

PAPER – 7 : DIRECT TAXES

QUESTIONS

1. Mr. Ganesh, an employee of a co-operative bank, received a certain sum by way of leave encashment while in service from his employer, in respect of which he claimed exemption under section 10(10AA), on the contention that the words 'or otherwise' in section 10(10AA) indicated that the exemption was to be given as and when there was a payment to the assessee in lieu of leave encashment and did not restrict the purview of the exemption to retiring employees only. Is Mr. Ganesh correct in claiming exemption under section 10(10AA) in respect of leave encashment received by him while in service? Discuss.
2. X Ltd. had let out the house property owned by it to the employees of its sister concern, Y Ltd. Under what head of income should the income from the house property of X Ltd., occupied by the employees of its sister concern Y Ltd., be assessed? Can X Ltd. claim that such income is not chargeable under the head "Income from house property", on the ground that the property is occupied for the purpose of its business or profession?
3. Heritage Public Charitable Trust runs a hospital, which derived income of Rs.325 lakhs from its operational activities. Expenses incurred to earn such income are Rs.80 lakhs. Depreciation on assets used in the hospital is Rs.22 lakhs. Out of the income of Rs.325 lakhs, the amount accrued but not received as on 31-03-2006 is Rs.45 lakhs. The institution earmarked and set apart Rs.42 lakhs in March, 2006 to give as advance for a floor of a building intended to be taken on lease for transfer of the Neurology department of the hospital, but the amount was paid on 13th April, 2006, as the lease agreement could not be signed by 31st March, 2006. The trust has got a software package developed and installed by Infosys during the year. The total cost to the trust on account of the software package was Rs.72 lakhs. The trust has also incurred Rs.23 lakhs for purchase of computer systems for use in the hospital. Compute the total income of the trust for A.Y.2006-07.
4. A Ltd. was a wholly owned subsidiary company of B Ltd. An agreement was entered into between B Ltd. and A Ltd., by which the textile unit belonging to B Ltd. was transferred to A Ltd.. The agreement provided, inter-alia, for continuity of service of workmen who were employed in the textile unit of B Ltd. taken over by A Ltd. and the agreement also protected the conditions of service of workmen. B Ltd. delivered possession of the properties to A Ltd. and the employees of B Ltd. working in the textile unit were transferred to A Ltd. with the benefit of continuity of service. For the subsequent two assessment years, A Ltd. claimed deduction of a certain sum as gratuity payment to workers (who were erstwhile employees of B Ltd.), who had retired during the relevant previous years. The Assessing Officer disallowed the same on the ground that the liability of A Ltd. towards gratuity payment for the employees for the services rendered by them in the period prior to the takeover of the unit would be a capital expenditure. Is the reasoning of the Assessing Officer correct? Discuss.
5. Can the expenditure incurred by an assessee to remove an encumbrance be allowed as a deduction under section 48, in the following cases -
 - (a) where the mortgage was created by the assessee himself;
 - (b) where the mortgage was created by the previous owner.Discuss with reference to a recent case law.
6. Axel Ltd. has two industrial undertakings - Unit I is engaged in production of television sets and Unit II is engaged in the production of refrigerators. The company has, as part of its restructuring program, decided to sell Unit II as a going concern by way of slump sale for Rs.520 lakhs to a new company called Gamma Ltd., in which it holds 85% equity shares. The following is the extract of the balance sheet of Axel Ltd. as on 31st March, 2006 :

	Rs. in lakhs	
	Unit I	Unit II
Fixed Assets	225	315
Debtors	175	135
Inventories	120	45
Liabilities	65	90
Paid up share capital	Rs.462 lakhs	
General Reserve	Rs.320 lakhs	
Share premium	Rs.78 lakhs	
Revaluation Reserve	Rs.210 lakhs	

The company set up Unit II on 1st April, 2002. The written down value of the block of assets for tax purpose as on 31st March, 2006 is Rs.300 lakhs of which Rs.120 lakhs are attributable to Unit II.

- (i) Determine what would be the tax liability of Axel Ltd. on account of slump sale;
 - (ii) How can the restructuring plan of Axel Ltd. be modified, without changing the amount of consideration, in order to make it more tax efficient?
7. Alpha Ltd., a running concern, received interest on the loans/advances made by it to its debtors. It contended that such interest was to be treated as business income. Discuss the correctness of the contention of Alpha Ltd., if such interest was not on account of delayed payment towards sales or compensation/damages or an item relatable to its business.
 8. Can income from cold storage be exempt under section 80P(2)(e), by considering the cold storage as a warehouse or godown where goods are stored?
 9. Prem, an employee of a bank, had opted for voluntary retirement and was paid Rs.6,15,000 by the employer under the special scheme of VRS framed in accordance with the guidelines prescribed under Rule 21A of the Income-tax Rules, 1962, in addition to other retirement benefits like gratuity, leave encashment etc. Prem claimed exemption of Rs.5 lakhs under section 10(10C) in respect of the VRS received and offered the balance as income from salary. He, however, claimed relief under section 89(1) on the balance amount by spreading the same in three preceding assessment years as provided in Rule 21A. The Assessing Officer while allowing the claim under section 10(10C), disallowed the relief claimed under section 89(1) on the ground that once exemption was allowed under section 10(10C), no further exemption could be allowed in relation to any other assessment year in view of the second proviso to section 10(10C). Is the contention of the Assessing Officer correct? Discuss.
 10. Essel Shipping Company Limited in Chennai plies three ocean-going vessels owned by it. The registered tonnage of the three vessels are – (i) 36,642 tons and 200 kgs; (ii) 43,356 tons and 500 kgs; (iii) 26,435 tons and 900 kgs. During the year 2005-06, the first vessel was operated for 280 days, the second vessel for 340 days and the third vessel for 175 days. The following data is available from the accounts of the company -
 - (i) Profit from core shipping activity Rs.103.32 lakhs
 - (ii) Profit from incidental activity Rs.23,000.
 Compute the tax payable by the company for the A.Y. 2006-07, applying the provisions of Chapter XII-G, which provides for special provisions for taxation of the income of shipping companies.
 11. The assessment of ABC Ltd. was completed under section 143(3). The assessing authority subsequently reopened the assessment by relying upon the circular issued by the CBDT in which the Board had given a direction to subordinate authorities to treat the ex-gratia amounts paid by the company to its employees under the Voluntary Retirement Scheme (VRS) as capital

expenditure. On writ, ABC Ltd. contended that the circular issued was contrary to the provisions of the Act and also that it was beyond the powers of the CBDT to issue such a circular against the interest of the assessee. Discuss the correctness or otherwise of ABC Ltd.'s contention.

12. The fringe benefits tax has been introduced by the insertion of Chapter XII-H in the Income-tax Act, 1961. Discuss the meaning of the following terms used in this Chapter -
 - (i) Fringe benefits.
 - (ii) Deemed fringe benefits.
13. Write short notes on the following -
 - (i) Belated return of fringe benefits
 - (ii) Revised return of fringe benefits
 - (iii) Advance tax in respect of fringe benefits
14. Is benefit of deduction under section 10B available to undertakings set up in domestic tariff area (DTA) subsequently approved as a 100% export oriented undertaking (100% EOU)? If yes, from which year and for what period is such deduction available?
15. Pursuant to a search conducted in the premises of Mr. Sriram, certain seizures were made. Mr. Sriram filed an application for settlement in terms of section 245C claiming to have received the amount by way of loan from several persons. The Settlement Commission accepted his statement and made an order under section 245D(4). The CBI, however, conducted enquiry at the request of the Revenue regarding the loans and opined that the alleged lenders had no means or financial capacity to advance such huge loans to the assessee and were mere name lenders. The Commissioner filed an application under section 245D(6) praying for the order to be declared void and for withdrawal of benefit granted. Mr. Sriram, however, contended that the order of the Settlement Commission was final in terms of section 245-I and any fresh analysis would amount to sitting in judgement over an earlier decision, for which the Settlement Commission was not empowered. Discuss the correctness of Mr. Sriram's contention.
16. Beta Ltd. filed its return declaring income computed as per the provisions of section 115JB. While processing the return, the Assessing Officer charged interest under sections 234B and 234C on the tax determined on the returned income. On appeal, the Commissioner (Appeals) deleted the levy of interest under sections 234B and 234C and held that such interest was not leviable since profits under section 115JB can only be determined after the close of the year. Analyse, with the help of a recent case law, whether the provisions of section 234B and 234C are attracted in a case where Beta Ltd. is assessed on the income computed under section 115JB?
17. What is the penalty leviable under the Income-tax Act for -
 - (a) failure to comply with notice issued under section 115D(2) to file a return of fringe benefits;
 - (b) concealment of particulars of fringe benefits or furnishing inaccurate particulars of fringe benefits;
 - (c) failure to furnish return of fringe benefits within the prescribed time.
18. Who are the persons vested with the responsibility to prepare and furnish quarterly returns in respect of payment of interest to residents without deduction of tax? What are the periods in respect of which the same should be prepared and to whom should it be delivered? What are the penal provisions for default in preparing and delivering such quarterly returns? Discuss.
19. Sterling Constructions Ltd. furnishes the following particulars of its wealth for the valuation date 31st March 2006. Compute its net wealth on valuation date.

<i>Particulars</i>	<i>Rs. in lakhs</i>
(i) Land in urban area (held as stock-in-trade since 1992)	52
(ii) Flats constructed remaining unsold (not held as stock)	47

(iii)	Motor car (including one imported car worth Rs.8 lakhs)	17
(iv)	Jewellery	6
(v)	Aircrafts	125
(vi)	Ships	107
(vii)	Cash in hand as per cash book	6.2
(viii)	Bank balance	37.7
(ix)	Guest house in rural area	13
(x)	Residential flats of uniform area provided to 5 employees (salary of 2 employees exceed Rs.5 lakhs p.a.)	25
(xi)	Residential house provided to a whole-time director (whose salary is Rs.4 lakhs p.a.)	9

The company has taken the following loans -

(a)	For purchase of land in urban area	20
(b)	For purchase of jewellery	4
(c)	For purchase of guest house in rural area	10
(d)	For purchase of ships	80

20. Mr. Hari furnishes the following particulars for compiling his wealth-tax return for A.Y.2006-07 -

Particulars	Rs.
Gift of jewellery made to Mrs. Hari – Rs.1,15,000	
Market value as on valuation date 31.3.2006	3,25,000
Residential house purchased under installment payment system in August 1973 used for self-occupation (Installment remaining unpaid Rs.40,000)	
Value as per Schedule III as on valuation date 31.3.74	5,40,000
Market value as on 31.3.2006	10,00,000
Vacant urban land transferred to minor handicapped child .	
Value as on 31.3.2006	3,50,000

SUGGESTED ANSWERS/HINTS

1. This issue came up before the Allahabad High Court in *CIT v. Vijai Pal Singh (2005) 144 Taxman 504*. The High Court observed that the words 'or otherwise' would draw the restricted meaning *qua* the immediately preceding word 'superannuation'. The superannuation is of an employee's severance of relationship of contract of employment with the employer. The phrase 'or otherwise' would cover only such an eventuality when there is severance of relationship of employer and employee and contract of employment. Therefore, the phrase 'or otherwise' will not cover such cases where there is no severance of relationship of employer and employee and the assessee continues to be under the employment of the same employer, and receives leave encashment. The Court held that this interpretation is in consonance with the legislative history of the section and it manifests the intention of the Legislature to give a limited benefit to an employee with respect to the income received by him at the time of his retirement or superannuation or severance of relationship.

Therefore, in view of the above case, exemption under section 10(10AA) cannot be claimed by Mr. Ganesh in respect of leave encashment received by him while in service from his employer.

2. These questions have been answered by the Madras High Court in *CIT vs. T.V. Sundaram Iyengar & Sons Ltd. (2005) 145 Taxman 380 / (2004) 271 ITR 0079*. The High Court observed that in order to claim exemption in respect of income from house property under section 22, the assessee must satisfy two conditions, namely –

- (1) the property or portion thereof must be occupied by the assessee for the purposes of his business or profession; and
- (2) the profits of such business should be chargeable to income-tax.

The issue under consideration is that in order to avail the exemption under section 22, is it necessary that the property must be –

- (i) in direct occupation of the assessee-company, and
- (ii) used as such for transaction of the assessee's business or profession.

The High Court observed that the term 'occupy' appearing in section 22, when judicially interpreted, means occupation, directly by the assessee himself or through an employee or agent, subservient and necessary for the performance of the duties in connection with the business of the company. The assessee had let out the properties in question to the employees of its sister concern, who were separate and independent assesseees by themselves, which made a vast difference from letting out of properties to the employees of the assessee itself. Therefore, the occupation of the properties in question by the employees of the sister concern could not be construed as an occupation by the employees of the assessee itself, in the absence of any specific provision in law to that effect.

Therefore, the income from the property let out to the employees of the sister concern Y Ltd. should be treated as income from house property of X Ltd. under section 22.

3. The total income of Heritage Charitable Trust for the A.Y. 2006-07 is computed hereunder:

Particulars	Rs. in lakhs	
Income derived from property held under trust	325.00	
Less: Expenses incurred thereto	80	
Depreciation on assets	22	102.00
	223.00	
Less: 15% to be set apart (15% of Rs.223 lakhs)	33.45	
	189.55	
Less: Income not received during the year, which can be spent in the year of receipt or in the immediately following year	45.00	
	144.55	
Less: Non-application of income due to delay in signing lease agreement [The amount was applied on 13.4.2006 i.e. in the immediately following year – Option to be exercised in writing before the expiry of the time allowed under section 139(1) for furnishing the return of income]	42.00	
Amount to be applied for the objects of the trust by 31.3.2006	102.55	
Less: Amount applied for the objects of the trust		
(i) For development and installation of a software package for the purpose of the trust	72	
(ii) For purchase of computer systems for the purpose of the trust	23	95.00
Taxable Income	7.55	

Note -

- (i) If the income applied to charitable purposes in India falls short of 85% of the income derived during the year from property held under trust for the reason that the whole or any part of its income has not been received during that year, then such income, at the option of the person in receipt of income, can be applied during the previous year in which the income is received or in the immediately following previous year. The option is to be exercised in writing before expiry of the time allowed u/s 139(1) for filing return of income.
 - (ii) The word "applied" used in section 11 means that the income is actually applied for the charitable purposes of the trust. The word "applied" does not necessarily imply "spent". Even if a certain amount is irretrievably earmarked and allocated for charitable purposes, the said amount can be deemed to have been applied for charitable purposes. [*CIT vs. Trustees of H.E.H. Nizams Charitable Trust, (1981) 131 ITR 497 (AP).*]
 - (iii) The cost of developing a software package and installing the same is a capital expenditure. A charitable trust can apply its income either for revenue purposes or for capital purposes, provided the expenditure is incurred for promoting the objects of the trust. Purchase of a fixed asset to be utilised for the purpose of the trust amounts to application of income for charitable purposes as held by the Supreme Court in *S.R.M.C.T.M.Tiruppani Trust vs. CIT(1998) 230 ITR 636*.
4. This issue came up before the Madras High Court in *Sree Akilandeswari Mills (P.) Ltd. v. Dy. CIT (2005) 145 Taxman 474 / 274 ITR 0001*. The High Court observed that as far as the gratuity liability is concerned, the obligation to pay gratuity on the part of the assessee to all its employees for the service rendered in a particular year is a definite and ascertainable liability on the basis of actuarial valuation. The assessee, by virtue of the deed of transfer, had taken over the liability of the transferor-company towards gratuity of the employees of the transferor-company on the date of transfer. The gratuity liability was an ascertained liability on the basis of actuarial valuation and this liability, which formed part of the sale consideration, was discharged later by actual payment by the assessee to the employees in subsequent years. The Court held that if an ascertained liability of the predecessor on the date of transfer was taken over by the successor in business, and later on it was discharged, the expenditure incurred would be capital in nature and is not allowable as business expenditure.
- Hence, in this case, the expenditure incurred by A Ltd., towards discharge of the gratuity liability of the employees of the unit taken over from B Ltd., is a capital expenditure. Therefore, the reasoning of the Assessing Officer is correct.
5. This question came up before the Bombay High Court in *CIT v. Roshanbabu Mohammed Hussein Merchant (2005) 144 Taxman 720 / 275 ITR 0231*. The High Court pointed out that there is a distinction between the obligation to discharge the mortgage debt created by the previous owner and the obligation to discharge the mortgage debt created by the assessee himself. Where the property acquired by the assessee is subject to mortgage created by the previous owner, he acquires absolute interest in that property only after the discharge of the mortgage debt. In such a case, the expenditure incurred by the assessee to discharge the mortgage debt, created by the previous owner, to acquire absolute interest in the property is treated as 'cost of acquisition' and is deductible from the full value of consideration received by the assessee on transfer of that property.
- However, where the assessee acquires a property which is unencumbered, he gets an absolute interest in that property on acquisition. When the assessee transfers that property, he is liable for capital gains tax on the full value realized, even if he has himself created an encumbrance on that property. The assessee is under an obligation to remove that encumbrance for effectively transferring the property. In other words, the expenditure incurred by the assessee to remove an encumbrance created by himself on the property, acquired by him without any encumbrance, is not an allowable deduction under section 48.
6. (i) As per section 50B, any profits or gains arising from the slump sale effected in the previous year is chargeable to income-tax as capital gains arising from the transfer of capital assets

and shall be deemed to be the income of the previous year in which the transfer took place. If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before slump sale, the capital gain shall be deemed to be long-term capital gain.

Particulars	Rs.
Calculation of capital gains	
Slump sale consideration	5,20,00,000
Less: Cost of acquisition (net worth) [See Working Note below]	2,10,00,000
Long-term capital gain	3,10,00,000
Calculation of tax liability	
Income-tax @ 20%	62,00,000
Surcharge @ 10%	6,20,000
	68,20,000
Education cess @2%	1,36,400
Total tax liability	69,56,400

Working Note:

Net worth of Unit II	Rs.
WDV of block of assets	1,20,00,000
Debtors	1,35,00,000
Inventories	45,00,000
	3,00,00,000
Less: Liabilities	90,00,000
Net worth	2,10,00,000

Note - Indexation benefit is not available in case of slump sale as per section 50B(2)

- (ii) Transfer of any capital asset from a holding company to its 100% Indian subsidiary company is exempted from tax under section 47(iv). Therefore, if it is possible for Axel Ltd to acquire the entire shareholding of Gamma Ltd and then make a slump sale, then the resultant capital gain shall not attract tax liability.

However, Axel Ltd should not transfer any shares in Gamma Ltd for 8 years from the date of slump sale.

7. The Allahabad High Court, in *CIT v. Radico Khaitan Ltd. (2005) 12 Taxman 681 / 274 ITR 0354*, observed that under section 14, the various heads of income have been specified. If an item does not fall under any of the heads enumerated in Heads A to E mentioned in section 14, it would fall under the residuary head - Head F i.e. 'Income from other sources'.

The High Court further observed that the assessee-company had received interest on loans/advances made by it to its debtors. The amount of interest was not relatable to any late payment of the invoices/bills or compensation/damages. Thus, the amount of interest which it had received could not, by any stretch of imagination, be treated as income from business but was to be treated under the head 'Income from other sources'.

Thus, in view of the above case, the contention of Alpha Ltd. is not correct.

8. This question was answered by the Allahabad High Court in *CIT v. District Co-operative Federation (2005) 144 Taxman 333 / (2004) 271 ITR 0022*. The High Court observed that the the

terms 'godowns' and 'warehouses' are synonymous and interchangeable. The common parlance meaning which can be attributed to godowns or warehouses is that they must be used for the purpose of storage of goods, even for a temporary period.

The High Court further observed that in a cold storage, vegetables, fruits and several other articles are stored. This can be established from the dictionary meaning of the term "cold storage" as well as from the following decisions -

1. Calcutta High Court in *CIT v. Radha Nagar Cold Storage (P.) Ltd.* (1980) 4 *Taxman* 351.
2. Apex Court in *Delhi Cold Storage (P.) Ltd. v. CIT* (1991) 59 *Taxman* 144.

Thus, by giving a liberal interpretation to the provisions of section 80P(2)(e), cold storage can be treated as a warehouse or godown where fixed temperature is maintained. Therefore, cold storage can be said to be a warehouse or godown where goods are stored, and hence, income from cold storage would be exempt.

9. This issue came up before the Madras High Court in *CIT v. G.V. Venugopal* (2005) 144 *Taxman* 78 / 273 *ITR* 0307. The Court opined that the view taken by the Assessing Officer was not correct. The second proviso to section 10(10C) only refers to exemption claimed in any other assessment year. However, in the instant case, the exemption claimed was in respect of the same assessment year, although exemption granted under section 89(1) had been spread over several assessment years. The mere fact that the relief has been spread over several years does not mean that the relief is not in respect of a particular assessment year.

The High Court held that the relief contemplated under section 89(1) is aimed to mitigate hardship that may be caused on account of the high incidence of tax due to progressive increase in tax rates. Hence, the assessee was eligible to claim benefit under section 10(10C) and section 89(1) in respect of compensation received under the VRS.

Therefore, the contention of the Assessing Officer is incorrect. Prem is entitled to exemption of Rs.5 lakhs under section 10(10C). Relief under section 89(1) can be claimed in respect of Rs.1,15,000, being the taxable portion of VRS compensation i.e. on the balance VRS compensation after excluding the amount claimed as exemption under section 10(10C).

10. Computation of daily tonnage income

Particulars	Ship 1 Rs.	Ship 2 Rs.	Ship 3 Rs.
First 1,000 tons (1000 x 46/100)	460	460	460
Next 9,000 tons (9,000 x 35/100)	3,150	3,150	3,150
Next 15,000 tons (15,000 x 28/100)	4,200	4,200	4,200
Balance [(11,600 tons / 18,400 tons / 1,400 tons) x 19/100]	2,204	3,496	266
	10,014	11,306	8,076

Tonnage income -

Ship 1 (10,014 x 280)	28,03,920
Ship 2 (11,306 x 340)	38,44,040
Ship 3 (8,076 x 175)	14,13,300
	80,61,260
Tax @ 30%	24,18,378
Add: Surcharge @ 10%	2,41,838
	26,60,216
Add: Education cess @ 2%	53,204
	27,13,420

Note:

1. Tonnage is to be rounded off to the nearest multiple of 100 tons. Hence, the first vessel will pay for 36,600 tons, the second for 43,400 tons and the third for 26,400 tons.
 2. Since the tonnage income under the special provisions of the Act is lower than the relevant shipping income, the lower sum is adopted for tax purposes.
 3. An option to get assessed under Chapter XII-G has to be filed by the company.
 4. 20% of the book profits of the company from the shipping business have to be credited to a reserve account to be utilized before the expiry of a period of 8 years for acquisition of a new ship; till then, the amount can be utilized for the purposes of the business of operating qualifying ships. However, the amount shall not be used for distribution of dividends or for remittance outside India or for creation of assets outside India.
11. This issue came up before the Madras High Court in *Madura Coats v. Dy. CIT (2005) 145 Taxman 226 / 273 ITR 0032*. The High Court held that under section 119(2), the CBDT is given the power to issue instructions to subordinate authorities for the purpose of proper and efficient management of the work of assessment and collection of revenue, provided that such instructions are not prejudicial to the assessee. Therefore, any instruction to be issued should not affect the interests of the assessee. If such directions are issued, they are ultra vires the scope of section 119(2). The reason behind the statutory bar under section 119(2) to issue any instruction contrary to the interests of the assessee is that a subordinate official is bound to comply with the directions/opinion of a superior authority. Any such instruction to an authority discharging the functions of a quasi-judicial nature would be impermissible. In the instant case, there was a positive direction to the assessing authorities to treat the ex-gratia amount as capital expenditure, which was certainly adverse to the assessee. Therefore, to the extent the circular was against the interests of the assessee, the same was liable to be held ultra vires..

Therefore, in this case, the contention of ABC Ltd. is correct.

12. (i) **Fringe Benefits** - According to section 115WB(1), "fringe benefits" means any consideration for employment by way of -
- (a) any privilege, service, facility or amenity, directly or indirectly, provided by an employer, whether by way of reimbursement or otherwise, to his employees (including former employee or employees);
- However, those perquisites in respect of which tax is paid or payable by the employee are not to be included in this clause as fringe benefits.
- (b) any free or concessional ticket provided by the employer for private journeys of his employees or their family members; and
 - (c) any contribution by the employer to an approved superannuation fund for employees.
- (ii) **Deemed fringe benefits [Section 115WB(2)]** - The fringe benefits shall be deemed to have been provided by the employer to his employees, if the employer has, in the course of his business or profession (including any activity, whether or not such activity is carried on with the object of deriving income, profits or gains) incurred any expense on, or made any payment for, the following purposes, namely:-
- (A) entertainment;
 - (B) provision of hospitality of every kind by the employer to any person;
 - (i) Such hospitality could be by way of provision of food or beverages or in any other manner;
 - (ii) Such provision may or may not be made by reason of any express or implied contract or custom or usage of trade.

However, the provision of hospitality does not include the following -

- (i) any expenditure on, or payment for, food or beverages provided by the employer to his employees in office or factory;
- (ii) any expenditure on, or payment through, paid vouchers which are not transferable and usable only at eating joints or outlets;

(C) conference (other than fee for participation by the employees in any conference);

The following expenditure, if incurred in connection with any conference, shall be deemed to be expenditure incurred for the purposes of conference –

- (i) Conveyance;
- (ii) Tour and travel (including foreign travel);
- (iii) Hotel, boarding and lodging.

(D) sales promotion including publicity;

However, the following expenditure on advertisement is outside the scope of sales promotion including publicity and hence, is not deemed to be a fringe benefit -

- (i) expenditure (including rental) on advertisement of any form in any print (including journals, catalogues or price lists) or electronic media or transport system;
- (ii) expenditure on the holding of, or the participation in, any press conference or business convention, fair or exhibition;
- (iii) expenditure on sponsorship of any sports event or any other event organized by any Government agency or trade association or body;
- (iv) expenditure on the publication in any print or electronic media of any notice required to be published by or under any law or by an order of a court or tribunal;
- (v) expenditure on advertisement by way of signs, art work, painting, banners, awnings, direct mail, electric spectacles, kiosks, hoardings, bill boards or by way of such other medium of advertisement; and
- (vi) expenditure by way of payment to any advertising agency for the purposes of clauses (i) to (v) above.

(E) employees' welfare;

However, the expenditure incurred or payment made for the following purposes is not considered as expenditure for employees' welfare –

- (i) to fulfill any statutory obligation or
- (ii) to mitigate occupational hazards or
- (iii) to provide first aid facilities in the hospital or dispensary run by the employer

(F) conveyance, tour and travel (including foreign travel);

(G) use of hotel, boarding and lodging facilities;

(H) repair, running (including fuel), maintenance of motorcars and the amount of depreciation thereon;

(I) repair, running (including fuel), maintenance of aircrafts and the amount of depreciation thereon;

(J) use of telephone (including mobile phone) other than expenditure on leased telephone lines;

(K) maintenance of any accommodation in the nature of guest house other than accommodation used for training purposes;

(L) festival celebrations;

- (M) use of health club and similar facilities;
- (N) use of any other club facilities;
- (O) gifts; and
- (P) scholarships.

13. (i) Belated return of fringe benefits - Any employer, responsible for paying fringe benefit tax, who has not furnished a return on or before the due date or within the time allowed under a notice issued under section 115WD(2), may furnish the return for any previous year, at any time before the expiry of one year from the end of the relevant assessment year or before the completion of the assessment, whichever is earlier.

(ii) Revised return of fringe benefits - If any employer, having furnished a return on or before the due date or in response to notice served by the Assessing Officer as per section 115WD(2), discovers any omission or any wrong statement therein, he may furnish a revised return at any time before the expiry of one year from the end of the relevant assessment year or before the completion of the assessment, whichever is earlier.

(iii) Advance tax in respect of fringe benefits -

- (1) Section 115WJ casts responsibility on every assessee who is liable to pay advance tax under section 115WI.
- (2) Such assessee should, on their own accord, pay advance tax on their current fringe benefits calculated in the manner laid down in (3), (4) and (5) below.
- (3) The amount of advance tax payable by an assessee in the financial year is 30% of the value of the fringe benefits referred to in section 115WC, paid or payable in each quarter.
- (4) Such advance tax is payable on or before the 15th day of the month following such quarter.
- (5) However, the advance tax for the quarter ending on the 31st March of the financial year is payable on or before 15th March of the said financial year.
- (6) Where an assessee has -
 - (a) failed to pay the advance tax for any quarter or
 - (b) where the advance tax paid by him is less than 30% of the value of fringe benefits paid or payable in that quarter,
 he is liable to pay simple interest at the rate of 1% per month or part of the month during which the shortfall continues.
- (7) The simple interest is to be calculated on the amount by which the advance tax paid falls short of 30% of the value of fringe benefits for any quarter.

14. The CBDT has, vide Circular no.1/2005 dated 6.1.2005, clarified that if an undertaking set up in Domestic Tariff Area (DTA) and deriving profit from export of articles or things or computer software manufactured or produced by it, is subsequently approved as a 100% EOU by the Board appointed by the Central Government in exercise of powers conferred under section 14 of the Industries (Development and Regulation) Act, 1951, it shall be eligible for deduction under section 10B. The deduction would be available only from the year in which the undertaking has got the approval as a 100% EOU. Further, the deduction would be available only for the remaining period of ten consecutive assessment years, beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or things or computer software, as a DTA unit. Also, in the year of approval, the deduction would be restricted to the profits derived from exports, from and after the date of approval of the DTA unit as a 100% EOU. Moreover, the deduction to such units in any case will not be available after A.Y.2009-10.

15. The Apex Court, in *CIT v. Om Prakash Mittal (2005) 143 Taxman 373 / 273 ITR 0326*, observed that a bare reading of section 245D(6) shows that every order passed under sub-section (4) has to provide for the following –

- (i) the terms of settlement and
- (ii) that the settlement would become void if it is subsequently found by the Settlement Commission that it has been obtained by fraud or misrepresentation.

The decision on whether the order has been obtained by fraud or misrepresentation is that of the Settlement Commission. However, there is no requirement that the Settlement Commission must *suo motu* initiate the action. The Revenue can move the Settlement Commission for a decision on an issue if it has material to show that the order was obtained by fraud or misrepresentation of facts.

The Supreme Court observed that the foundation for settlement is an application which an assessee can file at any stage of a case relating to him in such form and manner as may be prescribed. The fundamental requirement of the application under section 245C is that there must be full and true disclosure of the income along with the manner in which it has been derived. If an order is obtained by fraud or misrepresentation of facts, it cannot be said that there is a full and true disclosure. This is why the Legislature has prescribed the condition relating to declaration of the order void when it is obtained by fraud or misrepresentation of facts.

The Supreme Court held that merely because section 245-I provides that the order of settlement is conclusive, it does not take away the power of the Settlement Commission to decide whether the settlement order has been obtained by fraud or misrepresentation of facts. If the Commissioner is able to establish that the earlier decision was void because of misrepresentation of facts, then it is open for the Settlement Commission to decide the issue. It cannot be called by any stretch of imagination to be a review of the earlier judgment or the subsequent Bench sitting in appeal over the earlier Bench's decision.

Mr. Sriram's contention is, therefore, not correct.

16. This question was answered by the Punjab & Haryana High Court in *CIT v. Upper India Steel Mfg. & Engg. Co. Ltd. (2004) 141 Taxman 692*. The High Court observed that section 207 contemplates estimation of current income and on the basis of such estimation, the assessee is required to pay advance tax. Advance tax is payable on the current income, irrespective of whether the same is computed under section 115JB or under the other provisions of the Act. In other words, the expression 'current income' on which advance tax is payable under the provisions of section 207, does not exclude the income computed under the provisions of section 115JB.

All assesseees who maintain books of account have to estimate their total income for the purpose of payment of advance tax. If a profit and loss account could be drawn up on estimate basis for the purpose of Income-tax Act, there is no reason why a similar profit and loss account on estimate basis under the Companies Act could not be drawn up. Therefore, the explanation that profits under section 115JB can only be determined after the close of the year cannot be accepted since, in such a case, no assessee who maintains regular books of account would be liable to pay advance tax as in those cases also, income can only be finally determined after the close of the books of account at the end of the year.

The High Court, therefore, held that the assessee was liable to pay interest under sections 234B and 234C.

Therefore, Beta Ltd. is liable to pay interest under sections 234B and 234C, even in a case where its income is assessed under section 115JB.

17. (a) Penalty of Rs.10,000 is attracted under section 271(1)(b) for failure to comply with notice under section 115WD(2) to file a return of fringe benefits.
- (b) For concealment of particulars of fringe benefits or furnishing inaccurate particulars of fringe benefits, penalty is 100% to 300% of the tax sought to be evaded as per section 271(1)(d).

- (c) Section 271FB provides for penalty on an employer for failure to furnish return of fringe benefits, as required under section 115WD(1), within the prescribed time. The Assessing Officer is empowered to direct such employer to pay a penalty of Rs.100 for every day of continuing default. However, section 273B provides that no penalty is imposable on the employer under section 271FB, if he proves that there was a reasonable cause for the said failure.

18. Section 206A casts responsibility on every banking company or co-operative society or public company referred to in the proviso to section 194A(3)(i) to prepare quarterly returns if they are responsible for making payment by way of interest (other than interest on securities) not exceeding Rs.5,000 to a resident. Such quarterly returns have to be prepared for the periods ending on the 30th June, the 30th September, the 31st December and the 31st March in each financial year.

Such persons are vested with the responsibility to prepare and deliver or cause to be delivered quarterly returns within the prescribed time to the prescribed income-tax authority or the person authorized by such authority. Such quarterly returns should be in the prescribed form and verified in the prescribed manner. Such quarterly returns should be on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media.

Section 272A imposes penalty for failure to deliver or cause to be delivered the quarterly return within the prescribed time. The penalty would be Rs.100 for every day of continuing default.

19. **Computation of net wealth of Sterling Constructions Ltd. as on 31.3.2006**

Particulars		Rs. in lakhs
(i)	Land in urban area held as stock-in-trade for more than 10 years is an asset under section 2(ea)	52
(ii)	Flats constructed remaining unsold	47
(iii)	Motor cars (including imported motor car)	17
(iv)	Jewellery	6
(v)	Aircrafts	125
(vi)	Ships [not an asset under section 2(ea)]	Nil
(vii)	Cash on hand as per cash book [not an asset under section 2(ea)]	Nil
(viii)	Bank balance [not an asset under section 2(ea)]	Nil
(ix)	Guest house in rural area	13
(x)	Residential flats provided to 3 employees drawing a salary of less than Rs.5 lakhs p.a.	Nil
	Residential flats provided to 2 employees whose salary exceeds Rs.5 lakhs p.a.	10
(xi)	Residential house provided to a whole-time director drawing a salary of Rs.4 lakhs p.a.	Nil
Total wealth		270
Less: Debt –		
	Loan taken for purchase of land in urban area	20
	Loan taken for purchase of jewellery	4
	Loan taken for purchase of guest house in a rural area	10
	Loan taken for purchase of ships is not allowable since ship is not an asset chargeable to wealth-tax	Nil
Net wealth		34
		236

20. Under section 4(1)(a)(i) of the Wealth-tax Act read with Rule 18 of Schedule III, the market value of gifted jewellery i.e., Rs.3,25,000 will be included in the wealth of Hari.

As the flat is used by Hari for residential purposes, its value will be the value determined in accordance with the provisions of Schedule III as on 31.3.71 or as on the first valuation date next following the date on which he became the owner, whichever is later. In this case, therefore, Rs.5,00,000 (i.e. 5,40,000 minus Rs.40,000) is includible in the wealth of Hari. However, Hari can claim exemption under section 5(1)(vi).

Although vacant urban land is an asset as per section 2(ea), however, since the same has been transferred to a minor handicapped child, it cannot be clubbed with the wealth of Hari. It has been assumed that the minor child suffers from any disability of the nature specified in section 80U of the Income-tax Act, 1961. The clubbing provisions of section 4(1)(a)(ii) do not apply to assets transferred to a minor child suffering from any disability of the nature specified in section 80U of the Income-tax Act. They would be assessed in the hands of the minor.

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

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

1. Exemption of interest income of non-residents / not-ordinarily residents [Section 10(15)(viii)]

- (i) Sub-clause (viii) has been inserted in clause (15) of section 10 to provide for exemption of interest income received by a non-resident/not-ordinarily resident in India.
- (ii) Such interest income should be from a deposit made on or after 1.4.2005 in an Offshore Banking Unit referred to in section 2(u) of the SEZ Act, 2005 i.e. a branch of a bank located in a SEZ and which has obtained permission under section 23(1)(a) of the Banking Regulation Act, 1949.

2. Sunset clause inserted in respect of units located in SEZ for availing tax holiday under section 10A

- (i) Section 10A provides for a tax holiday in respect of newly established undertakings in a free trade zone (FTZ) or export processing zone (EPZ) or Electronic Hardware Technology Park or Software Technology Park or SEZ, notified by the Central Government, for a period of 10 consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce such articles, or things or computer software.
- (ii) Consequent to insertion of new section 10AA providing for a tax holiday in respect of newly established Units in SEZ, sub-section (7B) has been inserted in section 10A to provide for sunset clause under section 10A in respect of such units.
- (iii) Accordingly, any undertaking, being a Unit referred to in section 2(zc) of the SEZ Act, 2005, which has begun or begins to manufacture or produce articles or things or computer software during the previous year 2005-06 or thereafter in any SEZ is not eligible for benefit of tax holiday under section 10A.
- (iv) As per section 2(zc) of the SEZ Act, 2005,
 - (a) "Unit" means a unit set up by an entrepreneur in a SEZ
 - (b) It includes –
 - (1) an existing Unit,
 - (2) an Offshore Banking Unit and

(3) a Unit in an International Financial Services Centre.

(c) Such unit may be established before or after the commencement of the SEZ Act, 2005.

(v) "Offshore Banking Unit" means a branch of a bank located in a SEZ and which has obtained the permission under section 23(1)(a) of the Banking Regulation Act, 1949.

3. Tax holiday for newly established Units in SEZs [New Section 10AA]

- (i) This section applies to any undertaking, being the Unit, which has begun or begins to manufacture or produce articles or things or provide any services during the previous year relevant to the assessment year commencing on or after 1st April, 2006, in any SEZ.
- (ii) It provides for a tax holiday in computing the total income of an assessee, being an entrepreneur, from his Unit set up in a SEZ.
- (iii) Such assessee should be an entrepreneur referred to in section 2(j) of the SEZ Act, 2005 i.e., a person who has been granted a letter of approval by the Development Commissioner under section 15(9).
- (iv) He should begin to manufacture or produce articles or things or provide any services during the previous year relevant to any assessment year commencing on or after 1st April, 2006.
- (v) Sub-section (1) provides for the quantum of deduction under this section, which is -
 - (a) 100% of profits and gains derived from the export of such articles or things or from services for a period of 5 consecutive assessment years beginning with the assessment year relevant to the previous year in which the Unit begins to manufacture or produce such articles or things or provide services, as the case may be, and
 - (b) 50% of such profits and gains for further 5 assessment years and
 - (c) Thereafter, for the next 5 consecutive assessment years, so much of the amount not exceeding 50% of the profit as is debited to the profit and loss account of the previous year in respect of which the deduction is to be allowed and credited to a reserve account (to be called the "Special Economic Zone Re-investment Reserve Account") to be created and utilised for the purposes of the business of the assessee in the manner laid down in sub-section (2).
- (vi) The profits derived from the export of articles or things or services (including computer software) shall be the amount which bears to the profits of the business of the undertaking, being the Unit, the same proportion as the export turnover in respect of such articles or things or services bears to the total turnover of the business carried on by the assessee.
- (vii) The profits and gains derived from on site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India.
- (viii) Sub-section (2) provides that the deduction under (v)(c) above shall be allowed only if the following conditions are fulfilled, namely:-
 - (a) the amount credited to the Special Economic Zone Re-investment Reserve Account is utilised-
 - (1) for the purposes of acquiring machinery or plant which is first put to use before the expiry of a period of three years following the previous year in which the reserve was created; and
 - (2) until the acquisition of the machinery or plant as aforesaid, for the purposes of the business of the undertaking. However, it should not be utilized for
 - (i) distribution by way of dividends or profits; or
 - (ii) for remittance outside India as profits; or
 - (iii) for the creation of any asset outside India;

- (b) the particulars, as may be specified by the Central Board of Direct Taxes in this behalf, under section 10A(1B)(b) have been furnished by the assessee in respect of machinery or plant. Such particulars have to be furnished along with the return of income for the assessment year relevant to the previous year in which such plant or machinery was first put to use.
- (ix) Where any amount credited to the Special Economic Zone Re-investment Reserve Account -
 - (a) has been utilised for any purpose other than those referred to in sub-section (2), the amount so utilized shall be deemed to be the profits in the year in which the amount was so utilized and charged to tax accordingly; or
 - (b) has not been utilised before the expiry of the said period of 3 years, the amount not so utilised, shall be deemed to be the profits in the year immediately following the said period of three years and be charged to tax accordingly.[Sub-section (3)]
- (x) However, where, in computing the total income of the Unit for any assessment year, its profits and gains had not been included by application of the provisions of sub-section (7B) of section 10A, the undertaking, being the Unit shall be entitled to deduction under (v)[(a)/(b)] above only for the unexpired period of ten consecutive assessment years.
- (xi) Thereafter, it shall be eligible for deduction from income as provided in (v)(c) above.
- (xii) If an undertaking being the Unit, has already availed the deduction referred to in section 10A for ten consecutive assessment years before the commencement of the SEZ Act, 2005, such Unit is not eligible for deduction from income under this section.
- (xiii) Further, where a Unit initially located in any FTZ or EPZ is subsequently located in a SEZ by reason of conversion of such FTZ or EPZ into a SEZ, the period of 10 consecutive assessment years referred to above shall be reckoned from the assessment year relevant to the previous year in which the Unit began to manufacture, or produce or process such articles or things or services in such FTZ or EPZ.
- (xiv) Where a Unit initially located in any FTZ or EPZ is subsequently located in a SEZ by reason of conversion of such FTZ or EPZ into a SEZ and has completed the period of ten consecutive assessment years referred to above, it shall not be eligible for deduction from income as provided in (v)(c) with effect from 1.4.2006.
- (xv) In the event of any undertaking, being the Unit which is entitled to deduction under this section, being transferred, before the expiry of the period specified in this section, to another undertaking, being the Unit in a scheme of amalgamation or demerger, -
 - (a) no deduction shall be admissible under this section to the amalgamating or the demerged Unit for the previous year in which the amalgamation or the demerger takes place; and
 - (b) the provisions of this section would apply to the amalgamated or resulting Unit, as they would have applied to the amalgamating or the demerged Unit had the amalgamation or demerger had not taken place.
- (xvi) The loss referred to in section 72(1) or section 74(1)/(3), in so far as such loss relates to the business of the undertaking, being the Unit shall be allowed to be carried forward or set off.
- (xvii) In order to claim deduction under this section, the assessee should furnish report from a Chartered Accountant in the prescribed form along with the return of income certifying that the deduction is correct.
- (xviii) During the period of deduction, depreciation is deemed to have been allowed on the assets. Written down value shall accordingly be reduced.
- (xix) No deduction under section 80-IA and 80-IB shall be allowed in relation to the profits and gains of the undertaking.

- (xx) Any unabsorbed depreciation under section 32(2) or business loss under section 72(1) or loss under the head "Capital gains" under section 74 of the undertaking, being the Unit shall be allowed to be carried forward and set off in the subsequent years.
- (xxi) Where any goods or services held for the purposes of eligible business are transferred to any other business carried on by the assessee, or where any goods held for any other business are transferred to the eligible business and, in either case, if the consideration for such transfer as recorded in the accounts of the eligible business does not correspond to the market value thereof, then the profits eligible for deduction shall be computed by adopting market value of such goods or services on the date of transfer. In case of exceptional difficulty in this regard, the profits shall be computed by the Assessing Officer on a reasonable basis as he may deem fit. Similarly, where due to the close connection between the assessee and the other person or for any other reason, it appears to the Assessing Officer that the profits of eligible business is increased to more than the ordinary profits, the Assessing Officer shall compute the amount of profits of such eligible business on a reasonable basis for allowing the deduction.
- (xxii) **Definitions** – For the purpose of this section, the definition of certain terms and expressions shall be as follows -

- (1) "Export turnover" means the consideration in respect of export by the undertaking, being the Unit of articles or things or services received in, or brought into, India by the assessee but does not include freight, telecommunication charges or insurance attributable to the delivery of the articles or things outside India or expenses, if any, incurred in foreign exchange in rendering of services (including computer software) outside India;
- (2) "Export" in relation to the SEZs means taking goods or providing services out of India from a SEZ by land, sea, air, or by any other mode, whether physical or otherwise;
- (3) "Manufacture" shall have the same meaning as assigned to it in clause (r) of section 2 of the Special Economic Zones Act, 2005 i.e. to make, produce, fabricate, assemble, process or bring into existence, by hand or by machine, a new product having a distinctive name, character or use and shall include processes such as refrigeration, cutting, polishing, blending, repair, remaking, re-engineering and includes agriculture, aquaculture, animal husbandry, floriculture, horticulture, pisciculture, poultry, sericulture, viticulture and mining;
- (4) "Relevant assessment year" means any assessment year falling within a period of fifteen consecutive assessment years referred to in this section.
- (5) "Special Economic Zone" and "Unit" shall have the same meanings as assigned to them under clause (za) and (zc) of section 2 of the SEZ Act, 2005 i.e. -

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

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

4. Exemption of capital gains on transfer of assets in cases of shifting of industrial undertaking from urban area to any SEZ [New section 54GA] -

- (i) Sub-section (1) of this section provides for the treatment of capital gains arising on transfer of certain capital assets used for the purposes of the business of an industrial undertaking situated in an urban area.
- (ii) Such transfer must be effected in the course of, or in consequence of the shifting of such industrial undertaking to any SEZ, whether developed in an urban area or not.

- (iii) The capital asset should be either machinery or plant or building or land or any rights in building or land used for the purposes of the business of an industrial undertaking situated in an urban area.
- (iv) "Urban area" means any such area within the limits of a municipal corporation or municipality as the Central Government may, having regard to the population, concentration of industries, need for proper planning of the area and other relevant factors, by general or special order, declare to be an urban area for the purposes of this sub-section.
- (v) The assessee should, within a period of one year before or three years after the date on which the transfer took place,
 - (a) purchase machinery or plant for the purposes of business of the industrial undertaking in the SEZ to which the said undertaking is shifted;
 - (b) acquire building or land or construct building for the purposes of his business in the SEZ;
 - (c) shift the original asset and transfer the establishment of such undertaking to the SEZ; and
 - (d) incur expenses for such other purposes as may be specified in a scheme framed by the Central Government for the purposes of this section.
- (vi) If the capital gains is greater than the cost and expenses incurred in relation to all or any of the purposes mentioned in clauses (a) to (d) of (v) above (referred to as the new asset hereafter), then the difference is to be charged under section 45 as the income of the previous year.
- (vii) The cost of the new asset should be taken as nil for computation of capital gains on transfer of such asset within a period of 3 years of its purchase, acquisition, construction or transfer.
- (viii) If the amount of the capital gains is equal to, or less than, the cost of the new asset, the capital gains shall not be charged under section 45.
- (ix) In this case, the capital gains has to be reduced from the cost of the new asset, for computation of capital gains on transfer of the new asset within a period of 3 years of its purchase, acquisition, construction or transfer.
- (x) The amount of capital gain which is not appropriated by the assessee towards the cost and expenses for the said purposes mentioned in (v) above -
 - (a) within one year before the date on which the transfer of the original asset took place or
 - (b) before the date of furnishing the return of income u/s 139
 should be deposited in an account with any specified bank or institution and utilized in accordance with the scheme notified by the Central Government.
- (xi) Such deposit should be made before furnishing the return of income under section 139 or the due date for furnishing return of income under section 139(1), whichever is earlier.
- (xii) The return of income should be accompanied by the proof of such deposit.
- (xiii) In such a case, the cost of the new asset for the purposes of sub-section (1) would be deemed to be the cumulative of the following -
 - (a) the amount, if any, already utilized by the assessee for all or any of the aforesaid purposes mentioned in (v) above and
 - (b) the amount so deposited as per (x) above.
- (xiv) However, if the amount deposited as per (x) above is not utilized wholly or partly for all or any of the purposes mentioned in (v) above within the period mentioned therein, then, in such a case the amount not so utilized shall be charged under section 45 as the income of

the previous year in which the period of 3 years from the date of the transfer of the original asset expires.

- (xv) In such an event, the assessee would be entitled to withdraw such amount in accordance with the said scheme notified by the Central Government.

5. No deduction under section 80-IA in respect of any SEZ notified on or after 1.4.2005

Sub-section (13) has been inserted to provide that the deduction under section 80-IA would not be available in respect of any SEZ notified on or after 1.4.2005 in accordance with the Industrial Park Scheme, 2002 and notified schemes for SEZs, referred to in section 80-IA(4)(c)(iii) of the Income-tax Act.

6. Deductions in respect of profits and gains by an undertaking or enterprise engaged in development of SEZ [Section 80-IAB]

- (i) Sub-section (1) provides for a deduction of 100% of profits and gains derived by an undertaking or an enterprise from any business of developing a SEZ for 10 consecutive assessment years.

- (ii) The deduction is available to an assessee, being a Developer, whose gross total income includes any profits and gains derived by an undertaking or an enterprise from any business of developing a SEZ, notified on or after 1st April, 2005 under the SEZ Act, 2005.

- (iii) Developer means -

- (a) a person who, or
- (b) a State Government which

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

A developer includes –

- (a) an authority and
- (b) a Co-developer.

- (iv) Co-developer means -

- (a) a person who, or
- (b) a State Government which

has been granted a letter of approval by the Central Government under section 3(12) of the SEZ Act, 2005.

- (v) The deduction shall be allowed only if the accounts are audited by a Chartered Accountant and the audit report is furnished along with the return of income.

- (vi) The assessee has the option of claiming the said deduction for any ten consecutive assessment years out of fifteen years beginning from the year in which a SEZ has been notified by the Central Government.

- (vii) In a case where an undertaking, being a Developer, who develops a SEZ on or after 1.4.2005 and transfers the operation and maintenance of such SEZ to another Developer, the deduction under sub-section (1) shall be allowed to such transferee Developer for the remaining period in the ten consecutive assessment years as if the operation and maintenance were not so transferred to the transferee Developer.

- (viii) The profits and gains from the eligible business should be computed as if such eligible business were the only source of income of the assessee during the relevant assessment year.

- (ix) Where any goods or services held for the purposes of eligible business are transferred to any other business carried on by the assessee or, where any goods held for any other business are transferred to the eligible business and, in either case, if the consideration for

such transfer as recorded in the accounts of the eligible business does not correspond to the market value thereof, then the profits eligible for deduction shall be computed by adopting market value for such goods or services. In case of exceptional difficulty in this regard, the profits shall be computed by the Assessing Officer on a reasonable basis. Similarly, where due to the close connection between the assessee and the other person or for any other reason, it appears to the Assessing Officer that the profits of eligible business is increased to more than the ordinary profits, the Assessing Officer shall compute the amount of profits on a reasonable basis for allowing the deduction.

- (x) The deduction under this section should not exceed the profits of such eligible business of the undertaking or the enterprise.
- (xi) Further, where any amount of profits of an undertaking or enterprise is allowed as deduction under this section, no deduction under any other provision of Chapter VI-A is allowable in respect of such profits.
- (xii) The Central Government may notify that the benefit conferred by this section shall not apply to any class of industrial undertaking or enterprise with effect from any specified date.
- (xiii) Where any undertaking of an Indian company which is entitled to the deduction under this section is transferred before the expiry of the period of deduction to another Indian company in a scheme of amalgamation or demerger, no deduction shall be admissible to the amalgamating or demerged company for the previous year in which the amalgamation or demerger takes place and the amalgamated or the resulting company shall be entitled to the deduction as if the amalgamation or demerger had not taken place.

7. Deduction in respect of certain incomes of Offshore Banking Units and International Financial Services Centre [New Section 80LA]

- (i) The existing section 80LA has been substituted by a new section 80LA.
- (ii) This section is applicable to the following assesseees -
 - (a) a scheduled bank having an Offshore Banking Unit in a SEZ; or
 - (b) any bank, incorporated by or under the laws of a country outside India, and having an Offshore Banking Unit in a SEZ; or
 - (c) a Unit of an International Financial Services Centre (IFSC).
- (iii) The deduction will be allowed on account of the following income included in the gross total income of such assesseees -
 - (a) income from an Offshore Banking Unit in a SEZ; or
 - (b) income from the business referred to in section 6(1) of the Banking Regulation Act, 1949, with -
 - (1) an undertaking located in a SEZ or
 - (2) any other undertaking which develops, develops and operates or develops, operates and maintains a SEZ; or
 - (c) income from any Unit of the IFSC from its business for which it has been approved for setting up in such a Centre in a SEZ.
- (iv) The deduction allowable from such income is -
 - (a) 100% of such income for 5 consecutive assessment years beginning with the assessment year relevant to the previous year in which -
 - (1) the permission under section 23(1)(a) of the Banking Regulation Act, 1949 was obtained; or
 - (2) the permission or registration under the SEBI Act, 1992 was obtained; or
 - (3) the permission or registration under any other relevant law was obtained.

- (b) Thereafter, 50% of such income for the next 5 consecutive assessment years.
- (v) The following conditions have to be fulfilled for claiming deduction under this section -
 - (a) The report of a Chartered Accountant in Form no.10CCF certifying that the deduction has been correctly claimed in accordance with the provisions of this section, should be submitted along with the return of income.
 - (b) A copy of the permission obtained under section 23(1)(a) of the Banking Regulation Act, 1949 should also be furnished along with the return of income.

8. Minimum Alternate Tax (MAT) provisions not to apply to units in or developers of SEZs [Section 115JB(6)] -

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

- (i) income from any business carried on by an entrepreneur in a SEZ;
- (ii) income from services rendered by an entrepreneur from a unit in a SEZ;
- (iii) income of a Developer from the development of a SEZ.

9. No tax on dividends distributed, declared or paid on or after 1.4.2005 by the Developer of a SEZ or the enterprise developing a SEZ [Section 115-O(6)]-

- (i) Sub-section (6) has been inserted to provide that no tax on dividends would be chargeable in respect of the total income of an undertaking or enterprise engaged in –
 - (a) developing a SEZ; or
 - (b) developing and operating a SEZ; or
 - (c) developing, operating and maintaining a SEZ
 if such dividend, whether interim or final, is declared, distributed or paid by such Developer or Enterprise –
 - (a) on or after 1.4.2005
 - (b) out of its current income.
- (ii) It is to be noted that such dividend does not attract tax either in the hands of the Developer or the Enterprise nor in the hands of the person receiving such dividend [not falling under section 10(23G)].
- (iii) Consequential amendment has been made in section 10(34) by inserting an Explanation to provide that the dividend referred to in section 115-O shall not be included in the total income of the assessee, being a Developer or Entrepreneur.

10. Tax not to be deducted at source from certain interest payments by an Offshore Banking Unit to non-residents/not-ordinarily residents after 1.4.2005 [Section 197A(1D)]

- (i) Sub-section (1D) has been inserted to section 197A
- (ii) This sub-section provides that no deduction of tax shall be made by an Offshore Banking Unit from the interest paid on -
 - (a) deposit made by a non-resident/not-ordinarily resident on or after 1.4.2005; or
 - (b) borrowing from a non-resident/not-ordinarily resident on or after 1.4.2005.

IMPORTANT NOTIFICATIONS / CIRCULARS

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

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

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

[Notification no.189/2005 dated 12.8.2005]

2. Non-levy of interest/penalty on delayed payment of advance Fringe Benefit Tax for the first quarter due on 15-7-2005

The CBDT has, vide order F. No. 142/24/2005-TPL, dated 18.7.2005, decided that interest shall not be charged on delayed payment of the first installment of advance Fringe Benefit Tax upto 15.8.2005. Further, penalty is not leviable for delayed payment of advance Fringe Benefit Tax.

3. Extension of time for filing Quarterly Return of payment of interest to residents without deduction of tax at source for the quarter ended 30.6.2005 – Order F. No. 385/35/2005-IT(B), dated 25.8.2005

The CBDT, in exercise of its power under section 119(2)(a) has extended the due date for filing of quarterly return under section 206A(1), for the quarter ended 30.6.2005, to 30.9.2005.

4. CBDT's Explanatory Notes on the provisions relating to Fringe Benefit Tax

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

and clarifications relating to certain issues. For a detailed reading, students may go through Circular No.8/2005 dated 29.8.2005.

I. OBJECTIVE

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

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

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

II. CLASSIFICATION OF EXPENSES

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

Sl. No.	Type of expenditure/ payment	Is the expenditure liable to FBT?
---------	------------------------------	-----------------------------------

A – ENTERTAINMENT

- | | | |
|----|---|--|
| 1. | All expenditure in connection with exhibition, performance, amusement, game or sport, for affording some sort of amusement and gratification. | Yes. |
| 2. | Expenditure on meeting/get-togethers of employees and their family members on non-festival occasions (including annual day) | Yes. Alternatively, such expenditure can be classified under employee welfare [clause (E)] |

B – PROVISION OF HOSPITALITY

- | | |
|----|--|
| 1. | Provision of food and beverages by the employer in an exclusive training centre which is used to train its employees on various topics |
|----|--|

-
- | | |
|--|--|
| (a) if the training centre is owned by the employer | No; since such a centre is construed as an 'office or a factory' |
| (b) if the training centre is temporarily hired by the employer | Yes; since such training centre cannot be construed as an office or a factory |
| 2. Expenditure on imparting in-house training to employees | No; However, FBT is payable on any expenditure on food and beverage, tour and travel, and lodging and boarding in connection with such in-house training |
| 3. Reimbursement to employees of expenditure incurred by them (i.e., employees) on food and beverages in the office premises while working after office hours. | Yes; since only expenditure incurred on food or beverages procured by the employer for providing to his employees in an office or factory is exempt from FBT. |
| 4. Expenditure on or payment through food vouchers | No, provided the vouchers are non-transferable and used only at eating joint or outlets |

C - CONFERENCE

- | | |
|---|--|
| 1. Expenditure incurred for attending training programmes organized by trade bodies or institutions or any other agency | Yes, since a training programme entails congregation of a number of persons for discussion or exchange of views. |
| 2. Expenditure on fees for participation by the employees in any conference | No; However, if the participation fee includes any expenditure of the nature referred in clause (A), (B) and (D) to (P), such expenditure will be liable to FBT. |
| 3. Expenditure incurred for the purpose of conferences of the agents or dealers or development advisors | Yes; since expenditure incurred for the purposes of conference is liable to FBT irrespective of whether the conference is of agents or dealers or development advisors or any other persons. |

D - SALES PROMOTION INCLUDING PUBLICITY

- | | |
|---|---|
| 1. Expenditure on 'brand' or 'brand ambassador' or 'celebrity endorsement' | Yes; since it does not fall within the specified exclusions under the proviso to clause (D). |
| 2. Brokerage and selling commission paid to direct selling agents/direct marketing agents | No; since they are in the nature of ordinary selling expenses |
| 3. Reimbursement of expenses relating to salesman appointed by distributors for the company products | No; if the salesmen are the employees of the distributor, such reimbursement is a component of commission/ brokerage/ service charges/margin to distributors and therefore, in the nature of ordinary selling expenses. |
| 4. Sales discount or rebates to wholesalers or customers or bonus points given to credit card customers | No; since they are in the nature of selling expenses |
| 5. Incentives given to distributors for meeting | No; since these are in the nature of |

- | | |
|--|--|
| <p>quantity targets (including free goods for achieving certain sales targets and cash incentives adjustable against future supplies)</p> | <p>performance-based commission, which is in the nature of ordinary selling cost</p> |
| <p>6. Expenditure on product marketing research
The expenditure incurred on product marketing research is in the nature of expenditure for the purposes of testing the efficacy of the product.</p> | <p>No, if it is undertaken through a separate marketing agency. However, if the employer carries out the research through its own employees, the expenditure falling under clauses (A) to (P) will be liable to FBT in view of the legal maxim that a specific provision in law will override the general provisions of the law. This will be so, notwithstanding the expenditure being for the ultimate purpose of conducting product-marketing research.</p> |
| <p>7. Expenditure in the nature of call centre charges for canvassing sales (cold calls) or carrying out post-sale activities</p> | <p>No; since such expenditure is in the nature of selling cost</p> |
| <p>8. Expenditure on distribution of free medical or other product samples</p> | <p>Yes; since the Supreme Court has held in <i>Eskayef Ltd. (245 ITR 116)</i>, that any expenditure on free medical samples distributed to doctors is in the nature of sales promotion. Similarly, any expenditure on free samples of other products distributed to trade or consumers would also be liable to FBT.</p> |
| <p>9. Expenditure on making ad-film</p> | <p>No; since an ad-film is a medium for advertisement and therefore falls within the scope of clause (i) of the proviso to clause (D)</p> |
| <p>10. Expenditure (including expenditure on artwork and royalty charges) on free offers (with products) such as freebies like tattoos, cricket cards or similar products, to trade or consumers (excluding employees)</p> | <p>Yes; since such expenditure is for the purposes of sales promotion and publicity</p> |
| <p>11. Expenditure incurred for hotel stay, air ticket charges, etc. in relation to customers/ clients</p> | <p>Yes; such expenditure can be classified either under clause (D) or clause (G).</p> |

E - EMPLOYEES' WELFARE

- | | |
|---|---|
| <p>1. Expenditure incurred or payment made by the employer for the purpose of Group Personal Accident/Workman Compensation Insurance</p> | <p>No, if made under a statutory obligation. However, if there is no statutory obligation, the same would be liable to FBT.</p> |
| <p>2. Expenditure on Group Health Insurance or Group Medical Insurance or Group Life Insurance</p> | <p>Yes, since it is for the purposes of employee welfare. However, if there is a statutory obligation, the same would not be liable to FBT.</p> |
| <p>3. Expenditure incurred at a hospital/ dispensary not maintained by the employer, for injuries sustained during the course of employment</p> | <p>Yes; However, if such expenditure is incurred pursuant to a statutory obligation, it will not be liable to FBT.</p> |

Note – Expenditure incurred or payment made to provide first aid facilities in a hospital or dispensary **run by the employer** is **not** considered as expenditure for employees' welfare.

- | | | |
|----|---|---|
| 4. | Subsidy provided to a school not meant exclusively for employees' children | Yes; since the proximate purpose is promotion of employee welfare |
| 5. | Expenditure incurred on provision and maintenance of facilities like garden, site cleaning, light decoration, school, library, mess, television, cable connection etc. in employees' colonies | Yes; since such expenditure is for the purpose of promoting employee welfare |
| 6. | Expenditure incurred on providing safety shoes or uniforms or equipments to the employees, or for the purpose of reimbursement of washing charges | No, to the extent such expenditure is incurred to meet the statutory obligation under the Employment Standing Orders Act, 1948, since it falls within the scope of the exclusion in the <i>Explanation</i> to clause (E). |
| 7. | Reimbursement of expenditure on books and periodicals to employees | Yes, since it is in the nature of expenditure for the purposes of employee welfare |
| 8. | Expenditure incurred on prizes/ rewards to employees for achievements | Yes. |
| 9. | Expenditure incurred on transportation facility provided to the children of employees. | Yes. |

F - CONVEYANCE, TOUR AND TRAVEL INCLUDING FOREIGN TRAVEL

- | | | |
|----|--|---|
| 1. | Expenditure incurred by a company on traveling, wholly and exclusively for executing an assignment for its client, where such expenditure is subsequently reimbursed by the client as 'out of pocket' expenses | Yes; the company is liable to FBT in respect of such expenditure, but not the client |
| 2. | Expenditure incurred by a professional like a lawyer or auditor on conveyance, tour and travel, which is reimbursed by the client | No; since the reimbursement is essentially a component of professional fee paid by the client to the lawyer or auditor |
| 3. | Reimbursement in respect of car expenses on the basis of bills submitted and driver's salary (booked as 'salary') on the basis of a declaration, though treated as non-taxable reimbursement | Yes; since such expenditure falls outside the scope of 'salary' within the meaning of section 17(1), and is effectively expenditure incurred by the employer for the purposes of conveyance, tour and travel. |
| 4. | Rent paid or payable for an operating lease of a motor car | Yes. |

G – USE OF HOTEL, BOARDING & LODGING FACILITIES

- | | | |
|----|---|---|
| 1. | Expenditure incurred for hotel stay in relation to customers/clients | Yes |
| 2. | Expenditure incurred by a company on hotel, wholly and exclusively for executing an assignment for its client, where such expenditure is subsequently reimbursed by the | Yes; the company is liable to FBT in respect of such expenditure, but not the client. |

client as "out of pocket expenses".

- | | | |
|----|---|--|
| 3. | Per diem allowance given by the employer to employees for meeting the expenditure on lodging and boarding | Yes. However, employee is not liable to pay income-tax on any surplus accruing to him from such allowance. |
|----|---|--|

H – REPAIR, RUNNING AND MAINTENANCE OF MOTOR CARS

- | | | |
|----|--|---|
| 1. | Rent paid or payable for a financial lease of a motor car | Yes; since it is in the nature of expenditure on running or maintenance of a motor-car. |
| 2. | Depreciation on motor-car | Yes; Depreciation has to be computed under section 32 of the Income-tax Act for the purposes of FBT. Such amount must be the whole of the amount of depreciation in respect of the block of assets 'motor-cars' |
| 3. | Interest on loans taken for the purchase of motor- cars | Yes |
| 4. | Expenditure on repair, running and maintenance of delivery/ display vans, trucks/ lorries, ambulances and tractors | No; since the said vehicles are not 'motor cars' |
| 5. | Salary paid to the driver of a motor-car. | Yes |
| 6. | Rent paid for garages or parking slots | Yes; since it is for the purpose of running and maintenance of motor car. |

I – REPAIR, RUNNING AND MAINTENANCE OF AIRCRAFTS

- | | | |
|----|--|--|
| 1. | Depreciation on aircraft | Yes; Depreciation has to be computed under section 32 of the Income-tax Act for the purposes of FBT. |
| 2. | Salary paid to a pilot of an aircraft | Yes |
| 3. | Rent paid for airport tarmac/ hangar charges | Yes; since it is for the purpose of running and maintenance of aircraft |

J – USE OF TELEPHONE

- | | | |
|----|---|---|
| 1. | Expenditure for use of telephone installed in the office and payment of telephone bills (including mobile phone bills) in the name of the company | Yes; Expenditure on use of telephones (including mobile phones) installed in the office is liable to FBT, irrespective of whether the telephone is in the name of the company or not, or whether the payment for its use is made directly or indirectly by the company. |
|----|---|---|

K – MAINTENANCE OF GUEST HOUSE

- | | | |
|----|---|---|
| 1. | Expenditure on capital items like refrigerator, televisions, furniture and similar items in a guest house | No; since the proximate object of incurring such expenditure is the acquisition of a capital asset. Depreciation on these assets is also not liable to FBT in the absence of any specific charge. |
| 2. | Rent paid for the guest house | Yes |
| 3. | Expenditure on all guest houses or expenditure on holiday homes only relevant for the purpose of FBT | FBT is payable on expenditure incurred on all guest houses (other than accommodation used for training |

- purposes), irrespective of whether they are used as holiday homes or not.
4. Expenses on (i) provision of food at the guest house maintained by the employer, and (ii) contract charges paid to guest house staff Yes; since it is for the purpose of maintenance of the guest house
 5. Depreciation on guest house building No, since there is no legislative intent as in the case of depreciation on motor-car and aircraft.

L – FESTIVAL CELEBRATIONS

1. Expenditure on meeting/ get-togethers of employees and their family members on the occasion of -
 - (a) any festival like 'Navratri', 'Diwali', 'Id', 'Christmas' or 'New Year' Yes.
 - (b) Independence Day and Republic Day No; since they are not 'festivals', as normally understood.
 - (c) non-festival occasions (including annual day) Yes, but under 'Entertainment' or 'Employees' Welfare'.

M – USE OF HEALTH CLUB & SIMILAR FACILITIES /

N - USE OF ANY OTHER CLUB FACILITIES

1. Payment of entrance or membership fee Yes, since it is a fixed levy for use of some basic club facilities (like the lounge facilities)
2. Depreciation on club building No, since there is no legislative intent as in the case of depreciation on motor-car and aircraft.

O – GIFTS

1. Expenditure on gifts to distributors/ retailers under trade schemes or for promotion of company's products Yes; since ordinarily, a gift is defined as anything given or presented without consideration
2. Expenditure on gifts to customers Yes; such expenditure has to be classified under 'gifts', and not under 'sales promotion', since in terms of the rules of interpretation of a statute, a specific provision in law overrides a general provision.
3. Expenditure on gifts to employees on the occasion of marriage Yes; such expenditure is liable to FBT, whether the gift is on the occasion of marriage or otherwise
4. Gift in kind Yes; the cost to the employer of the gift would be taken into account for the purpose of valuation of such fringe benefit.

P – SCHOLARSHIPS

1. Expenditure on education of employees sent to educational institutions Yes; such expenditure has to be classified under 'scholarships' even though it may be for the purpose of promoting employees' welfare since in terms of the rules of interpretation of a

- | | |
|--|--|
| 2. Scholarships awarded to students and trainees | statute, a specific provision in law overrides a general provision.
Yes; since FBT is payable on the expenditure incurred or payment made for the purposes of scholarship, irrespective of whether the recipient is an employee or his relative or any other person |
|--|--|

III. CBDT CLARIFICATIONS ON OTHER ISSUES

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

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

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

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

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

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

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

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

4. Pre-requisites for the levy of FBT

FBT is payable by a person satisfying the following conditions -

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

referred to in clauses (A) to (P) of sub-section (2) of section 115WB of the Income-tax Act.

5. FBT liability on Indian companies having global operations

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

6. Applicability of FBT on foreign companies

- (i) FBT applies to foreign companies only if it has employees based in India.
- (ii) If it has employees based in India, it will be liable to FBT in respect of fringe benefits provided or deemed to have been provided within the meaning of section 115WB.
- (iii) FBT is chargeable from an entity even if its income is exempt under a DTAA, since exemption under a DTAA is only in respect of income of the entity, whereas FBT is a liability of an entity *qua* employer.
- (iv) A foreign company not having any permanent establishment in India and doing business promotion through an event manager or a liaison office would not be liable to FBT if it does not have any employees based in India.
- (v) FBT will apply to liaison offices of foreign companies in India if the liaison offices have employees based in India.
- (vi) If a foreign company has a permanent establishment in India and it incurs expenditure outside India or makes payments which are attributable to the operations of its permanent establishment in India (whether such expenses are incurred in India or outside India), such expenditure/payments are liable to FBT.
- (vii) Credit for FBT paid in India may be available in the foreign country of residence on the basis of tax laws prevailing in that foreign country and in the light of the provisions of the DTAA between India and that foreign country.
- (viii) A foreign company deputing personnel to India for short duration under a technical supervision contract is liable to FBT in India if -
 - (a) the salary, as defined in section 17 of the Income-tax Act, of such employees is liable to income-tax in India; or
 - (b) the company has employees based in India other than those deputed to India

for a short duration.

- (ix) If the foreign company incurs expenditure for the purposes enumerated in clauses (A) to (P) of section 115WB(2) and claims re-imbursement of such expenditure from an Indian entity, the foreign company would be liable to FBT on the expenditure so incurred for the purposes enumerated in section 115WB(2).
- (x) If a foreign company has employees based in India and the remuneration received by all its employees is not taxable in India in terms of the Article relating to dependent personal services in any treaty, such foreign companies would not be liable to FBT in India.

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

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

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

8. Benefits/ Perquisites to employees

(1) Leave travel concession/assistance

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

(2) Medical re-imbursement

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

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

9. Segregation of expenses not permissible

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

personal purposes.

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

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

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

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

12. FBT on expenses capitalized and amortised over a period

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

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

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

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

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

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

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

16. Applicability of FBT on expenses disallowed under section 37

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

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

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

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

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