of a public sector company sold by the Government to the non-resident in foreign currency; and
- » 10% of the long-term capital gains arising from the transfer of the aforesaid bonds or Global Depository receipts.

v) Filing of return — Similar to resident assessees :

However, a non-resident shall not be required to file a return of income u/s. 139(1), if his total income consists only of income subject to special rates of tax as mentioned in rate of tax under clauses (iv) supra and the tax has been deducted therefrom at source.

Case Laws:

i) For purpose of section 164(1) what is relevant is that income is receivable on behalf of beneficiaries and is not necessary that income is received by beneficiaries - *Gosar Family Trust v. CIT* 81 Taxman 146/ 215 ITR 55.

ii) *Provision merely sets out how tax is to be charged and does not create a charge on the income. CIT v. Kamalini Khatau* 209 ITR 101



Transfer Pricing

Introduction

The increasing participation of multi-national groups in economic activities in the country has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multi-national group. The profits derived by such enterprises carrying on business in India can be controlled by the multi-national group, by manipulating the prices charged and paid in such intra-group transactions, thereby, leading to erosion of tax revenues. The Finance Act 2001 has introduced detailed provisions relating to transfer pricing, requiring all 'international transactions' between 'associated enterprises' to be at arm's length. These provisions are applicable with effect from 1 April 2001.

The provisions are exhaustive in many respects and generally in line with international practices prescribing methodologies, documentation requirements and penalties.

Scope of application of the Provisions

Any income / expense arising from an international transaction with an associated enterprise must be computed having regard to the arm's-length price. Also, costs or expenses allocated or apportioned between two or more associated enterprises should be determined having regard to arm's-length prices.

The transfer pricing provisions are wide enough to cover transactions between a foreign entity and its permanent establishment in India.

The transfer pricing provisions would not apply in cases wherein the application of arm's length price results in a downward revision in the income chargeable to tax in India.

International transactions

- The term covers a wide range of revenue and capital transactions between two or more associated enterprises where either or both are non-residents;
- The term also includes arrangements between associated enterprises for cost-sharing in connection with benefits, services or facilities provided to any of such enterprises.

Additionally, another type of transaction is deemed to be an international transaction between two associated enterprises. This is when an enterprise, say X, has entered into a transaction with an unassociated person, say A Ltd. and there exists a prior agreement in relation to this transaction between A Ltd and Y Ltd. (an associated enterprise of X); or the terms of this transaction are determined in substance between A Ltd and Y Ltd.

Computation of arm's-length price

The arm's-length price in relation to an international transaction is to be determined using the most appropriate method out of the specified methods, having regard to the nature or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as may be prescribed.

The five specified methods are:

Comparable Uncontrolled Price Method ('CUP')

A transfer pricing method that compares the price in an international transaction between associated enterprises to the price charged or paid in a comparable uncontrolled transaction. This method makes direct price comparisons between products / services sold to associated enterprises and unrelated parties. The price so determined is adjusted to account for differences, if any, between the international transaction and the uncontrolled transaction or between the enterprises entering into such transaction, which could materially affect the price in the open market.

Resale Price Method ('RPM')

This transfer pricing method is typically used in cases where the property or services are purchased by the taxpayer from the associated enterprise and are resold to an unrelated enterprise. The resale price so arrived at is further reduced by the amount of normal gross profit margin accruing to the taxpayer or to an unrelated enterprise from the purchase and resale of the same or similar property / services, in a comparable uncontrolled transaction. The price so arrived at is reduced by expenses incurred by the taxpayer in connection with the purchase of the property / services, to arrive at the inter-company purchase price of the product from an associated enterprise. The price may be further adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market.

Cost Plus Method ('CPLM')

This transfer pricing method arrives at an arm's length price by using at the outset, the costs incurred by the taxpayer in producing property or in respect of services provided, to the associated enterprise. An appropriate gross profit mark-up to such costs arising from the provision of the same or similar property or services by the taxpayer or by unrelated enterprise, in a comparable uncontrolled transaction is added to such costs to arrive at the arm's length price. In arriving at the appropriate gross profit mark up due adjustments may be made to take into account functional or other differences between the international transaction and the comparable uncontrolled transactions which could materially affect such profit mark-up in the open market.

Profit Split Method ('PSM')

The PSM may mainly be used in case the transactions involve transfer of unique intangibles or in cases where there are multiple transactions amongst associated enterprises, which are so interrelated that they cannot be evaluated separately. This method combines the net profits of all associated enterprises from all such transactions. The relative contribution made by each such associated enterprise including the taxpayer to the earning of such profits, is then evaluated on the basis of the functions performed, assets utilized and risks assumed by each enterprise



and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances. The combined profits are then split amongst the enterprises in proportion to their relative contribution, which is then taken into account to arrive at an arm's length price.

Further, the provisions also provide that the combined net profit may, in the first instance, be partially allocated to each enterprise to provide it with a basic return, with reference to market returns achieved for similar types of transactions by independent enterprises, and thereafter, the residual net profit remaining after such allocation may be split amongst the enterprises in proportion to their relative contribution.

Transactional Net Margin Method ('TNMM')

The TNMM compares the taxpayer's net profit margins, (computed in relation to costs incurred or sales effected or assets utilised by the taxpayer or having regard to any other relevant factor), realised from an international transaction entered into with an associated enterprise to the net profit margin realised by the taxpayer or by an unassociated enterprise from a comparable uncontrolled transaction having regard to the same factors. In arriving at the net profit margin from a comparable uncontrolled transaction, due adjustment may be made to take into account any differences between the international transaction and the comparable uncontrolled transactions, which could materially affect the amount of net profit margin in the open market;

Though the provisions allow for use of any other Method as the Central Board of Direct Taxes may prescribe, no other method has been prescribed till date.

Factors affecting determination of the most appropriate method

The most appropriate method would be the one, which is best suited to the facts and circumstances of the international transactions, and which provides the most reliable measure of an arm's length result in relation to the international transaction. The provisions enlist certain factors, which should be taken into account in selecting the most appropriate method:-

- (a) the nature and class of the international transaction;
- (b) the class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;
- (c) the availability, coverage and reliability of data necessary for application of the method;
- (d) the degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions;
- (e) the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions;
- (f) the nature, extent and reliability of assumptions required to be made in application of a method.

Factors establishing comparability

The regulations prescribe certain attributes that should be referred to, to establish comparability:-

- (a) the specific characteristics of the property transferred or services provided;
- (b) the functions performed, taking into account assets employed or to be employed and the risks assumed, by parties to the transactions;
- (c) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;
- (d) conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

Use of Multiple year data

It is pertinent to note that the regulations prescribe that the data used in comparing the uncontrolled transaction with the international transaction should relate to the same financial year in which the international transaction was entered into. However, if the previous years' data reveals facts that could have an influence on the determination of transfer prices in relation to the international transactions being compared, then, data relating to a period of up to two years prior to the financial year in which the international transaction is carried out could be considered.

Arithmetic Mean

The provisions specify that where more than one price is determined by the most appropriate method, the arm's length price shall be:

- the arithmetical mean of such prices; or,
- at the option of the assessee, a price, which may vary from the arithmetical mean by an amount not exceeding five percent of such arithmetical mean.

Computation of arm's length price by Assessing Officer

Where the Assessing Officer is, on the basis of material or information or document in his possession, of the opinion that—

- (a) the price charged or paid in an international transaction has not been determined in accordance with the most appropriate method; or
- (b) any information and document relating to an international transaction have not been kept and maintained by the assessee in accordance with the provisions or
- (c) the information or data used in computation of the arm's length price is not reliable or correct; or



- (d) the assessee has failed to furnish, within the specified time, any information or document which he was required to furnish

the Assessing Officer may proceed to determine the arm's length price in relation to the said international transaction in accordance with the procedure prescribed under the law, on the basis of such material or information or document available with him:

Where an arm's length price is determined by the Assessing Officer he may compute the total income of the assessee having regard to the arm's length price so determined.

No deduction under section 10A, *section 10AA*, or section 10B or under Chapter VI-A shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income under this provision.

Cost Accountant's Role in Planning

It is, therefore necessary for the enterprise to maintain appropriate record and transact at ALP. A Cost Accountant can play a significant role in data compilation for and computation of Arm's Length Price.

Expenditure incurred under VRS

Now a days, voluntary retirement scheme are announced by companies for doing away with the excess manpower. Therefore, special provision under section 3DDA has been made for deduction of expenses incurred under a VRS scheme.

Where an assessee incurs any expenditure in any previous year by way of payment to any employee in connection with his voluntary retirement, in accordance with any scheme or schemes of voluntary retirement, one-fifth of the amount so paid shall be deducted in each of the five years commencing from that previous year.

Where an Indian company is entitled to the VRS deduction and the undertaking of such Indian company entitled to the said deduction is transferred, before the expiry of the five year period to another Indian company in a scheme of amalgamation, the provisions of this section shall apply to the amalgamated company as they would have applied to the amalgamating company if the amalgamation had not taken place.

Where the undertaking of an Indian company entitled to the VRS deduction is transferred, before the expiry of the period specified in that sub-section, to another company in a scheme of demerger, the provisions of this section shall, as far as may be, apply to the resulting company, as they would have applied to the demerged company, if the demerger had not taken place.

Where there has been reorganisation of business, whereby a firm is succeeded by a company fulfilling the conditions laid down in section 47(xiii) or a proprietary concern is succeeded by a company fulfilling the conditions laid down in section 47(xiv), the VRS deduction shall, as far as may be, apply to the successor company, as they would have applied to the firm or the proprietary concern, if reorganisation of business had not taken place.

In the year of reorganisation, the predecessor entity shall not be entitled for any deduction.