

PAPER – 7 : DIRECT TAX LAWS

QUESTIONS

1. What is the meaning attributed to “disaster” under the Income-tax Act, 1961? Is there any exemption under the Act in respect of compensation received on account of disaster?
2. Mr. Ganesh retires on 31.10.2007 voluntarily from XYZ (P) Ltd. as per the scheme approved under section 10(10C) of the Income-tax Act, 1961. He furnishes the following particulars: Salary Rs.10,000 p.m.; Pension Rs.6,000 p.m.; D.A. forming part of basic pay Rs.2,000 p.m.; Compensation on voluntary retirement Rs.6,00,000; Gratuity Rs.1,50,000; Leave Salary Rs.40,000; He gets 60% of his pension commuted for Rs.54,000 on 31.1.2008. Completed years of service 18 years and 7 months. Leave availed while in service 19 months. But for the voluntary retirement Mr. Ganesh would have retired only after 45 months. The last increment he received was on 1.11.2006. Compute his taxable salary income for the A.Y. 2008-09.
3. State, with reasons, whether the following statements are true or false:
 - (a) All firms have to pay surcharge @10% irrespective of their total income.
 - (b) Mrs. Geetha, a non-resident Indian 70 years of age, is eligible for a basic exemption limit of Rs.1,95,000.
 - (c) Sale of drawings and paintings does not attract capital gains tax.
 - (d) Subscription to notified bonds of NABARD qualifies for deduction under section 80C.
 - (e) The order of the Transfer Pricing Officer determining the arm's length price of an international transaction is not binding on the Assessing Officer.
4. Section 80-IE provides a tax holiday in respect of profits and gains from eligible business of certain undertakings in the North-Eastern States. What are the eligible businesses in respect of which benefit of deduction under this section can be availed and what is the quantum of deduction?
5. X Ltd incurred Rs.12 lakh on account of stamp duty and registration fees for the issue of bonus shares. It claimed the same as revenue expenditure. Is the claim of X Ltd. tenable in law? Discuss.
6. Alpha Co-operative Bank amalgamated with Beta Co-operative Bank on 1.12.2007. The depreciation for the year ended 31.3.2008 calculated as per Income-tax Rules allowable to Alpha Co-operative Bank had the amalgamation had not taken place amounts to Rs.2,40,000. Compute the deduction on account of depreciation allowable in the hands of Alpha Co-operative Bank and Beta Co-operative Bank for A.Y. 2008-09. Explain the method of computing such deduction and the conditions to be fulfilled to avail such deduction.

7. State, with reasons, whether the following statements are true or false:
- Medical insurance premium paid by the employer to insure the health of his employees would qualify for deduction under section 36(1)(ib) for A.Y.2008-09 only if the same is paid by cheque.
 - Under section 80E, deduction is allowable for A.Y.2008-09 in respect of interest on loan taken for higher education of self alone
 - The disallowance under section 40A(3) in respect of expenditure for which payments exceeding Rs.20,000 have been made otherwise than by account payee cheque or account payee bank draft is 20% of the expenditure.
 - Minimum Alternate Tax (MAT) provisions are not attracted in respect of units claiming exemption under section 10A and section 10B.
 - Tax is deductible@5% in respect of payment of fees for professional services to a resident.
8. (i) What are the conditions to be fulfilled by a public facility to be eligible to be notified as an infrastructure facility in accordance with the provisions of section 36(1)(viii)?
- (ii) List 10 public facilities which have been notified by the CBDT as infrastructure facility for the purposes of section 36(1)(viii).
9. Does redemption of preference shares amount to a 'transfer' within the meaning of section 2(47) of the Income-tax Act in the hands of the shareholder? What will be the nature of excess realisation by a shareholder over the cost of acquisition of such shares for purpose of income-tax? Discuss.
10. Mr. Ramanan's salary for the previous year 2007-08 is Rs.3,00,000 and arrears of salary received is Rs.1,00,000. The following are the particulars of salary relating to the earlier years in respect of which arrears have been received during the P.Y.2007-08 -

Previous year	Taxable Salary	Arrears now received
Rs.	Rs.	Rs.
2000-2001	70,000	25,000
2001-2002	75,000	35,000
2002-2003	80,000	40,000

Compute the relief available under section 89 of the Income-tax Act and the tax payable for the A.Y. 2008-09.

- (a) Rates of taxes for A.Y. 2001-02, 2002-03 & 2003-04
- Up to 50,000 – Nil;
 50,000 to 60,000 –10%;
 60,000 to 1,50,000 – 20%;
 Above 1,50,000 - 30%

(b) Surcharge

A.Y. 2001-02	- 12% (if total income exceeds Rs.60,000);
	- 17% (if total income exceeds Rs.1,50,000);
A.Y. 2002-03	- 2% (if total income exceeds Rs.60,000);
A.Y. 2003-04	- 5% (if total income exceeds Rs.60,000).

11. HIG Ltd is a public limited company. As a good corporate citizen and as a measure of gaining goodwill of the people living in and around its industry, which is to some extent a polluting industry, it provided funds for establishing drinking water facilities to the residents in the vicinity of the refinery and also provided aid to the school run for the benefit of the children of those local residents. The Assessing Officer declined to allow that expenditure on the ground that it was not an item of expenditure incurred by the assessee for earning the income. The company, however, contended that such expenditure can be claimed as deduction. Is the claim of HIG Ltd. tenable in law? Discuss.
12. Manasarovar Ltd. is an Indian company engaged in the manufacture and sale of cotton fabrics. Its net profit for the year ending 31.3.2008 after debit/credit of the following items to the Profit and Loss Account was Rs.60 lakh.

Dividend received from a foreign company Rs.80,000.

Retrenchment compensation paid to employees of one of the units closed down during the year Rs.8 lakh.

Interest paid under section 234B for short payment of advance tax pertaining to the A.Y.2007-08 Rs.45,000.

Compensation received from supplier for delay in supply of raw materials Rs.50,000.

Loss incurred in transactions of purchase and sale of shares of various companies Rs.2 lakh

Banking cash transaction tax paid Rs.20,000.

Fringe benefit tax paid Rs.2.50 lakh.

Capital expenditure incurred for the purpose of promoting family planning amongst its employees Rs.1 lakh.

Payment to two employees of Rs.3 lakh each in connection with their voluntary retirement.

Compute the total income of Manasarovar Ltd. for the assessment year 2008-09.

Furnish explanation for the treatment of the various items given above.
13. Alpha Ltd. credited Rs.19,000 towards fees for professional services and Rs.17,000 towards fees for technical services to the account of Mr.Ganesh in its books of account on 13.12.2007. The total sum of Rs.36,000 was paid by cheque to Mr. Ganesh on 18.12.2007. Discuss the liability of Alpha Ltd. to deduct tax at source.

14. Speedy Motors Ltd., an Indian company declared income of Rs.20 crore computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the year ended on 31.3.2008:

- (i) Royalty of \$ 50,00,000 was paid to Fista Ltd. for use of technical know-how in the manufacturing of van. However, Fista Ltd. had provided the same know-how to another Indian company for \$ 45,00,000. The manufacture of van by Speedy Motors Ltd. is wholly dependent on the use of the technical know-how, in respect of which Fista Ltd. has exclusive rights.
- (ii) Loan of Euro 5 crore carrying interest @ 10% p.a. advanced by Hughes Ltd., a French company, was outstanding on 31.3.2008. The total book value of assets of Speedy Motors Ltd. on the date was Rs.500 crores. Hughes Ltd. had also advanced a loan of similar amount to another Indian company @ 8% p.a. Total interest paid for the year was EURO 0.5 crore.
- (iii) 7,000 vans sold to Hitech Ltd. which holds 41% shares in Speedy Motors Ltd. at a price which is less by \$ 100 each van than the price charged from Bento Ltd.

Briefly explain the provisions of the Act affecting all these transactions and compute the taxable income of Speedy Motors Ltd. for A.Y.2008-09 assuming that the value of 1\$ and of 1 EURO was Rs.42 and Rs.67, respectively, throughout the year.

15. Mr. Kamal has filed his return of loss under section 139(3) for A.Y.2008-09 on 13.6.2008 disclosing a loss of Rs.7 lakh. His brother, Mr. Vimal has filed his return of income under section 139(4) for A.Y.2008-09 on 18.8.2008 disclosing an income of Rs.5 lakh. Later, the brothers found that they had erroneously omitted to claim deduction under section 80D in respect of medical insurance premium paid by them. They want to file a revised return for claiming such deduction. However, they are advised that they cannot do so, since only a return of income filed under section 139(1) can be revised. Is this advice correct, taking into account the provisions of the Income-tax Act? Discuss.
16. Are the TDS provisions under section 194-I attracted on the gross amount of rent paid/payable including service tax or on the net amount of rent paid/payable excluding service tax?
17. Discuss any three provisions which have been incorporated in the tax laws to counteract ethical failures on the part of the taxpayer.
18. Briefly explain the difference in treatment of the following items under the Income-tax Act and Accounting Standards –
- (a) Valuation of inventories; and
 - (b) Depreciation.
19. Dr. Hari gives the particulars of the assets held by him on 31.3.2008. You are required to compute his net wealth giving reasons for the treatment of each item of asset :
- (i) He is a qualified doctor and was in possession of surgical equipments used for his professional activity. The value of all such equipments was Rs.3 lakh.

- (ii) House located in Gurgaon shown in his wealth-tax return for A.Y.2007-08 at Rs.62 lakh was sold on 28.3.08 for Rs.70 lakh, but the sale deed thereof was executed on 5.4.08.
- (iii) Urban land located at Pune was purchased for Rs.4 lakh in April 2005, in the name of his minor daughter who is suffering from a disability specified under section 80U. The value of land on 31.3.2008 was Rs.8 lakh.
- (iv) A flat in Bangalore purchased under installment scheme in 1990 for Rs.20 lakh and used for own residence since then. The market value of it was Rs.52 lakh on 31.3.2008 and installment of Rs.2 lakh was also outstanding.
- (v) Jewellery gifted to wife from time to time in total of Rs.2 lakh and were available with her on the valuation date having market value of Rs.7 lakh.
20. Compute the taxable wealth of Arihant Ltd., which is engaged in the construction of residential flats, for the valuation date 31.3.2008. The particulars for computation of taxable wealth are given hereunder -

Particulars		Rs. in lakh
(a)	Land in urban area (Construction is not permitted as per municipal laws in force)	35
(b)	Land in urban area (held as stock-in-trade since 1995)	8
(c)	Jewellery (investment)	6
(d)	Cash balance (as per books)	1.5
(e)	Bank balance (as per books)	5
(f)	Guest house (situated in rural area)	5
(g)	Residential flat occupied by Managing Director (annual remuneration of whom is Rs. 8 lakh)	12
(h)	Residential house let-out for 100 days in the financial year	15
	Loan obtained:	
	For purchase of guest house	3
	For purchase of jewellery	4

The reason for inclusion or exclusion should be stated in the computation.

SUGGESTED ANSWERS/HINTS

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

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

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

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

Section 10(10BC) exempts any amount received or receivable as compensation by an individual or his legal heir on account of any disaster. Such compensation should be granted by the Central Government or a State Government or a local authority. However, exemption would not be available in respect of compensation for alleviating any damage or loss, which has already been allowed as deduction under the Act.

2. Computation of taxable salary of Mr. Ganesh for the A.Y. 2008-09

Particulars	Rs.
Salary Rs.10,000 x 7	70,000
Dearness allowance Rs. 2,000 x 7	14,000
Gratuity (Note 1)	42,000
Uncommuted and Commuted pension (Note 2)	46,800
Compensation on voluntary retirement (Note 3)	1,00,000
Leave Salary (Note 4)	40,000
Gross Salary	3,12,800
Less : Deduction under section 16	Nil
Taxable salary	3,12,800

Working Notes :-

1. Gratuity – Least of the following is exempt under section 10(10)

(i) Rs.3,50,000

(ii) Half months salary for 18 years of service $\text{Rs.}12,000 \times \frac{1}{2} \times 18 = \text{Rs.}1,08,000$

(iii) Actual gratuity Rs.1,50,000

Rs.1,08,000, being the least of the above, is exempt and the balance of Rs.42,000 is taxable.

It is assumed that the employee is not covered under the Payment of Gratuity Act, 1972.

2. Pension	Rs.
(i) Uncommuted pension before the date of commutation Rs.6,000 x 3	18,000
(ii) Uncommuted pension after the date of commutation Rs.6,000 x 40% x 2	4,800

(iii) Commuted pension	54,000	
Less : Exempt under section 10(10A)		
54,000 ÷ 60 x 100 = 90,000		
(1/3 rd of Rs.90,000 since he is in receipt of gratuity)	<u>30,000</u>	<u>24,000</u>
		<u>46,800</u>

3. Compensation on voluntary retirement – Exempt under section 10(10C)

- (i) Last drawn salary × 3 × completed years of service (or)
 Last drawn salary × remaining months of service
 i.e. 18 x 3 x 12,000 = Rs.6,48,000 (or) 45 x 12,000 = Rs.5,40,000
- (ii) Monetary ceiling Rs.5,00,000
- (iii) Actual compensation Rs.6,00,000
- Rs.5,00,000 being the least of the above is exempt. The balance Rs.1 lakh is taxable.

4. Exemption for leave salary under section 10(10AA)

Total leave eligible on the basis of 30 days for each completed year of service i.e. 540 days or 18 months	18 months
Total leave taken	19 months
Leave to his credit	Nil
Average of last 10 months salary	Rs.12,000

Least of the following is exempt :

1. Cash equivalent of leave to the credit of employee at the time of retirement	Nil
2. 10 months salary [12,000 x 10]	1,20,000
3. Amount notified	3,00,000
4. Actual leave salary	40,000

The least of the above is Nil. Therefore, the entire leave salary of Rs.40,000 is taxable.

3. (a) This statement is false. Surcharge@10% is attracted only in the case of those firms whose total income exceeds Rs.1 crore.
- (b) This statement is false. The higher basic exemption limit of Rs.1,95,000 is available only to resident individuals of the age of 65 years or more during the relevant previous year. Non-residents are not eligible for this higher basic exemption limit.

- (c) This statement is false. Drawings and paintings have been excluded from the ambit of personal effects. Therefore, they now fall within the meaning of the term "Capital assets". Hence, capital gains tax liability is attracted in respect of sale of drawings and paintings.
 - (d) This statement is true. The Finance Act, 2007 has amended section 80C(2) to provide that the subscription to such bonds issued by NABARD (as the Central Government may notify in the Official Gazette) would qualify for deduction under section 80C w.e.f. A.Y.2008-09.
 - (e) This statement is false. New sub-section (4) has been inserted in section 92CA to provide that the order of the Transfer Pricing Officer determining the arm's length price of an international transaction would now be binding on the Assessing Officer and the Assessing Officer shall proceed to compute the total income in conformity with the arm's length price determined by the Transfer Pricing Officer.
4. Eligible business means the business of -
- (a) hotel (not below two star category);
 - (b) adventure and leisure sports including ropeways;
 - (c) providing medical and health services in the nature of nursing home with a minimum capacity of 25 beds;
 - (d) running an old-age home;
 - (e) operating vocational training institute for hotel management, catering and food craft, entrepreneurship development, nursing and para-medical, civil aviation related training, fashion designing and industrial training;
 - (f) running information technology related training centre;
 - (g) manufacturing of information technology hardware; and
 - (h) Bio-technology.

Where the gross total income of an assessee includes any profits and gains derived by an undertaking carrying on such eligible business in a North-Eastern State, a deduction of 100% of the profits and gains derived from such business for 10 consecutive assessment years commencing from the initial assessment year shall be allowed in computing the total income of the assessee.

5. This issue has been settled by the Supreme Court in CIT v. General Insurance Corporation (2006) 286 ITR 232. The Supreme Court observed that there is no inflow of fresh funds or increase in capital employed on account of issue of bonus shares. There is merely a reallocation of company's fund on account of issue of bonus shares by capitalization of reserves. Therefore, the company has not acquired a benefit or advantage of enduring nature. The total funds available with the company will remain the same and there is no change in the capital structure of the company consequent to the bonus issue. Thus, issue of bonus shares does not result in the expansion of capital base of the company. Therefore, the

expenditure incurred by the company on account of stamp duty and registration fees for the issue of bonus shares is allowable as revenue expenditure.

Therefore, the claim of X Ltd. is valid. It can claim the amount of Rs.12 lakh incurred by it on account of stamp duty and registration fees for the issue of bonus shares as revenue expenditure.

6. (i) Section 44DB provides the manner in which the deduction, inter alia, under section 32 is to be allowed in a case where business reorganisation of a co-operative bank has taken place during the financial year.
- (ii) Business reorganisation means the reorganisation of business involving the amalgamation or demerger of a co-operative bank.
- (iii) The amount of deduction allowable to the amalgamating co-operative bank (i.e. Alpha Co-operative bank, in this case) under section 32 has to be determined in accordance with the following formula -

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

A = the amount of deduction allowable to the predecessor co-operative bank (i.e. Alpha Co-operative bank, in this case) if the business reorganisation had not taken place. In this case, the amount of deduction is Rs.2,40,000.

B = the number of days comprised in the period beginning with the 1st day of the financial year (i.e. 1.4.2007, in this case) and ending on the day immediately preceding the date of business reorganization (i.e. 30.11.2007, in this case); and

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

- (iv) The amount of deduction allowable to the amalgamated co-operative bank (i.e. Beta Co-operative bank, in this case) under section 32 has to be determined in accordance with the formula -

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

A = the amount of deduction allowable to the predecessor co-operative bank (i.e. Alpha Co-operative bank, in this case) if the business reorganisation had not taken place. In this case, the amount of deduction is Rs.2,40,000.

B = the number of days comprised in the period beginning with the date of business reorganisation (i.e. 1.12.2007, in this case) and ending on the last day of the financial year (i.e. 31.3.2008); and

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

- (v) In this case, the deduction that would have been allowable under section 32 to Alpha co-operative bank had the business reorganization had not taken place is Rs.2,40,000 and the business re-organisation took place on 1.12.07. Therefore, the deduction allowable to Alpha co-operative bank under section 32 would be Rs.1,60,000 i.e. $\text{Rs.2,40,000} \times \frac{244}{366}$. The deduction allowable to Beta co-operative bank would be Rs.80,000 i.e. $\text{Rs.2,40,000} \times \frac{122}{366}$.
 - (vi) It must be noted that for the purpose of availing benefit under this section, the amalgamation should fulfill the following conditions –
 - (1) all the assets and liabilities of Alpha co-operative bank immediately before the merger (other than the assets transferred, by sale or distribution on winding up, to Beta co-operative bank) should become the assets and liabilities of Beta co-operative bank;
 - (2) the members holding 75% or more voting rights in Alpha co-operative bank should become members of Beta co-operative bank; and
 - (3) the shareholders holding 75% or more in value of the shares in Alpha co-operative bank (other than the shares held by Beta co-operative bank or its nominee or its subsidiary, immediately before the merger) should become shareholders of Beta co-operative bank.
7. (a) This statement is false. Section 36(1)(ib) provides for deduction of medical insurance premium paid by an employer to insure the health of his employees if it is paid by any mode other than cash.
- (b) This statement is false. The Finance Act, 2007 has, w.e.f. A.Y.2008-09, extended the deduction under section 80E available to an individual in respect of interest on loan taken for his higher education to interest on such loan taken for higher education of his relative (i.e. his or her spouse and children) as well.
- (c) This statement is false. Under section 40A(3), the entire expenditure in respect of which payments exceeding Rs.20,000 has been made otherwise than by way of account payee cheque or account payee bank draft is disallowed.
- (d) This statement is false. The Finance Act, 2007 has, w.e.f. A.Y.2008-09, extended the levy of minimum alternate tax (MAT) to units claiming exemption under sections 10A and 10B also.
- (e) This statement is false. The rate of TDS on fees for professional services payable to a resident has been increased from 5% to 10% w.e.f. 1.6.2007.
8. (i) The CBDT has, vide Notification No.187/2006 dated 20.7.2006, spelt out the conditions to be fulfilled by a public facility to be eligible to be notified as an infrastructure facility in accordance with the provisions of clause (d) of the Explanation to section 36(1)(viii). The conditions specified are that -

- (a) it should be owned by a company registered in India or by a consortium of such companies or by an authority or a board or a corporation or any other body established or constituted under any Central or State Act;
 - (b) it has entered into an agreement with the Central Government or a State Government or a local authority or any other statutory body for (i) developing or (ii) operating and maintaining or (iii) developing, operating and maintaining a new infrastructure facility similar in nature to an infrastructure facility referred to in the Explanation to section 80-IA(4)(i);
 - (c) it has started or starts operating and maintaining such infrastructure facility on or after 1st April, 1995.
- (ii) The CBDT has, vide Notification No.188/2006 dated 20.7.2006, notified the following public facilities as infrastructure facility for purposes of section 36(1)(viii)-
- (1) Inland Container Depot and Container Freight Station notified under the Customs Act, 1962
 - (2) Mass Rapid Transit system
 - (3) Light Rail Transit system
 - (4) Expressways
 - (5) Intra-urban or semi-urban roads like ring roads or urban by-passes or flyovers
 - (6) Bus and truck terminals
 - (7) Subways
 - (8) Road dividers
 - (9) Bulk Handling Terminals which are developed or maintained or operated for development of rail system
 - (10) Multilevel Computerised Car Parking.
9. When a preference share is redeemed by a company, what the shareholder does in effect is to sell the share to the company. The company redeems its preference shares only by paying the preference shareholders the value of the shares and taking back the preference shares. The definition of the term "transfer" under section 2(47) is not an exhaustive definition but an inclusive one. "Transfer" in relation to capital asset includes, inter alia, sale, exchange or relinquishment of a capital asset. When preference shares are redeemed by a company, the shareholder has to surrender the shares in order to get the money in lieu thereof. Therefore, there is also a relinquishment which brings the transaction within the meaning of section 2(47). The consideration received by the shareholder from the company is certainly for sale/relinquishment of the shares and therefore, the redemption of preference shares amounts to "transfer" and the gain arising therefrom, being the excess realisation over the cost of acquisition, shall be charged to tax under the head "Capital Gains". This was upheld by the Supreme Court in *Anarkali Sarabhai vs CIT* (1997) 224 ITR 422.

10. Computation of tax payable for A.Y. 2008-09

Particulars	Incl. arrears of salary	Excl. arrears of salary
Current year salary	3,00,000	3,00,000
Add: Arrears of salary	<u>1,00,000</u>	<u>-</u>
Taxable salary	<u>4,00,000</u>	<u>3,00,000</u>
Income-tax thereon	69,000	39,000
Add: Education cess @ 3% (includes 1% secondary and higher education cess)	<u>2,070</u>	<u>1,170</u>
Tax payable	<u>71,070</u>	<u>40,170</u>

Computation of tax payable on arrears of salary if charged to tax in the respective assessment years

Particulars	A.Y. 2001-02		A.Y. 2002-03		A.Y. 2003-04	
	Incl. Arrears	Excl. Arrears	Incl. Arrears	Excl. Arrears	Incl. Arrears	Excl. Arrears
Taxable Salary	70,000	70,000	75,000	75,000	80,000	80,000
Add : Arrears of salary	<u>25,000</u>	<u>-</u>	<u>35,000</u>	<u>-</u>	<u>40,000</u>	<u>-</u>
Taxable salary	<u>95,000</u>	<u>70,000</u>	<u>1,10,000</u>	<u>75,000</u>	<u>1,20,000</u>	<u>80,000</u>
Tax on the above	8,000	3,000	11,000	4,000	13,000	5,000
Add : Surcharge	<u>960</u>	<u>360</u>	<u>220</u>	<u>80</u>	<u>650</u>	<u>250</u>
Tax Payable	<u>8,960</u>	<u>3,360</u>	<u>11,220</u>	<u>4,080</u>	<u>13,650</u>	<u>5,250</u>

Computation of relief under section 89

Particulars	Rs.	Rs.
(i) Tax payable in A.Y.2008-09 on arrears:		
Tax on income including arrears	71,070	
Less: Tax on income excluding arrears	<u>40,170</u>	30,900

(ii)	Tax payable during the respective years on arrears:		
	Tax on income including arrears (8,960 + 11,220 + 13,650)	33,830	
	Less: Tax on income excluding arrears (3,360 + 4,080 + 5,250)	<u>12,690</u>	21,140
	Relief under section 89 [(i) – (ii)]		<u>9,760</u>

Tax payable for A.Y.2008-09 after relief under section 89

Particulars	Rs.
Income-tax payable on total income including arrears of salary	71,070
Less: Relief under section 89	<u>9,760</u>
Tax payable	<u>61,310</u>

11. The Madras High Court has recognized the relevance of social costs to business in deciding the case of CIT v. Madras Refineries Ltd. (2004) 138 Taxman 261. The High Court observed that the concept of business is not static. It has evolved over a period of time to include within its fold the concrete expression of care and concern for the society at large and the people of the locality in which the business is located in particular. Further, to be known as a good corporate citizen brings goodwill of the local community, as also with the regulatory agencies and the society at large, thereby creating an atmosphere in which the business can succeed in a greater measure with the aid of such goodwill. In this case, the High Court observed that monies spent for bringing drinking water as also for establishing or improving the school meant for the residents of the locality in which the business is situated cannot be regarded as being wholly outside the ambit of the business concerns of the assessee, especially, where the undertaking owned by the assessee is one which is to some extent a polluting industry. The High Court, therefore, upheld the order of the Tribunal allowing deduction for the amount spent on bringing drinking water to the locality and in aiding a local school.

Thus, in view of the above case, the claim of HIG Ltd. is tenable in law.

12. Computation of total income of Manasarovar Ltd. for the A.Y.2008-09

Particulars	Rs.
Profits and gains of business or profession [See Working Note below]	69,75,000
Income from other sources	
- Dividend received from foreign company	<u>80,000</u>
Gross Total Income	<u>70,55,000</u>

Working Note –

Computation of profits and gains of business or profession

Particulars	Rs.
Net profit as per profit and loss account	60,00,000
Add:	
1. Interest under section 234B for the A.Y. 2007-08 [See Note 3 below]	45,000
2. Loss on purchase and sale of shares [See Note 5 below]	2,00,000
3. Fringe benefit tax paid [See Note 7 below]	2,50,000
4. Capital expenditure on family planning amongst employees [See Note 8 below]	80,000
5. Amount paid in connection with VRS [See Note 9 below]	4,80,000
	70,55,000
Less: Dividend received from foreign company [See Note 1 below]	80,000
Profits and gains of business or profession	69,75,000

Notes -

- (1) Dividend received from a foreign company is chargeable to tax under section 56 and therefore, it has been deducted from the computation of business income and charged to tax under the head "Income from other sources".
- (2) Retrenchment compensation paid to employees at the time of closure of one of the units of the business is allowable as per the decision of the Allahabad High Court in CIT (Central) Kanpur vs. JK Cotton Spinning & Weaving Co. Ltd. (2005) 145 Taxman 5.
- (3) Interest for short payment of advance income-tax is a part and parcel of the income-tax itself and accordingly disallowed under section 40(a)(ii).
- (4) A sum of Rs.50,000 received as compensation from supplier for delay in supply of raw materials is chargeable to tax under section 28.
- (5) Loss of Rs.2 lakh incurred by the company in dealing of shares constitutes speculation loss in view of the Explanation to section 73. In the absence of any speculative profit for the year, speculation loss is to be carried forward under section 73(2) for set off against speculation profits of subsequent assessment years. It can be carried forward for a maximum of 4 assessment years.
- (6) Banking cash transaction tax is an allowable expenditure under section 36(1)(xiii).
- (7) Section 40(a)(ic) provides that any amount paid as fringe benefit tax shall not be allowed as deduction while computing the taxable income. Therefore, the same has been added back.

- (8) Any capital expenditure incurred for the purpose of promoting family planning amongst employees of the assessee, being a company, shall be allowed as deduction over a period of 5 years i.e., $\frac{1}{5}^{\text{th}}$ of such expenditure shall be allowed as deduction in each year [Section 36(1)(ix)]. Accordingly, in the given case Rs.20,000, being $\frac{1}{5}^{\text{th}}$ of Rs.1,00,000 is allowable as deduction for A.Y.2008-09 and the balance of Rs.80,000 has been added back to net profit.
 - (9) The company has paid a sum of Rs. 6 lakh in connection with VRS for two of its employees. Under section 35DDA, where any sum has been paid in connection with any scheme of VRS, $\frac{1}{5}^{\text{th}}$ of the sum paid alone shall be allowable in the year of payment and the balance shall be allowed in the same proportion for the balance period of four years. In the given case, assuming that the VRS is in accordance with the scheme, amount deductible under section 35DDA would be Rs.1,20,000 being $\frac{1}{5}^{\text{th}}$ of Rs.6,00,000. The balance amount of Rs.4,80,000 is to be added back to the net profit.
13. The requirement to deduct tax at source in respect of fees for professional or technical services is covered under section 194J in case the amount exceeds Rs.20,000 in a financial year. Further, the tax shall be deducted at source either on credit or payment, whichever is earlier.
- The limit of Rs.20,000 for non-deduction of tax under section 194J has been separately fixed for fees for professional services and fees for technical services. This means that if a person has rendered services falling under both the categories, tax need not be deducted if the fees for each category does not exceed Rs.20,000 even though the aggregate of the amounts credited to the account of such person or paid to him for both the categories of services exceed Rs.20,000. Therefore, Alpha Ltd., is not required to deduct tax at source in respect of the fees either at the time of credit or at the time of payment.
14. Any income arising from an international transaction, where two or more "associated enterprises" enter into a mutual agreement or arrangement, shall be computed having regard to arm's length price as per the provisions of Chapter X of the Act.
- Section 92A defines an "associated enterprise" and sub-section (2) of this section speaks of the situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2)(a) to (m) to the given facts, it is clear that "Speedy Motors Ltd." is associated with :-
- (i) Fista Ltd. as per section 92A(2)(g), since Speedy Motors Ltd. is wholly dependent on the use of technical know-how supplied by Fista Ltd. Further, Fista Ltd. has the exclusive rights over the technical know-how used by Speedy Motors Ltd. in its manufacturing process;
 - (ii) Hughes Ltd. as per section 92A(2)(c), since this company has financed an amount which is more than 51% of the book value of total assets of Speedy Motors Ltd;
 - (iii) Hitech Ltd. as per section 92A(2)(a), because this company holds shares carrying more than 26% of the voting power in Speedy Motors Ltd.

The transactions entered into by Speedy Motors Ltd. with different companies are therefore to be adjusted accordingly to work out the taxable income for the A.Y. 2008-09.

	Particulars	Rs. in crore
	Income of Speedy Motors Ltd. as computed under Chapter IV-D, prior to adjustments as per Chapter – X	20.00
Add:	Difference on account of adjustment in the value of international transactions:	
(i)	Difference for excess payment of royalty of \$ 5,00,000 (\$ 5,00,000 x 42)	2.10
(ii)	Difference for excess interest paid on loan of EURO 5 crore (67*5*2/100)	6.70
(iii)	Difference in price of van @ \$ 100 each for 7,000 vans (\$ 100 x 7,000 x 42)	2.94
	Taxable Income	31.74

15. Where an assessee has filed a loss return under section 139(3), he can file a revised return under section 139(5). According to section 139(3), once a loss return is filed within the time allowed under section 139(1), all the provisions of the Income-tax Act shall apply as if such return has been filed under section 139(1). The Madras High Court has, in CIT vs. Periyar District Co-operative Milk Producers Union Ltd. (2004) 266 ITR 705, held that a return of loss filed under section 139(3) takes the character of a return filed under section 139(1), in respect of which the assessee can file a revised return under section 139(5). Consequently, the filing of a revised loss return is valid and section 80 does not come in the way of disallowing the carry forward of such increased amount of loss. In this case, Mr. Kamal has filed his loss return on 13.6.2008, which is before the due date specified under section 139(1), namely, 31.7.2008. Therefore, Mr. Kamal can file a revised return claiming deduction under section 80D.

However, where an assessee has filed a belated return under section 139(4), he cannot file a revised return under section 139(5). The Apex Court has, in Kumar Jagdish Chandra Sinha vs. CIT (1996) 220 ITR 67, held that the provisions of section 139(5) provide that a revised return can be filed only where a return has been furnished under section 139(1) or in response to a notice issued under section 142(1). In this case, Mr. Vimal has filed a belated return under section 139(4). Therefore, he cannot file a revised return claiming deduction under section 80D.

16. CBDT Circular No.4/2008 dated 28.4.2008 provides clarification on deduction of tax at source (TDS) on service tax component of rental income under section 194-I.

As per the provisions of 194-I, tax is deductible at source on income by way of rent paid to any resident. Further, rent has been defined in 194-I to mean any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of (either separately or together) any,-

- (a) land; or

- (b) building (including factory building); or
- (c) land appurtenant to a building (including factory building); or
- (d) machinery; or
- (e) plant; or
- (f) equipment; or
- (g) furniture; or
- (h) fittings,

whether or not any or all of the above are owned by the payee.

Service tax paid by the tenant doesn't partake the nature of income of the landlord. The landlord only acts as a collecting agency for the Government for collection of service tax. Therefore, tax deduction at source under section 194-I would be required to be made on the amount of rent paid/payable without including the service tax.

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

- (i) Incorporation of clubbing provisions

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

- (ii) Incorporation of transfer pricing provisions

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

(iii) Enforcing compliance of TDS provisions

This has been enforced by denying deduction of expenditure to an assessee in case of failure to deduct tax at source or remit such tax deducted within the prescribed time. However, such expenditure would be allowed as deduction in the year in which such tax is deducted and paid. This provision is to prevent loss of tax revenue on account of failure of the assessee to deduct/remit tax. The introduction of this provision is one step to encourage ethical tax practices by assesseees.

18. (a) Valuation of Inventories

Section 145A requires assesseees to follow only the Inclusive method, whereas AS-2 on "Valuation of Inventories" requires adoption of Exclusive method. There are two methods for accounting of tax, duty, cess etc. while preparing accounts. They are the Inclusive method and the Exclusive method. Under the Inclusive method, the amounts are grossed up whereas under the Exclusive method, the figures are shown net of CENVAT credit.

(b) Depreciation

The basis for provision of depreciation as per AS-6 is the estimated useful life of an asset. However, under the Income-tax Act, the useful life of an asset is not relevant. The concept of "block of assets" is applicable and the rates of depreciation are higher under the Income-tax Act with the objective of providing incentive to the assessee. Further, incentive is also provided by way of additional depreciation in respect of new plant and machinery installed by assesseees engaged in the manufacture or production of any article or thing.

The Accounting Standard provides for allowance of depreciation on revalued amount in the case of revaluation. Under Income-tax Act, depreciation is allowed only on the written down value of block of assets. Revaluation is not recognized for income-tax purposes.

19. Computation of Net Wealth of Dr. Hari on 31.3.2008

Particulars of asset with reason for chargeability	Amount (Rs.)
(i) Professional equipments held on the valuation date used for the purpose of profession are not assets for the purpose of levy of wealth-tax.	Nil
(ii) The property at Gurgaon was sold during the year and is, therefore, not an asset of the assessee but is an asset of the beneficial owner as per section 4(8).	Nil
(iii) Urban land is an asset by virtue of section 2(ea)(v). However, since the same is in the name of his minor daughter who suffers from a disability specified under section 80U, the clubbing provisions are not applicable as per section 4(1)(a)(ii).	Nil

(iv) The flat at Bangalore used by the assessee for his own residence is exempt under section 5(vi).	Nil
(v) Under section 4(1)(a)(i) read with Rule 18 of Schedule III, the fair market value of gifted jewellery on the valuation date will be included in the wealth of Dr. Hari.	7,00,000
Net Wealth	<u>7,00,000</u>

20. Computation of taxable wealth of Arihant Ltd. as on 31.3.2008

Particulars	Notes	Rs. in lakh
(a) Land in urban area (Construction not permitted as per municipal laws)	1	Nil
(b) Land in urban area (held as stock-in-trade since 1995)	2	8
(c) Jewellery	3	6
(d) Cash balance	4	Nil
(e) Bank balance	5	Nil
(f) Guest house in a rural area	6	5
(g) Residential flat occupied by Managing Director	7	12
(h) Residential house let out for 100 days	8	15
		<u>46</u>
Less : Debts – Loan obtained for purchase of:		
(i) Guest house	3	
(ii) Jewellery	<u>4</u>	<u>7</u>
Taxable wealth as on 31.3.2008		<u>39</u>

Notes:

- (1) Land in urban area on which the construction is not permitted as per municipal laws in force is not an asset with in the meaning of 'asset' defined under section 2(ea) and therefore, excluded from taxability.
- (2) Land in urban area held as stock-in-trade is not taxable only for 10 years. Since the land is held as stock-in-trade from the year 1995, it is taxable.
- (3) Jewellery is always taxable unless the same is held as stock-in-trade.
- (4) In the case of assesseees other than individuals and HUFs, cash on hand is not taxable to the extent it is reflected in the books of account.
- (5) Bank balance is not an asset with in the meaning of asset defined under section 2(ea).

- (6) Guest House situated in rural area is an asset and therefore taxable. Only in the case of farm house, if it is situated beyond 25 kms. from the local limits of any municipality, taxability does not arise.
- (7) Residential flat which is allotted by a company to an employee or an officer or a director who is in whole-time employment, having gross annual salary of less than Rs. 5 lakh is not an asset within the meaning of asset defined under section 2(ea). In the given case, the residential flat is a taxable asset since, it is occupied by Managing Director whose gross annual remuneration exceeds Rs. 5 lakh.
- (8) Any residential property which is let out for a minimum period of 300 days in the previous year is not an asset. In the given case, the residential house is taxable since it has been let out for less than 300 days during the previous year. Therefore, it is an asset.
- (9) Debts incurred in relation to assets chargeable to tax shall be allowed as deduction in the computation of net wealth. Accordingly, the loan obtained for purchase of guest house and jewellery shall be allowed as both these assets are chargeable to wealth-tax.

IMPORTANT CIRCULARS / NOTIFICATIONS ISSUED BETWEEN 1.5.07 and 30.04.08

NOTIFICATIONS

1. NOTIFICATION NO. 208 / 2007, DATED 27-6-2007

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

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

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

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

- (j) where the payment was required to be made on a day on which the banks were closed either on account of holiday or strike;
- (k) where the payment is made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person;
- (l) where the payment is made by an authorised dealer or a money changer against purchase of foreign currency or travellers cheques in the normal course of his business.

2. NOTIFICATION NO. 213/2007, DATED 3-8-2007

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

3. NOTIFICATION NO. 214/2007, DATED 3-8-2007

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

S. No.	Financial Year	Cost Inflation Index
1.	1981-82	100
2.	1982-83	109
3.	1983-84	116
4.	1984-85	125
5.	1985-86	133
6.	1986-87	140
7.	1987-88	150
8.	1988-89	161
9.	1989-90	172
10.	1990-91	182
11.	1991-92	199
12.	1992-93	223
13.	1993-94	244
14.	1994-95	259
15.	1995-96	281
16.	1996-97	305
17.	1997-98	331
18.	1998-99	351

19.	1999-2000	389
20.	2000-01	406
21.	2001-02	426
22.	2002-03	447
23.	2003-04	463
24.	2004-05	480
25.	2005-06	497
26.	2006-07	519
27.	2007-08	551

4. NOTIFICATION NO. 262/2007, DATED 16-10-2007

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

The Chief Commissioner or the Commissioner, by a general or special order in writing, may authorise a Tax Recovery Officer to exercise or perform the powers and functions conferred on or assigned to an Assessing Officer under section 154 for rectifying any mistake apparent from record in respect of an order passed by the Assessing Officer consequent to which a sum is payable and the Tax Recovery Officer has drawn a Certificate under section 222 in respect of such sum. The Tax Recovery Officer shall exercise or perform such powers and functions concurrently with the Assessing Officer.

5. NOTIFICATION NO. 264/2007, DATED 23-10-2007

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

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

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

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

- (1) For the purposes of clause (ba) of sub-section (1) of section 115WC, the fair market value of any specified security or sweat equity share, being an equity share in a

company, on the date on which the option vests with the employee, shall be determined in the manner laid down in (2) and (3) below.

- (2) In a case where, on the date of the vesting of the option, the share in the company is listed on a recognized stock exchange, the fair market value shall be the average of the opening price and closing price of the share on that date on the said stock exchange. However, where, on the date of vesting of the option, the share is listed on more than one recognized stock exchanges, the fair market value shall be the average of opening price and closing price of the share on the recognised stock exchange which records the highest volume of trading in the share.

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

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

6. NOTIFICATION NO. 271/2007 DATED 7-11-2007

The Finance Act, 2007 has introduced a deeming provision to define concession in the matter of rent by inserting Explanations to section 17(2)(ii) with retrospective effect from

1.4.2006, that is, with effect from assessment year 2006-07. This has necessitated reduction of rates in case of both rent free and concessional rent accommodations and leased accommodation in Table I of rule 3 with retrospective effect from 1st April, 2006, that is, in relation to assessment year 2006-07 and subsequent years. The amendment has taken place in valuation of perquisite of unfurnished accommodation (rent free and concessional) provided to other than Government employees.

Employee	Value of perquisite
Where the accommodation is owned by the employer.	Where accommodation is provided in a city where population as per 2001 census is: (a) 10 lakh or less – 7.5% of salary; (b) More than 10 lakh upto 25 lakh -10% of salary; (c) More than 25 lakh – 15% of salary. in respect of the period during which the said accommodation was occupied by the employee during the previous year as reduced by the rent, if any, actually paid by the employee.
Where the accommodation is taken on lease or rent by the employer and provided to the employee	The value of perquisite would be the lower of the following: (a) Actual amount of lease rental paid or payable by the employer ; or (b) 15% of salary. This value would be reduced by the rent, if any, actually paid by the employee.

Further, the Finance Act, 2005 had inserted a new Chapter XII-H in the Act, relating to levy of fringe benefit tax on the employer with effect from 1st April, 2006, i.e., applicable for assessment year 2006-07 and subsequent years. Accordingly, rule 3 was amended vide notification number S.O. 265(E) dated the 28th February, 2005, to avoid double taxation on certain items.

Since, Chapter XII-H relating to Fringe Benefit Tax, as provided in the Finance Act, 2005, is not applicable to the employer, being an individual or a Hindu undivided family or any fund or trust or institution eligible for exemption under clause (23C) of section 10 or registered under section 12AA, rule 3 is required to be amended so as to include valuation of perquisite in case of benefits provided by such employers to its employees. Accordingly, sub-rules 2, 6, 7 (ii), (iii), (iv), (v) and (vi) have been inserted to provide for such valuation. Sub-rule 7(ix) has been inserted to provide for valuation of any other benefit or amenity, etc. in residual cases relating to any employer. These sub-rules will take effect from 1st April, 2008 and will, accordingly, apply in relation to A.Y.2008-09 and subsequent years.

The following perquisites provided by an employer, who is not liable to pay fringe benefit tax under Chapter-XIIH, shall be chargeable to tax in the hands of the employee under the head "Salaries".

Motor Car - Rule 3(2)

Sl. No.	Circumstances	Where cubic capacity of engine does not exceed 1.6 litres	Where cubic capacity of engine exceeds 1.6 litres
(1)	(2)	(3)	(4)
(1)	Where the motor car is owned or hired by the employer and (a) is used wholly and exclusively in the performance of his official duties; (b) is used exclusively for the private or personal purposes of the employee or any member of his household and the running and maintenance expenses are met or reimbursed by the employer; (c) is used partly in the performance of duties and partly for private or personal purposes of his	No value, provided the documents specified in Note 2 below this table are maintained by the employer. Actual amount of expenditure incurred by the employer on the running and maintenance of motor car during the relevant previous year including remuneration, if any, paid by the employer to the chauffeur as increased by the amount representing normal wear and tear of the motor car and as reduced by any amount charged from the employee for such use.	No value, provided the documents specified in Note 2 below this table are maintained by the employer. Actual amount of expenditure incurred by the employer on the running and maintenance of motor car during the relevant previous year including remuneration, if any, paid by the employer to the chauffeur as increased by the amount representing normal wear and tear of the motor car and as reduced by any amount charged from the employee for such use.

	own or any member of his household and		
	(i) the expenses on maintenance and running are met or reimbursed by the employer,	Rs.1,200 (plus Rs.600, if chauffeur is also provided to run the motor car)	Rs.1,600 (plus Rs.600, if chauffeur is also provided to run the motor car)
	(ii) the expenses on running and maintenance for such private or personal use are fully met by the assessee.	Rs.400 (plus Rs.600, if chauffeur is provided by the employer to run the motor car)	Rs.600 (plus Rs.600, if chauffeur is also provided to run the motor car)
(2)	Where the employee owns a motor car but the actual running and maintenance charges (including remuneration of the chauffeur, if any) are met or reimbursed to him by the employer and		
	(i) such reimbursement is for the use of the vehicle wholly and exclusively for official purposes,	No value, provided that the documents specified in Note 2 below this table are maintained by the employer.	No value, provided that the documents specified in Note 2 below this table are maintained by the employer.
	(ii) such reimbursement is for the use of the vehicle partly for official purposes and partly for personal or private purposes of the employee or any member	The actual amount of expenditure incurred by the employer as reduced by Rs.1,200 (plus Rs.600, if chauffeur is also provided to run the motor car). However, the documents specified in Note 2 below this table should be maintained by the employer.	The actual amount of expenditure incurred by the employer as reduced by Rs.1,600 (plus Rs.600, if chauffeur is also provided to run the motor car). However, the documents specified in Note 2 below this table should

	of his household.		be maintained by the employer.
(3)	Where the employee owns any other automotive conveyance but the actual running and maintenance charges are met or reimbursed to him by the employer and		
	(i) such reimbursement is for the use of the vehicle wholly and exclusively for official purposes,	No value, provided that the documents specified in Note 2 below this table are maintained by the employer.	Not applicable
	(ii) such reimbursement is for the use of the vehicle partly for official purposes and partly for personal or private purposes of the employee.	The actual amount of expenditure incurred by the employer as reduced by an amount of Rs.600, provided the documents specified in Note 2 below this table are maintained by the employer.	

Note -

- (1) Where one or more motor-cars are owned or hired by the employer and the employee or any member of his household are allowed the use of such motor-car or all or any of such motor-cars (otherwise than wholly and exclusively in the performance of his duties), the value of perquisite shall be the amount calculated in respect of one car in accordance with Sl. No. (1)(c)(i) of the above Table as if the employee had been provided one motor-car for use partly in the performance of his duties and partly for his private or personal purposes and the amount calculated in respect of the other car or cars in accordance with Sl. No. (1)(b) of the above Table as if he had been provided with such car or cars exclusively for his private or personal purposes.
- (2) Where the employer or the employee claims that the motor-car is used wholly and exclusively in the performance of official duty or that the actual expenses on the running and maintenance of the motor-car owned by the employee for official

purposes is more than the amounts deductible in Sl. No. 2(ii) or 3(ii) of the above Table, he may claim a higher amount attributable to such official use and the value of perquisite in such a case shall be the actual amount of charges met or reimbursed by the employer as reduced by such higher amount attributable to official use of the vehicle provided that the following conditions are fulfilled:

- (a) the employer has maintained complete details of journey undertaken for official purpose which may include date of journey, destination, mileage, and the amount of expenditure incurred thereon;
 - (b) the employer gives a certificate to the effect that the expenditure was incurred wholly and exclusively for the performance of official duties.
- (3) The normal wear and tear of a motor-car shall be taken at 10 per cent per annum of the actual cost of the motor-car or cars.

Free or concessional tickets [Sub-rule (6) of Rule 3]

The value of any benefit or amenity resulting from the provision by an employer (who is not liable to pay FBT) engaged in the carriage of passengers or goods to any employee or to any member of his household for personal or private journey free of cost or concessional fare in any conveyance owned, leased or made available by any other arrangement shall be the value at which such benefit or amenity is offered by such employer to the public. Any amount recovered from the employee for such benefit or amenity shall be reduced in determining the value of the perquisite.

However, this sub-rule shall not apply to the employees of an airline or the railways.

Travelling, touring and accommodation [Sub-rule 7(ii) of Rule 3]

The value of travelling, touring, stay and other expenses borne by the employer for any holiday availed by the employee or any member of his household shall be the amount of the expenditure incurred by the employer. This provision applies in respect of trips other than those which are exempt under section 10(5) read with Rule 2B. If the facility is maintained by the employer and it is not available uniformly to all employees, the value of benefit shall be taken to be the value at which such facilities are offered by other agencies to the public.

Where the employee is on official tour and the expenses are incurred in respect of any member of his household accompanying him, the amount of expenditure so incurred shall also be a fringe benefit or amenity. However, if the official tour is extended as a vacation, the value of such fringe benefit will be limited to the expenses incurred in relation to such extended period of stay or vacation. The amount so determined shall be reduced by the amount, if any, paid or recovered from the employee for such benefit or amenity.

Free or concessional food and non-alcoholic beverages [Sub-rule 7(iii) of Rule 3]

The value of free food and non-alcoholic beverages provided by the employer shall be the amount of expenditure incurred by the employer as reduced by the amount, if any, paid or recovered from the employee for such benefit or amenity. However, the following shall not be chargeable as perquisites:

- (a) Free food and non-alcoholic beverages provided by the employer during the working hours at office or business premises up to Rs.50 per meal;
- (b) Free food and non-alcoholic beverages provided through paid vouchers which are not transferable and usable only at eating joints if the value thereof is up to Rs.50 per meal;
- (c) Tea or snacks provided during working hours; and
- (d) Free food and non-alcoholic beverages during working hours provided in a remote area or an offshore installation.

Value of gift, voucher or token in lieu of such gift [Sub-rule 7(iv) of Rule 3]

The value of any gift, or voucher or token in lieu of which such gift may be received by the employee or by member of his household on ceremonial occasions or otherwise from the employer shall be the sum equal to the amount of such gift. If the value of such gift, voucher or token is below Rs. 5,000 in the aggregate during the previous year, the value of perquisite shall be taken as nil.

Credit card expenses [Sub-rule 7(v) of Rule 3]

The amount of expenses including membership fees and annual fees incurred by the employee or any member of his household which is charged to a credit card (including add-on-card) provided by the employer or otherwise, paid for or reimbursed by the employer shall be taken to be the value of perquisite chargeable to tax. The amount so determined shall be reduced by the amount, if any, paid or recovered from the employee for such benefit or amenity. However, such expenses incurred wholly and exclusively for official purposes would not be treated as a perquisite if the following conditions are satisfied:

- (a) complete details in respect of such expenditure are maintained by the employer which may, inter alia, include the date of expenditure and the nature of expenditure;
- (b) the employer gives the certificate for such expenditure to the effect that the same - was incurred wholly and exclusively for the performance of official duties;

Club expenditure [Sub-rule 7(vi) of Rule 3]

If employer reimburses or makes payment of any expenditure incurred in a club including the amount of annual or periodical fee for the employee or any member of household, the actual amount of such expenditure shall be the value of perquisite. The amount so determined shall be reduced by the amount, if any, paid or recovered from the employee for such benefit or amenity. Where the employer has obtained corporate membership of the club and the facility is enjoyed by the employee or any member of his household, the value of perquisite shall not include the initial fee paid for acquiring such corporate membership.

If the employer provides uniformly to all employees the use of health club, sports and similar facilities, there will be no taxable perquisite in respect of such facilities. Besides, there will be no taxable perquisite if the club expenditure is incurred wholly and

exclusively for business purposes and the following conditions are fulfilled:

- (a) complete details in respect of such expenditure are maintained by the employer which may, inter alia, include the date of expenditure and the nature of expenditure and its business expediency;
- (b) the employer gives a certificate for such expenditure to the effect that the same was incurred wholly and exclusively for the performance of official duties.

Other benefit or amenity [Sub-rule 7(ix) of Rule 3]

The value of any other benefit or amenity, service, right or privilege provided by the employer shall be determined on the basis of cost to the employer under an arms' length transaction as reduced by the employee's contribution, if any. However, there will be no taxable perquisite in respect of expenses on telephones including mobile phone actually incurred on behalf of the employee by the employer i.e., if an employer pays or reimburses telephone bills or mobile phone charges of employee, there will be no taxable perquisite.

7. NOTIFICATION NO. 281/2007, DATED 27-11-2007

The Finance Act, 2007 inserted a new section 80-ID in the Income-tax Act, 1961 to provide for a 100% deduction of the profits and gains derived by an undertaking from the business of operating a hotel or from the business of building, owning and operating a convention centre in a specified area subject to the conditions prescribed therein.

Clause (a) of sub-section (6) of section 80-ID of the said Act defines a 'convention centre' as a building of prescribed area and having such other facilities as may be prescribed. Accordingly, a new rule 18DE and a new form 10CCBBA have been inserted in the Income-tax Rules for this purpose.

Rule 18DE prescribes the following conditions to be fulfilled in order to avail deduction under section 80-ID:

- (a) the convention centre shall have a minimum covered plinth area of 25,000 sq. mts;
- (b) it shall have minimum of 3,000 seating capacity;
- (c) there shall be minimum of 10 convention halls;
- (d) the convention centre shall have convention halls, whether called conference halls or seminar halls or auditorium for holding seminars and conferences;
- (e) each convention hall of the convention centre shall be equipped with modern public address system, slide and power-point projection system and LCD projector or video screening facility;
- (f) the convention centre shall have a documentation centre with computers and printers, telephone with STD or ISD facilities, e-mail, photocopy and scanning facility along with trained operators to provide these facilities;
- (g) the convention centre shall be completely centrally air-conditioned;

- (h) the convention centre shall have adequate parking facility and other public convenience as per local building regulations and should also fulfill all local building regulations in respect of fire and safety.

In addition to the above facilities, the convention centers may have the following:

- (a) an amphitheatre and landscaped open spaces for outdoor conference or seminar related activities;
- (b) a kitchen, dining facility, cafeteria or restaurant only to support events in the convention centre.

The new rule 18DE and the new form 10CCBBA will take effect from 1st April, 2008 and will, accordingly, apply in relation to A.Y.2008-09 and subsequent years.

8. NOTIFICATION NO. 2/2008, DATED 8-1-2008

The CBDT has substituted the existing Rule 18C with new Rule 18C, which lays down the following eligibility criteria for Industrial Parks to claim benefit under section 80-IA (4)(iii) -

- (1) The undertaking should begin to develop, develop and operate or maintain and operate an industrial park any time during the period from 1.4.2006 to 31.3.2009.
- (2) The undertaking and the Industrial Park should be notified by the Central Government under the Industrial Park Scheme, 2008.
- (3) The undertaking should continue to fulfill the conditions envisaged in the Industrial Park Scheme, 2008.

9. NOTIFICATION NO. 6/2008, DATED 14-1-2008

Section 10(15)(vii) exempts interest on bonds issued by a local authority or by a State Pooled Finance Entity and notified by the Central Government in the Official Gazette. Accordingly, the Central Government has specified the "Tax-free Pooled Finance Development Bonds" under Pooled Finance Development Fund Scheme of Government of India, interest from which would be exempt under section 10(15)(vii).

10. NOTIFICATION NO. 7/2008, DATED 15-1-2008

As per section 10(39), any specified income arising from any notified international sporting event held in India, to the person or persons notified by the Central Government in the Official Gazette, is exempt from tax. Accordingly, in exercise of the powers conferred by section 10(39), the Central Government has notified the following:

- (a) the Commonwealth Games Federation, London, United Kingdom as the person,
- (b) the Commonwealth Games 2010 to be held in India, as the international sporting event,
- (c) the income arising to Commonwealth Games Federation from Commonwealth Games 2010 on account of Host Fee, received or receivable from the Organising Committee Commonwealth Games 2010 Delhi, India amounting to 7.3 million GBP, as the specified income,

for the purposes of exemption under section 10(39).

11. NOTIFICATION NO. 11/2008, DATED 18-1-2008

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

Explanation (i) to clause (ba) of sub-section (1) of section 115WC of the Income-tax Act defines fair market value to mean the value determined in accordance with the method as may be prescribed by the Board. A new rule 40D has been inserted in the Income-tax Rules w.e.f. A.Y.2008-09 for the purposes of valuation of specified security not being an equity share in the company.

As per new Rule 40D, for the purposes of section 115WC(1)(ba), the fair market value of any specified security, not being an equity share in a company, on the date on which the option vests with the employee, shall be such value as determined by a merchant banker on the specified date.

12. NOTIFICATION NO. 20/2008, DATED 5-2-2008

The CBDT has inserted new Rule 14B, which lays down the guidelines for the purposes of determining expenses for audit under section 142(2A).

The said notification is applicable when the audit under section 142(2A) is directed by an Assessing Officer on or after 1st June, 2007. The expenses of, and incidental to, audit (including the remuneration of the accountant, qualified assistants, semi-qualified and other assistants who may be engaged by such Accountant) should not be less than Rs.3750 and not more than Rs.7500 for every hour of the period as specified by the Assessing Officer under section 142(2C). Such period shall be specified in terms of the number of hours required for completing the report.

13. NOTIFICATION NO. 21/2008, DATED 5-2-2008

Section 36(1)(xii) provides that deduction shall be allowed in respect of any expenditure (not being a capital expenditure) incurred by a corporation or a body corporate, by whatever name called, if such corporation or a body corporate is, inter alia, notified by the Central Government in the Official Gazette. Accordingly, the Central Government has notified the Oil Industry Development Board for the purpose of deduction under section 36(1)(xii), w.e.f. A.Y.2008-09.

14. NOTIFICATION NO. 23/2008, DATED 6-2-2008

Section 2(48) defining zero coupon bonds requires that such bonds should be notified by the Central Government. Accordingly, the Central Government has, vide this Notification, specified the 10 year zero coupon bonds of National Housing Bank (NHB), to be issued on or before 31.3.2009, as zero coupon bonds for the purposes of section 2(48).

15. NOTIFICATION NO. 34/2008, DATED 13-3-2008

The CBDT has inserted a new Rule 125 which has made electronic payment of taxes (including interest and penalty) by corporate assessees and assesseees subject to tax audit mandatory on or after 1st April 2008. Electronic payment of taxes means payment of taxes by way of internet banking facility or credit or debit cards.

16. NOTIFICATION NO. 45/2008, DATED 24-3-2008

The CBDT has inserted a new Rule 8D which lays down the method for determining amount of expenditure in relation to income not includible in total income.

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

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

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

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

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

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

Where,

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

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

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

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

17. NOTIFICATION NO. S.O. 752(E), DATED 28-3-2008

The CBDT has notified income-tax return forms for the A.Y. 2008-09. In Appendix II, Form ITR-1, Form ITR-2, Form ITR-3, Form ITR-4, Form ITR-5, Form ITR-6, Form ITR-7 and Form ITR-8 have been substituted by new forms.

S. No.	Form No.	Description
1	ITR-1	For Individuals having income from Salary & Interest
2	ITR-2	For Individuals & HUFs not having Income from Business or Profession
3	ITR-3	For Individuals/HUFs being partners in firms and not carrying out business or profession under any proprietorship
4	ITR-4	For Individuals & HUFs having income from a proprietary business or profession
5	ITR-5	For firms, AOPs and BOIs
6	ITR-6	For Companies other than companies claiming exemption under section 11
7	ITR-7	For persons including companies required to furnish return under section 139(4A) or section 139(4B) or section 13(4C) or section 139(4D). (Not available for e-Filing)
8	ITR-8	Return of Fringe Benefits

CIRCULARS

1. CIRCULAR NO.4/2007 DATED 15.6.2007

This Circular provides the tests for distinction between shares held as stock-in-trade and shares held as investment.

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

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

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

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

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

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

- (3) The Authority for Advance Rulings (AAR) 288 ITR 641, referring to the decisions of the Supreme Court in several cases, has culled out the following principles :-

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

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

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

2. CIRCULAR NO. 6/2007, DATED 11-10-2007

This Circular is to clarify the issue of allowability of the claim of harvesting and transportation expenses incurred by the Co-operative sugar mills for procuring sugarcane from farmers, who are members of such Co-operative Sugar Mills and who are bound under an agreement to supply the sugarcane exclusively to the concerned sugar Mill.

The issue of allowability of such expenses in the case of Co-operative Sugar Mills has been examined by the CBDT. These expenses are incurred by the Sugar Mills for ensuring an adequate and sustained supply of freshly cut sugarcane that is an essential input for the continuous running of such Mills. These expenses are, therefore, incurred for commercial expediency and are prima facie wholly and exclusively for the purpose of business. Such expenses are, therefore, allowable in the computation of the income of the Co-operative Sugar Mills.

3. CIRCULAR NO. 1/2008, DATED 10-1-2008

This Circular provides clarification regarding applicability of provisions of section 194-I to payments made by the customers on account of cooling charges to the cold storage owners.

The main function of the cold storage is to preserve perishable goods by means of a mechanical process, and storage of such goods is only incidental in nature. The customer is also not given any right to use any demarcated space/place or the machinery of the cold store and thus does not become a tenant. Therefore, the provisions of 194-I are not applicable to the cooling charges paid by the customers of the cold storage.

However, since the arrangement between the customers and cold storage owners are basically contractual in nature, the provisions of section 194-C would be applicable to the amounts paid as cooling charges by the customers of the cold storage.

4. CIRCULAR NO. 2/2008, DATED 22-2-2008

Securities and Exchange Board of India (SEBI) vide Circular No. MRD/DoP/SE/DEP/Cir. 14/2007, dated 20-12-2007, has decided to permit all classes of investors (individuals, institutional, etc.) to short sell. Further, with a view to provide a mechanism for borrowing of securities to enable settlement of securities sold short, SEBI has also decided to put in place a full-fledged Securities Lending and Borrowing (SLB) Scheme for all market participants in the Indian securities market under the overall framework of Securities Lending Scheme, 1997 of SEBI.

In this context, the following taxation issues have arisen in respect of transactions under the scheme of securities lending -

- (i) Would the lending/borrowing of securities under the Securities Lending Scheme amount to a transfer under section 2(47) in the hands of the lender?
- (ii) Would lending/borrowing of the securities be subject to Securities Transaction Tax (STT)?

The Lending and Borrowing of Securities under the new scheme notified by SEBI vide Circular No. MRD/DoP/SE/DEP/Cir.14/2007, dated 20-12-2007 is in accordance with the overall framework of the Securities Lending Scheme of 1997. Accordingly, the provisions of section 47(xv) will be equally applicable in respect of the transactions under the new scheme.

Securities Transaction Tax (STT) is levied on purchase or sale of an equity share, unit and derivative, under such circumstances as specified in section 98 of the Finance (No. 2) Act, 2004. The transactions in the nature of lending and borrowing under the new scheme do not fall within the scope of section 98 to the Finance (No.2) Act, 2004. Therefore, the transactions of lending and borrowing are not liable to Securities Transaction Tax (STT).

5. CIRCULAR NO. 4/2008, DATED 28-4-2008

This Circular provides clarification on deduction of tax at source (TDS) on service tax component of rental income under section 194-I.

As per the provisions of 194-I, tax is deductible at source on income by way of rent paid to any resident. Further, rent has been defined in 194-I to mean any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of (either separately or together) any,-

- (a) land; or
- (b) building (including factory building); or
- (c) land appurtenant to a building (including factory building); or
- (d) machinery; or
- (e) plant; or
- (f) equipment; or
- (g) furniture; or
- (h) fittings,

whether or not any or all of the above are owned by the payee.

Service tax paid by the tenant doesn't partake the nature of income of the landlord. The landlord only acts as a collecting agency for Government for collection of service tax. Therefore, tax deduction at source under section 194-I would be required to be made on the amount of rent paid/payable without including the service tax.

6. CIRCULAR NO. 9/2007, DATED 20-12-2007

Explanatory circular on Fringe Benefit Tax arising on allotment or transfer of specified securities or sweat equity shares

1. In terms of the provisions of Chapter XII-H of the Income-tax Act, an employer, being a company, is liable to pay Fringe Benefit Tax (FBT) in respect of the fringe

benefits provided or deemed to have been provided by it to its employees, directly or indirectly, during the previous year.

With a view to bring grant of stock options by employers to employees within the purview of FBT, Finance Act, 2007 has inserted a new clause (d) in section 115WB(1). The salient features of this provision are:-

- (i) FBT shall apply in all cases where any specified security or sweat equity shares has been allotted or transferred by the employer to his employees;
- (ii) FBT shall be payable in the previous year in which such allotment or transfer has taken place;
- (iii) the provisions of this new clause shall apply even if the allotment or transfer is made directly or indirectly;
- (iv) the provisions of this new clause shall apply even if the allotment or transfer is free of cost or at concessional rate;
- (v) the provisions of this new clause shall apply even if the allotment or transfer is to current or former employee or employees;
- (vi) the provisions of this new clause shall apply in cases where the allotment or transfer is on or after 1st April, 2007.

The expressions specified security and sweat equity shares have also been defined. The value of fringe benefit is subjected to FBT at the prevailing rate, which is currently 30% plus surcharge plus education cess.

2. Method of computation of the value of the fringe benefit

Under the existing provisions contained in section 115WC, the method of computation of the value of fringe benefits referred to in section 115WB has been provided. A new clause (ba) has been inserted in sub-section (1) of the said section 115WC to provide for computation of fringe benefit related to allotment or transfer of specified security or sweat equity shares by employers to employees.

It has been provided that the value of fringe benefit in such cases shall be determined in accordance with the formula -

$A - B$

Where,

A = the Fair Market Value (FMV) of the specified security or sweat equity shares on the date of vesting of the option. Such value has to be determined in accordance with the method as may be prescribed by the CBDT; and

B = the amount, if any, actually paid by, or recovered from the employee;

Option means a right but not an obligation granted to an employee to apply for the specified security or sweat equity shares at a predetermined price.

The CBDT has, vide notification S.O. number 1805(E) dated 23rd October, 2007, inserted Rule 40C in the Income-tax Rules, which has prescribed the method for determination of fair market value of specified security or sweat equity share, being a share in the company [See Notification No.264/2007 dated 23.10.2007 given under Notifications].

3. Determination of the cost of acquisition for capital gains purposes

Consequent to insertion of clause (ba) in sub-section (1) of section 115WC providing for the valuation of fringe benefits referred to in clause (d) of sub-section (1) of section 115WB, a new sub-section (2AB) has been inserted in section 49.

This new sub-section provides that the cost of acquisition of specified security or sweat equity shares shall be the fair market value which has been taken into account while computing the value of fringe benefit under the new clause (ba) of sub-section (1) of section 115WC.

4. Determination of the period of holding

A new sub-clause (hb) has also been inserted in clause (i) of Explanation 1 to clause (42A) of section 2. This new sub-clause provides that the period of holding in case of such specified security or sweat equity shares, in the hand of the employee, shall be reckoned from the date of allotment or transfer of such security or shares.

5. Recovery of FBT by the employer from its employee

A new section 115WK has also been inserted enabling the employer to recover the fringe benefit tax from the employee in respect of specified security or sweat equity shares, if such security or shares are transferred or allotted to the employee on or after 1st April, 2007.

It has been prescribed that the employer can vary the agreement or scheme under which such specified security or sweat equity shares has been allotted or transferred. The agreement or scheme can be varied with a purpose to recover from the employee the fringe benefit tax to the extent to which such employer is liable to pay the fringe benefit tax in relation to the allotment or transfer of such specified security or sweat equity shares to such employee.

6. Illustration

The above amendments are explained with the help of an illustration.

A company X grants option to its employee R on 1st April, 2004 to apply for 100 shares of the company at a pre-determined price of Rs.50 per share with date of vesting of the option being 1st April, 2006 and exercise period being 1st April, 2006 to 31st March, 2010.

Employee R exercises his option on 31st March, 2007 and shares are allotted/transferred to him on 3rd April, 2007. On 25th October, 2007, these shares are sold for Rs.200/- each. On the date of vesting of the option, fair market value of

the share was Rs.80/- per share. The tax implication of above situation will be as under:-

Since shares are allotted or transferred on or after 1st April, 2007, provisions of fringe benefit tax are attracted. Fringe benefit with respect to employee R is $(Rs.80 - Rs.50) \times 100 = Rs. 3,000$.

Company X will pay fringe benefit tax on Rs.3,000.

Cost of acquisition in the hands of employee R = Rs.80 per share

Capital gain = $(Rs.200 - Rs.80) \times 100 = Rs.12,000$

Period of holding = 3rd April, 2007 to 25th October, 2007 i.e., less than 12 months. Hence, the amount of Rs.12,000 will be charged to tax as short term capital gain.

7. Frequently Asked Questions

1. Whether a foreign company is liable to pay FBT on shares allotted or transferred to the employees of its Indian subsidiary?

In terms of the provisions of Chapter XII-H of the Act, an employer, being a company, is liable to pay FBT in respect of the fringe benefits provided or deemed to have been provided by it to its employees, directly or indirectly, during the previous year. Since the shares are allotted or transferred to employees of the Indian subsidiary, by virtue of their employment with the subsidiary company, the liability to pay fringe benefit tax on such shares vests upon the Indian subsidiary and not on the foreign company.

2. Whether charge back of costs by the foreign company to the Indian subsidiary is relevant to determine the obligation of the Indian company to pay FBT?

As stated in answer No.1, the Indian subsidiary is liable to fringe benefit tax irrespective of whether or not there is a charge back of cost by the foreign holding company.

3. Will FBT apply in case of employees of the Indian subsidiary for shares awarded by the foreign holding company if the employees of the Indian subsidiary are allotted or transferred shares while outside India?

In the answer to Question No.20 of CBDT Circular No.8/2005 dated 29.8.2005, it has been clarified that an employer is liable to fringe benefit tax on the value of fringe benefits provided or deemed to have been provided to employees based in India. Therefore, an Indian subsidiary would be liable to pay FBT in respect of the value of the shares allotted or transferred by the foreign holding company if the employee was based in India at any time during the period beginning with the grant of the option and ending with the date of vesting of such option (hereafter such period is referred to as grant period), irrespective of the place of location of the employee at the time of allotment or transfer of such shares.

4. How will the value of fringe benefit be determined in case where the employee was based in India only for a part of the grant period?

In a case where the employee was based in India only for a part of grant period, a proportionate amount of the value of the fringe benefit will be liable to FBT. The proportionate amount shall be determined by applying to the value of the fringe benefit, the proportion which the length of the period of stay in India by the employee during the grant period bears to the length of the grant period.

The value of fringe benefit means the fair market value of the specified security or sweat equity shares, on the date on which the option vests with the employee, as reduced by the amount actually paid by, or recovered from, the employee in respect of such shares.

5. Whether a foreign company is liable to fringe benefit tax in respect of shares allotted or transferred to an employee who is deputed to work in India in the year of such allotment or transfer?

A foreign company is liable to FBT in respect of shares allotted or transferred to its employee who is based in India. However, in such cases only a proportionate amount of the value of the fringe benefit will be liable to FBT. The proportionate value shall be determined by applying to the value of the fringe benefit, the proportion which the length of the period of stay in India by the employee during the grant period bears to the length of the grant period.

The value of fringe benefit means the fair market value of the specified security or sweat equity shares, on the date on which the option vests with the employee, as reduced by the amount actually paid by, or recovered from, the employee in respect of such shares.

6. What will be the cost of acquisition of shares, referred to in question nos 4 and 5, where only a proportionate value of fringe benefit has been subjected to FBT?

In accordance with section 49(2AB), the cost of acquisition of such shares shall be the fair market value on the date on which the option vests with the employee. The calculation of fringe benefit for the purpose of determining FBT does not change this value. Hence, the subsequent calculation of reducing such fair market value by the amount actually paid by or recovered from the employee as well as the calculation of proportionate value in certain cases, referred to in Question No.4 & 5 above, will not change the cost of acquisition.

7. Where the benefit on account of shares allotted or transferred under Employee Stock Option Plans (ESOPs) is taxed in the hands of the employees in different countries, would the employer still be liable to FBT? If yes, can the employer claim credit for payment of tax by the employee in other countries?

Employer will be liable to FBT in India irrespective of whether employees have

been charged to tax in different countries or not. An employer cannot claim any credit in India against its FBT liability for taxes paid by employees in other countries.

8. Where FBT, on account of shares allotted or transferred under ESOPs, has been paid by the employer in respect of an employee based in India and subsequently recovered from him, can such employee claim credit in a foreign country for this FBT paid by the employer in India?

Ordinarily, the employee is liable to tax in respect of fringe benefits received by him from his employer. However, the taxation of fringe benefits in the hands of the employee raises several problems. Accordingly, it was decided to introduce FBT as a surrogate tax on employer in respect of the fringe benefits provided or deemed to have been provided by it to its employees during the previous year. This being so, in a case where FBT, on account of share allotted or transferred ESOPs, has been paid by the employer in respect of an employee based in India and subsequently recovered from him; the FBT is effectively paid by the employee in respect of fringe benefits enjoyed by him. Therefore, such employee can claim credit, in a foreign country, for the FBT, on account of shares allotted or transferred under ESOPs, paid by the employer in India.

9. Whether the benefits arising on account of shares allotted or transferred under ESOPs can be taxed as a perquisite under section 17 of the Act instead of being taxed as fringe benefit under Chapter XII-H of the said Act, at the option of the employer?

Any fringe benefit liable to be taxed in the hands of the employer under Chapter XII-H cannot be taxed in the hands of the employee as a perquisite under section 17 of the said Act. Therefore, an employer does not have an option to tax the benefit arising on account of shares allotted or transferred under ESOPs as perquisite which otherwise is to be taxed as fringe benefit.

10. Whether there will be any FBT liability in a case where the FMV on the date of vesting is less than the price paid by the employee to the employer for allotment or transfer of shares?

No. FBT would not be payable in such cases.

11. What will be the valuation methodology for foreign companies if the shares are not listed in a recognized stock exchange in India but are listed on any globally recognised stock exchange?

If the shares are not listed in a recognized stock exchange in India, the shares will be treated as unlisted. Accordingly, such shares will have to be valued by category 1 Merchant Banker registered with Securities and Exchange Board of India. However, if the shares are listed in any globally recognised stock exchange, the merchant banker shall use the listed price as one of the basis for valuation and recommend the best value.

12. Whether an independent valuation carried by any foreign merchant banker/other experts as recognized for the purposes of valuation in the foreign country be treated as sufficient compliance for the purposes of valuation of fringe benefit arising on account of allotment or transfer of shares under ESOPs of an unlisted foreign company or is it mandatory that the merchant banker should be registered with the Securities and Exchange Board of India?

For the purposes of valuation of fringe benefit arising on account of allotment or transfer of shares under ESOPs of an unlisted foreign company, it is mandatory for the valuer to be a Category I Merchant Banker registered with the Securities and Exchange Board of India.

13. When there exists different methods for valuing FMV for unlisted companies, which method should be used by the merchant bankers to determine the FMV?

The Merchant Banker should determine the FMV on the basis of alternative methods and recommend the most appropriate value.

14. What is the significance of specified date? Whether the valuation is to be made on a specified date or specified security or sweat equity share is to be valued as on the specified date?

The process of valuation may be carried out by the merchant banker at any time before or after the date of vesting of the option, but the specified security or the sweat equity share is required to be valued as on the specified date.

15. What is the FMV that a company should adopt if the shares have been valued by more than one merchant banker or by one merchant banker on more than one occasion?

The valuation which value the specified security or sweat equity share on the specified date, which is closest to the date of the vesting of the option, should be adopted, if the shares have been valued by more than one Merchant Banker or by one Merchant Banker on more than one occasion.

16. Whether the fringe benefit arising on account of shares allotted or transferred under an ESOP is allowed as deduction in calculating the taxable income of the employer company?

In case where the employer purchases the shares and then subsequently transfers such shares to its employees, the expenditure so incurred is allowable as deduction in computing the taxable income of the employer company. However, if the shares are allotted to the employees from the share capital of the company, no deduction is allowable in computing the taxable income of the company since no expenditure has been incurred by it.

17. Whether ESOPs issued to non-executive directors or non-employees liable to FBT?

Benefit arising out of ESOPs issued to non-employees will not be liable to FBT. However, in such cases, the taxability of such benefits in the hands of the non-employees will be determined in accordance with the existing law.

18. Which method, first-in-first-out (FIFO) or last-in-first-out (LIFO) shall be followed in case there are multiple date of vesting for different number of shares. For example, if the dates of vesting are:

31 Mar 06 - 300 options FMV Rs.8 per share (one share per option)

31 Mar 07 - 300 options FMV Rs.9 per share (one share per option) and the employee is allotted 500 shares as on 30th September 2007, how will FBT be calculated?

In such cases, the First-in-First-Out (FIFO) method shall be followed. Hence, the FBT shall be calculated with respect to 300 shares at FMV of Rs.8 per share and 200 shares at FMV of Rs.9 per share.

19. Whether it is binding upon the Assessing Officer to accept the valuation made by the merchant banker?

It is binding upon the Assessing Officer to accept the valuation made by the Merchant Banker unless the valuation by such banker is perverse.

20. How would the recovery of FBT be treated in the hands of the employer?

Since FBT is not an allowable deduction in computation of the income of the employer, any recovery of FBT will not be treated as income in his hands.

21. What should be the mechanism and timing of recovery of FBT?

The law does not provide for any specific mechanism or timing of recovery of FBT.

22. Is it lawful for the employer to recover FBT with respect to ESOPs granted prior to April 1, 2007?

It would be lawful for the employer to recover FBT with respect to ESOPs granted prior to April 1, 2007, but allotted or transferred to the employee after such date.

23. What will be the date of allotment of an Employee Stock Option?

The date of allotment of an Employee Stock Option shall be the date on which the underlying asset is allotted or transferred to the employee

24. Whether the FBT recovered from the employee would form the cost basis for employee for calculating Capital Gain on subsequent sale of shares?

No. The recovery of FBT from the employee by the employer will not change the cost of acquisition of the shares in the hand of the employee.

25. Will Rule 40C of Income-tax Rules also apply in a case where shares are allotted or transferred to an employee under Employee Stock Purchase Plan, or Employee Stock Option Scheme, or Employee Stock Ownership Plan, or Employee Stock Purchase Scheme, or Employee Stock Option Scheme or Employee Appreciation Rights or Plans?

Rule 40C shall apply in all cases where specified security or sweat equity shares, being shares in a company, are allotted or transferred to an employee under any scheme or plan or otherwise. For the purpose of this circular an Employees Stock Option Plan shall include all such schemes or plans, etc.