

PAPER – 7 : DIRECT TAXES

QUESTIONS

1. Discuss the correctness or otherwise of the statement – “Income deemed to accrue or arise in India to a non-resident by way of interest, royalty and fees for technical services is to be taxed irrespective of territorial nexus.”
2. Hari, an individual, carried on the business of purchase and sale of agricultural commodities like paddy, wheat, etc. He borrowed loans from Andhra Pradesh State Financial Corporation and Indian Bank and has not paid interest as detailed hereunder:

(i) Andhra Pradesh State Financial Corporation (P.Y. 2006-07 & 2007-08)	15,00,000
(ii) Indian Bank (P.Y. 2007-08)	<u>30,00,000</u>
	<u>45,00,000</u>

Both Andhra Pradesh State Financial Corporation and Indian Bank, while restructuring the loan facilities of Hari during the year 2007-08, converted the above interest payable by Hari to them as a loan repayable in 60 equal installments. During the year ended 31.3.2008, Hari paid 5 installments to Andhra Pradesh State Financial Corporation and 3 installments to Indian Bank.

Hari claimed the entire interest of Rs.45,00,000 as an expenditure while computing the income from business of purchase and sale of agricultural commodities. Discuss whether his claim is valid and if not what is the amount of interest, if any, allowable.

3. Explain the method for determining the amount of expenditure in relation to income not includible in total income.
4. Discuss the taxability of anonymous donations received by the following trusts during the financial year 2007-08:
 - (i) A charitable trust referred to in section 11 which applied the entire amount of anonymous donations for purposes of the trust during the financial year 2007-08.
 - (ii) A trust established wholly for religious purposes which applied 85% of the amount of anonymous donations for the purposes of the objects of the trust during the financial year 2007-08.
5. X Ltd. entered into an agreement with Y Ltd. for purchase of the undertaking of Y Ltd. for Rs.2 crore (constituting Rs.1.60 crore towards plant and machinery, Rs.0.35 crore towards building and Rs.0.05 crore towards land). In addition to this sum, by the same agreement, X Ltd. had also taken over the accrued and future liability of Rs.3.5 crore of Y Ltd. for the gratuity to its employees for the period during which they served with Y Ltd. X Ltd. treated the said amount of Rs.3.5 crore towards gratuity liability as capital expenditure and claimed depreciation under section 32 in respect of the same. Discuss whether the claim of X Ltd. is tenable in law.
6. State the conditions to be satisfied for carry forward and set-off of accumulated loss and unabsorbed depreciation allowance in case of business reorganisation of co-operative

banks. Also, explain the manner in which the accumulated loss and unabsorbed depreciation allowable to the resulting co-operative bank is to be calculated.

7. List the eligibility criteria, as laid down in Rule 18C, for Industrial Parks to claim benefit under section 80-IA(4)(iii).
8. The Finance Act, 2007 has inserted a new section 80-ID in the Income-tax Act, 1961 to provide for a 100% deduction of the profits and gains derived by an undertaking, inter alia, from the business of building, owning and operating a convention centre in a specified area. Convention Center is defined as a building of a prescribed area and having such other facilities and amenities as may be prescribed. Enlist such prescribed conditions to be fulfilled by a convention centre to avail the benefit of deduction under this section.
9. What is the time limit for completion of assessment/re-assessment where a reference is made to the Transfer Pricing Officer under section 92CA(1) in the following cases –
 - (i) for completion of assessment under section 143 for the A.Y.2008-09.
 - (ii) for completion of assessment/re-assessment/re-computation under section 147, if notice is served under section 148 on 1.7.2007.
 - (iii) for completion of assessment in cases where the last of the authorizations for search under section 132 was executed during the financial year 2007-08.
10. M/s. XYZ, a firm, consisting of three partners namely, X, Y and Z, carried on the business of purchase and sale of air-conditioners in wholesale and manufacture and sale of stationery items under a deed of partnership executed on 1.4.2003. X, Y and Z were partners in their individual capacity. The deed of partnership provided for payment of salary amounting to Rs.90,000 each to X and Y, who were the working partners. A new deed of partnership was executed on 1.10.2007 which, apart from providing for payment of salary to the two working partners as mentioned in the deed of partnership executed on 1.4.2003, for the first time provided for payment of simple interest @ 10% per annum on the balances standing to the credit of the Capital accounts of partners from 1.4.2007. The firm was dissolved on 31.3.2008 and the Capital assets of the firm were distributed among the partners on 4.4.2008. The net profit of the firm for the year ending 31.3.2008 after payment of salary to the working partners and debit/credit of the following items to the Profit and Loss Account was Rs.75,000:
 - (i) Interest amounting to Rs.80,000 paid to the partners on the balances standing to the credit of their capital accounts from 1.4.2007 to 31.3.2008.
 - (ii) Interest amounting to Rs.25,000 paid to the partners on the balances standing to the credit of their current accounts from 1.4.2007 to 31.3.2008.
 - (iii) Interest amounting to Rs.32,000 paid to the Hindu undivided family of partner X @ 15% per annum.
 - (iv) Two payments of Rs.25,000 and Rs.30,000 towards purchase of air-conditioners were made by crossed cheque and cash, respectively.

- (v) Rs.50,000 being the value of a diamond pendant received as gift from a manufacturer for achieving sales target.
- (vi) Depreciation amounting to Rs.20,000 on car bought and used exclusively for business purposes, but not registered in the name of the firm.
- (vii) Depreciation under section 32(1)(ii) amounting to Rs.52,500 of new machinery bought and installed for manufacture of stationery items on 1.11.2007 at a cost of Rs.7,00,000. There was no increase in the installed capacity as a result of the installation of the new machinery.
- (viii) Interest amounting to Rs.30,000 received from bank on fixed deposits made out of surplus funds.

The firm furnishes the following information relating to it:

- (a) Closing stock-in-trade was valued at Rs.80,000 as per the method of lower of cost or market rate consistently followed by it. The market value of the closing stock-in-trade was Rs.90,000.
- (b) Brought forward business loss relating to the assessment year 2007-08 was Rs.15,000.
- (c) The fair market value of the capital assets as on 3.1.3.2008 was Rs.32,00,000 and the cost of their acquisition was Rs.21,00,000.

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

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

11. Mohan, an individual, filed his return of income for the A.Y. 2008-09 on 29.05.2008. He later discovered that he had not claimed deduction under section 80E in the said return. He claimed the said deduction through a letter addressed to the Assessing Officer. The Assessing Officer completed the assessment without allowing the deduction claimed by Mohan. Is the Assessing Officer justified in doing so? Discuss.
12. Mr. Bhuvan, an individual, has got his books of account for the year ending 31.3.2008 audited under section 44AB. His total income for the A.Y. 2008-09 is Rs. 2,50,000. He desires to know if he can furnish his return of income for the A.Y. 2008-09 through a Tax Return Preparer.
13. The Assessing Officer issued directions for special audit under section 142(2A) to Mr. A. Mr. A contended that such directions were issued without giving him an opportunity of being heard. The Assessing Officer maintained that it was not necessary to give Mr. A an opportunity of being heard. Discuss, with reasons, whether the contention of the Assessing Officer is correct or that of Mr. A.
14. "The presumptions provided in section 132(4A) can be made only with regard to the proceedings for search and seizure under section 132". Discuss the correctness or otherwise of this statement.

15. Flyjet is an airline incorporated in London. Its aircrafts land at the Indira Gandhi International Airport in India. The airline pays landing and parking charges to the Airport Authorities. Can such payments be subject to deduction of tax at source under section 194-I?
16. Explain whether the TDS provisions under section 194C are attracted in respect of a contract for fabrication of an article or thing as per the specifications given by the assessee.
17. Discuss whether the provisions of tax deduction at source are applicable to payments made by the customers on account of cooling charges to the cold storage owners.
18. "The power of the Settlement Commission to grant immunity from prosecution has now been restricted". Is this statement correct? Elucidate.
19. Compute the net wealth of ABC Ltd. (carrying on the business of running cars on hire and also dealing in jewellery) which furnishes the following particulars of its assets and liabilities as on 31.3.2008:

	(Rs. in crore) Book value	(Rs. in crore) Value as per Schedule III
Assets		
(i) Fixed Assets:		
Plant & Machinery	25	30
Factory Building	35	25
Urban land (300 sq. meters)	30	70
Motor cars (used in the business of running them on hire)	7	15
(ii) Investments		
Jewellery	12	28
Plot of land in Bangalore (400 sq. meters)	14	60
Equity shares in subsidiary companies	15	22
(iii) Current assets :		
Inventories (Jewellery)	75	75
Sundry Debtors	15	15
Cash and bank balances (includes cash balance of Rs.1,00,000)	7	7

Liabilities

(i) Current Liabilities	25	25
(ii) Secured Loan taken for purchase of urban land	50	50

20. "Urban Land is an asset chargeable to wealth tax" – Is this statement correct? Discuss, explaining the meaning of urban land. Also, state whether there are any exclusions from the definition of urban land.

SUGGESTED ANSWERS/HINTS

1. This statement is correct.

The Supreme Court, in *Ishikawajima-Harima Heavy Industries Ltd. v. Director of Income-tax* (2007) 288 ITR 408, observed that in order to tax the income of a non-resident assessee under section 9(1)(vii), relating to fee for technical services, the income sought to be taxed must have sufficient territorial nexus with India i.e. the fees paid for technical services provided by a non-resident cannot be taxed in India unless the services were utilized in India and rendered in India.

However, the Finance Act, 2007 has now inserted an Explanation to section 9 with retrospective effect from 1.6.1976 to clarify that such income by way of interest, royalty or fee for technical services which is deemed to accrue or arise in India by virtue of clauses (v), (vi) and (vii) of section 9(1), shall be included in the total income of the non-resident, whether or not the non-resident has a residence or place of business or business connection in India.

2. According to section 43B, any interest payable on the term loans to specified financial institutions and any interest payable on any loans and advances to scheduled banks shall be allowed only in the year of payment of such interest irrespective of the method of accounting followed by the assessee. Where there is default in the payment of interest by the assessee, such unpaid interest may be converted into loan. Such conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose of section 43B. The amount of unpaid interest so converted as loan shall be allowed as deduction only in the year in which the converted loan is actually paid.

In the given case of Hari, the unpaid interest of Rs.15,00,000 due to Andhra Pradesh State Financial Corporation and of Rs.30,00,000 due to Indian Bank was converted into loan. Such conversion would not amount to payment of interest and would not, therefore, be eligible for deduction in the year of such conversion. Hence, claim of Hari that the entire interest of Rs.45,00,000 is to be allowed as deduction in the year of conversion is not tenable. The deduction shall be allowed only to the extent of repayment made during the financial year. Accordingly, the amount of interest eligible for deduction for the A.Y. 2008-09 shall be calculated as follows:

	Interest outstanding	Number of Installments	Amount per installment	Installments paid	Interest allowable (Rs.)
Andhra Pradesh State Financial Corporation	15 lakh	60	25,000	5	1,25,000
Indian Bank	30 lakh	60	50,000	3	1,50,000
Total amount eligible for deduction					2,75,000

3. The CBDT has, vide Notification No.45/2008 dated 24.3.2008, inserted a new Rule 8D which lays down the method for determining the amount of expenditure in relation to income not includible in total income.

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

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

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

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

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

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

Where,

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

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

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

- (iii) an amount equal to one-half per cent of the average of the value of investment, income from which does not or shall not form part of the total income, as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year.
4. (i) Section 115BBC(1) provides for levy of tax @ 30% on anonymous donation received by, inter alia, charitable trusts or institutions referred to in section 11. Further, section 13(7) provides that the exemption provisions contained in sections 11 and 12 shall not be applicable in respect of any anonymous donation liable to tax under section 115BBC. As such, application of the anonymous donations received by the charitable trust for charitable purposes does not confer exemption from tax.
 - (ii) Section 115BBC(2) provides that the provisions contained in section 115BBC(1) relating to the taxability of anonymous donations are not applicable to any trust or institution created or established wholly for religious purposes. As such, the trust established wholly for religious purposes is not liable to be taxed in respect of the anonymous donations received by it. The application or non-application of such anonymous donation for the purposes of trust during the relevant financial year is not germane to the issue of taxability under section 115BBC.
 5. This issue was settled by the Supreme Court in Commissioner of Income-tax v. Hoogly Mills Co. Ltd. [2006] 287 ITR 333 (SC). In this case, it was observed that in the same agreement for sale of the undertaking, not only was it mentioned that a sum of Rs.2 crore would be paid as consideration but also that the vendee would take over the accrued and future gratuity liability of the employees of the vendor. Hence, the consideration for the sale was not only Rs.2 crore but, in addition, the gratuity liability of the vendor as well. Thus, the entire amount of consideration was a capital expenditure because it was an expenditure incurred for acquiring an asset of an enduring nature. The Apex Court, therefore, held that the sum of Rs.3.5 crores towards gratuity liability of employees of the vendor was also a capital expenditure as it was incurred for acquiring an asset of an enduring nature. However, no depreciation was allowable in respect of gratuity liability even if it was regarded as a capital expenditure, since gratuity liability does not fall under the category of building, machinery, plant or furniture nor is it an intangible asset of the kind mentioned in section 32(1)(ii). Further, even the deeming meaning given to "plant" in section 43(3) does not include gratuity liability.

Therefore, in view of this decision of the Apex Court, the claim for depreciation by X Ltd. in this case is not tenable in law.
 6. Section 72AB provides that in a case where the amalgamation has taken place during the previous year, set-off of accumulated loss and the unabsorbed depreciation of the predecessor co-operative bank will be allowed in the hands of the successor co-operative bank as if the amalgamation had not taken place. All the other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation would apply accordingly.

The benefit of carry-forward and set-off of accumulated losses under this section would be allowed only on fulfillment of the following conditions -

- (a) Conditions to be fulfilled by the predecessor co-operative bank
 - (1) It should have been engaged in the business of banking for three or more years; and
 - (2) It should have held at least three-fourths of the book value of fixed assets as on the date of the business reorganisation, continuously for two years prior to the date of business reorganisation;
- (b) Conditions to be fulfilled by the successor co-operative bank
 - (1) It should hold at least three-fourths of the book value of fixed assets of the predecessor co-operative bank acquired through business reorganisation, continuously for a minimum period of five years immediately succeeding the date of business reorganisation;
 - (2) It continues the business of the predecessor co-operative bank for a minimum period of five years from the date of business reorganisation; and
 - (3) It fulfils such other conditions as may be prescribed to ensure the revival of the business of the predecessor co-operative bank or to ensure that the business reorganisation is for genuine business purpose.

The Central Government may specify other conditions by notification in the Official Gazette as it considers necessary, to ensure that the business reorganisation is for genuine business purposes.

The amount of set-off of the accumulated loss and unabsorbed depreciation allowable to the resulting co-operative bank has to be calculated in the following manner -

- (1) In a case where the whole of the amount of such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting co-operative bank - the entire accumulated loss or unabsorbed depreciation of the demerged co-operative bank is allowed to be set-off.
 - (2) In a case where the accumulated loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting co-operative bank - the amount which bears the same proportion to the accumulated loss or unabsorbed depreciation of the demerged co-operative bank as the assets of the undertaking transferred to the resulting co-operative bank bears to the assets of the demerged co-operative bank.
7. The CBDT has, vide Notification No.2/2008 dated 8.1.2008, substituted the existing Rule 18C with new Rule 18C, which lays down the following eligibility criteria for Industrial Parks to claim benefit under section 80-IA (4)(iii) -
- (1) The undertaking should begin to develop, develop and operate or maintain and operate an industrial park any time during the period from 1.4.2006 to 31.3.2009.

- (2) The undertaking and the Industrial Park should be notified by the Central Government under the Industrial Park Scheme, 2008.
 - (3) The undertaking should continue to fulfill the conditions envisaged in the Industrial Park Scheme, 2008.
8. Under section 80-ID, a 'convention centre' is defined as a building of prescribed area and having such other facilities and amenities as may be prescribed.

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

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

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

- (a) an amphitheatre and landscaped open spaces for outdoor conference or seminar related activities;
 - (b) a kitchen, dining facility, cafeteria or restaurant only to support events in the convention centre.
9. (i) 33 months from the end of the assessment year in which the income was first assessable i.e. by 31.12.2011.
- (ii) 21 months from the end of the financial year in which notice under section 148 is served i.e. by 31.12.2009.
- (iii) 33 months from the end of the financial year in which the last of the authorizations for search under section 132 was executed i.e. by 31.12.2010.

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

Particulars	Rs.	Rs.
Profits and gains of business or profession		
Net profit as per profit & loss account		75,000
Add: Interest to partners on capital accounts for the period from 1.4.2007 to 30.9.2007	40,000	
Interest to partners on current accounts from 1.4.2007 to 31.3.2008	25,000	
Rs.55,000 paid towards purchase of airconditioners otherwise than by way of account payee cheque/draft.	55,000	
Difference on account of valuation of closing stock-in-trade at market value	10,000	
Salary paid to working partners considered separately	<u>1,80,000</u>	
		<u>3,10,000</u>
		3,85,000
Less: Additional depreciation on new machinery		<u>70,000</u>
		3,15,000
Less: Interest received from bank on fixed deposits considered separately		<u>30,000</u>
Book profit		2,85,000
Less: Salary to working partners -		
On first Rs.75,000 book profit @ 90%	67,500	
On next Rs.75,000 book profit @ 60%	45,000	
On balance Rs.1,35,000 book profit @ 40%	<u>54,000</u>	
		<u>1,66,500</u>
		1,18,500
Less: Business loss relating to assessment year 2007-08 set off		<u>15,000</u>
		1,03,500
Income from other sources		
Interest received from bank on fixed deposits		<u>30,000</u>
Total Income		<u>1,33,500</u>

Explanation for the treatment of various items

- (i) Interest to partners authorised by the partnership deed will be allowed as deduction only for the period beginning with the date of the partnership deed and not for any earlier period as per section 40(b)(iv). Therefore, interest paid to the partners on the balances standing to the credit of their capital accounts from 1.10.2007 alone is eligible for deduction, since the partnership deed was executed only on 1.10.2007. Interest for the period prior to 1.10.2007 is not allowed.
- (ii) The partnership deed of 1.10.2007 provided for payment of interest on balances in capital accounts of partners only. As such, the interest paid on the balances standing to the credit of the current accounts of partners is not allowable under section 40(b). The Kerala High Court has, in *Novel Distributing Enterprises v. DCIT & Anr.* (2001) 251 ITR 704 (Ker), on identical facts, held that interest paid to the partners on their current account balances is not allowable.
- (iii) Since X is a partner in his individual capacity, interest paid to the Hindu Undivided Family of partner X does not attract disallowance under section 40(b)(iv).
- (iv) Under section 40A(3), any payment towards expenditure incurred exceeding Rs.20,000 made otherwise than by an account payee cheque / account payee bank draft will attract disallowance of 100% thereof. Since the firm has made payments towards purchase of air-conditioners by crossed cheque and cash and not by an account payee cheque, 100% of such expenditure would be disallowed.
- (v) Diamond pendant valued at Rs.50,000 received as gift from a manufacturer for achieving sales target is taxable under section 28(iv), being a benefit arising from business.
- (vi) Depreciation on car bought and used exclusively for purposes of business is allowable though not registered in the name of the firm in view of the ratio of the decision of the Supreme Court in *Mysore Minerals Ltd. v. CIT* (1999) 239 ITR 775 (SC).
- (vii) The firm is entitled to additional depreciation@ 20% under section 32(1)(iia) in respect of the new machinery installed for manufacture of stationery items. Since the new machinery is put to use for less than 180 days during the relevant previous year, the additional depreciation is restricted to 50% of the prescribed rate of 20% i.e. it is restricted to 10%.
- (viii) Interest received from bank on fixed deposits made out of surplus funds is assessable under the head 'Income from other sources'. Hence, it is not taken into account for the purpose of computing book-profit.
- (ix) The Supreme Court has, in *A.L.A Firm v. CIT* (1991) 189 ITR 285 (SC), held that the closing stock has to be valued at market rate in the case of a dissolved firm. As such, the closing stock-in-trade of the firm has to be valued at the market rate.
- (x) Net profit shown in the profit and loss account computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or

payable to all the partners constitutes book profit as per Explanation 3 to section 40(b). Carry forward and set off of business loss is covered under Chapter VI. Hence, brought forward business loss relating to the assessment year 2007-08 is not considered for calculation of book-profit.

- (xi) Section 45(4) is not applicable to the firm for the assessment year 2008-09, since though the dissolution of the firm took place on 31.3.2008, there was no transfer by way of distribution of capital assets during the relevant previous year. The distribution of the capital assets took place on 4.4.2008. The capital gains will be assessable in the A.Y.2009-10.

11. A return of income filed within the due date may be revised by filing a revised return under section 139(5) where the assessee finds any omission or wrong statement in the original return subject to satisfying other conditions. There is no provision in the Income-tax Act to make changes or modification in the return of income by filing a letter. In a case where a return of income has been filed within the due date, the only option available to the assessee to make an amendment to such return is by way of filing a revised return under section 139(5). The Supreme Court in *Goetze (India) Ltd. vs. CIT* (2006) 284 ITR 323 has held that there was no provision in the Income-tax Act to allow an amendment in the return of income filed except by way of filing a revised return.

In the instant case, Mohan had filed return of income for the A.Y. 2008-09 within the due date specified under section 139(1). Later, he discovered that he had not claimed deduction under section 80E. He claimed the said deduction through a letter addressed to the Assessing Officer, which was not considered by the Assessing Officer. The proper course of action which Mohan must have followed is to file a revised return for claiming the deduction. Hence, the action of the Assessing Officer is justified in law, since he has no power to entertain a claim for deduction otherwise than by way of a revised return.

12. Section 139B provides for the scheme of submission of return of income through Tax Return Preparers. It empowers the Central Board of Direct Taxes (CBDT) to frame a scheme for the purpose of enabling any specified class or classes of persons to prepare and furnish their returns of income through Tax Return Preparers. Specified class or classes of persons have been defined to mean any person, other than a company or a person whose accounts are required to be audited under section 44AB or under any other existing law, who is required to furnish a return of income under the Act. Thus, companies and persons whose accounts are liable for tax audit under section 44AB do not fall within the definition of 'specified class or classes of persons' and consequently, cannot furnish their returns of income through Tax Return Preparers. In the instant case, the books of account of Mr. Bhuvan for the year ending 31.3.2008 have been audited under section 44AB. As such, he cannot furnish his return of income for the A.Y. 2008-09 through a Tax Return Preparer.
13. The Supreme Court in *Rajesh Kumar & Ors. v. DCIT* (2006) 287 ITR 91 observed that the order under section 142(2A) is a quasi judicial order. Therefore, the principles of natural justice have to be applied and the assessee has to be given an opportunity of being heard before directing the special audit. The principles of natural justice are based on

two principles, namely, (i) nobody shall be condemned unheard; (ii) nobody shall be a judge of his own cause. Once it is held that the assessee suffers civil consequences and any order passed would be prejudicial to him, the principles of natural justice must be held to be implicit. If the principles of natural justice were to be excluded, the Parliament could have said so expressly.

Accordingly, to give effect to the observation of the Supreme Court, the Finance Act, 2007 has provided that the Assessing Officer is now required to give the assessee a reasonable opportunity of being heard before issuing directions for special audit under section 142(2A).

Therefore, the contention of Mr.A is correct.

14. This statement is not correct.

Section 292C has been inserted by the Finance Act, 2007 retrospectively with effect from 1.10.1975 so that the presumptions contained in section 132(4A) can be made in any proceedings under the Act. This section provides that where any books of account, other documents, money, bullion, jewellery or other valuable article or thing are or is found in the possession or control of any person in the course of a search under section 132, it may, in any proceeding under this Act, be presumed that -

- (1) such books of account, other documents, money, bullion, jewellery or other valuable article or thing belong or belongs to such person;
- (2) the contents of such books of account and other documents are true;
- (3) the signature and every other part of such books of account and other documents which purport to be in the handwriting of any particular person or which may reasonably be assumed to have been signed by, or to be in the handwriting of, any particular person, are in that person's handwriting; and
- (4) In the case of a document stamped, executed or attested, that it was duly stamped and executed or attested by the person by whom it purports to have been so executed or attested

15. The Delhi High Court has, in *United Airlines vs. CIT* (2006) 287 ITR 281, held that the landing and parking fee for aircraft charged by the Airport Authorities is considered as rent for the purpose of section 194-I. As per Explanation (i) to section 194-I, rent means any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of, inter alia, land. When the wheels of an aircraft coming into an airport touches the surface of the air-field, the use of the land of the airport immediately begins. Similarly, for parking the aircraft in that airport, there is use of the land. Thus, even the landing of aircraft or parking of the aircraft amounts to use of the land of the airport. Hence, the landing fee and parking fee will amount to rent for the purpose of section 194-I.
16. The CBDT has, vide Circular No.13/2006 dated 13.12.2006, clarified the issue regarding the applicability of TDS provisions of section 194C on a contract for fabrication of article or thing as per the specifications given by the assessee. The CBDT observed that before

taking a decision on the applicability of TDS under section 194C on a contract, it would have to be examined whether the contract in question is a contract for work or a contract for sale.

The CBDT clarified that the provisions of section 194C would apply in respect of a contract for supply of any article or thing as per prescribed specifications only if it is a contract for work and not a contract for sale. Where the property in the article or thing so fabricated passes from the fabricator-contractor to the assessee only after such article or thing is delivered to the assessee, such contract would be a contract of sale and would, therefore, fall outside the purview of section 194C.

17. Circular No.1/2008 dated 10.1.2008 provides clarification regarding applicability of provisions of section 194-I to payments made by the customers on account of cooling charges to the cold storage owners.

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

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

18. This statement is correct. Under section 245H, the Settlement Commission may grant immunity from prosecution for any offence under the Indian Penal Code, Income-tax Act and any other Central Act. This power has now been restricted in respect of application made under section 245C on or after 1.6.2007. In respect of such cases, the Settlement Commission shall not grant immunity from prosecution for any offence under the Indian Penal Code or under any Central Act other than the Income-tax Act and Wealth-tax Act. However, in respect of applications pending as on 1.6.2007, the Settlement Commission has the power to grant immunity from prosecution for any offence under the Indian Penal Code and other Central Acts also.

19. Computation of Net Wealth of ABC Limited as on the valuation date 31.03.2008

Particulars	Reasons	Value (Rs. in crores)
Assets:		
(i) Fixed Assets:		
Plant & machinery	Not an asset u/s 2(ea)	Nil
Factory building	Commercial property. Hence, not an asset u/s 2(ea)	Nil

Urban land (300 sq. meters)	It is an asset u/s 2(ea) – Refer Note below	70
Motor cars	Used for running them on hire. Hence, not an asset u/s 2(ea)	Nil
(ii) Investments:		
Jewellery	Not stock-in-trade. Hence, an asset u/s 2(ea)	28
Plot of land in Bangalore	An asset u/s 2(ea). Refer Note below	60
Equity shares in subsidiary companies	Not an asset u/s 2(ea)	Nil
(iii) Current assets:		
Inventories (Jewellery)	Stock-in-trade. Hence, not an asset u/s 2(ea)	Nil
Sundry Debtors	Not an asset u/s 2(ea)	Nil
Cash and bank balances (includes cash balance of Rs.1,00,000)	Bank balance – not an asset under section 2(ea) Cash in hand – recorded in books – hence, not an asset under section 2(ea).	Nil
Value of assets as per Schedule III of the Wealth-tax Act, 1957 (A)		<u>158</u>
Liabilities:		
(i) Current Liabilities	Not incurred in relation to an asset under section 2(ea). Hence, not eligible for deduction.	Nil
(ii) Secured loan taken for purchase of urban land	Since the loan is taken for purchase of urban land, which is included in the net wealth, it is eligible for deduction.	50
Liabilities eligible for deduction (B)		<u>50</u>
Net wealth [(A) – (B)]		108

Note: Plot of land not exceeding 500 sq. meters is exempt only in the case of an individual or HUF and not in the case of a company.

20. This statement is correct. Urban land is an “asset” as per section 2(ea)(v) of the Wealth Tax Act and it means (i) land situated in any area comprised within the jurisdiction of a municipality or cantonment board and which has a population of not less than 10,000

according to the last preceding census; (ii) land situated in any area not being more than 8 kms from the local limits of any municipality or cantonment board.

However, in spite of fulfilling the above conditions, the following are not treated as urban land:-

- (i) land on which construction of a building is not permissible under any law for the time being in force in the area in which such land is situated;
- (ii) land occupied by any building which has been constructed with the approval of the appropriate authority;
- (iii) unused land held by the assessee for industrial purposes for a period of 2 years from the date of its acquisition by him; and
- (iv) any land held by the assessee as stock-in-trade for a period of 10 years from the date of its acquisition by him.

IMPORTANT CIRCULARS / NOTIFICATIONS ISSUED BETWEEN 1.5.07 and 30.04.08

NOTIFICATIONS

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

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

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

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

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

- (k) where the payment is made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person;
- (l) where the payment is made by an authorised dealer or a money changer against purchase of foreign currency or travellers cheques in the normal course of his business.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Further, if, on the date of vesting of the option, there is no trading in the share on any recognized stock exchange, the fair market value shall be -
 - (a) the closing price of the share on any recognised stock exchange on a date closest to the date of vesting of the option and immediately preceding such date; or
 - (b) the closing price of the share on a recognised stock exchange, which records the highest volume of trading in such share, if the closing price, as on the date closest to the date of vesting of the option and immediately preceding such date, is recorded on more than one recognized stock exchange.
- (3) In a case where, on the date of vesting of the option, the share in the company is not listed on a recognized stock exchange, the fair market value shall be such value of the share in the company as determined by a merchant banker [Category I merchant banker registered with SEBI] on the specified date [i.e. the date of vesting of the option or any date earlier than the date of the vesting of the option, not being a date which is more than 180 days earlier than the date of the vesting].
- (4) Closing price of a share on a recognised stock exchange on a date shall be the price of the last settlement on such date on such stock exchange. However, where the stock exchange quotes both buy and sell prices, the closing price shall be the sell price of the last settlement.
- (5) Opening price of a share on a recognised stock exchange on a date shall be the price of the first settlement on such date on such stock exchange. However, where the stock exchange quotes both buy and sell prices, the opening price shall be the sell price of the first settlement.
- (6) "Specified date" means –
 - (i) the date of vesting of the option;
 - (ii) any date earlier than the date of vesting of the option, not being a date which is more than 180 days earlier than the date of vesting.

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

The Finance Act, 2007 has introduced a deeming provision to define concession in the matter of rent by inserting Explanations to section 17(2)(ii) with retrospective effect from 1.4.2006, that is, with effect from assessment year 2006-07. This has necessitated reduction of rates in case of both rent free and concessional rent accommodations and leased accommodation in Table I of rule 3 with retrospective effect from 1st April, 2006, that is, in relation to assessment year 2006-07 and subsequent years. The amendment has taken place in valuation of perquisite of unfurnished accommodation (rent free and concessional) provided to other than Government employees.

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

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

Since, Chapter XII-H relating to Fringe Benefit Tax, as provided in the Finance Act, 2005, is not applicable to the employer, being an individual or a Hindu undivided family or any fund or trust or institution eligible for exemption under clause (23C) of section 10 or registered under section 12AA, rule 3 is required to be amended so as to include valuation of perquisite in case of benefits provided by such employers to its employees. Accordingly, sub-rules 2, 6, 7 (ii), (iii), (iv), (v) and (vi) have been inserted to provide for

such valuation. Sub-rule 7(ix) has been inserted to provide for valuation of any other benefit or amenity, etc. in residual cases relating to any employer. These sub-rules will take effect from 1st April, 2008 and will, accordingly, apply in relation to A.Y.2008-09 and subsequent years.

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

Motor Car - Rule 3(2)

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

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

	wholly and exclusively for official purposes, (ii) such reimbursement is for the use of the vehicle partly for official purposes and partly for personal or private purposes of the employee or any member of his household.	maintained by the employer. The actual amount of expenditure incurred by the employer as reduced by Rs.1,200 (plus Rs.600, if chauffeur is also provided to run the motor car). However, the documents specified in Note 2 below this table should be maintained by the employer.	maintained by the employer. The actual amount of expenditure incurred by the employer as reduced by Rs.1,600 (plus Rs.600, if chauffeur is also provided to run the motor car). However, the documents specified in Note 2 below this table should be maintained by the employer.
(3)	Where the employee owns any other automotive conveyance but the actual running and maintenance charges are met or reimbursed to him by the employer and (i) such reimbursement is for the use of the vehicle wholly and exclusively for official purposes, (ii) such reimbursement is for the use of the vehicle partly for official purposes and partly for personal or private purposes of the employee.	No value, provided that the documents specified in Note 2 below this table are maintained by the employer. The actual amount of expenditure incurred by the employer as reduced by an amount of Rs.600, provided the documents specified in Note 2 below this table are maintained by the employer.	Not applicable

Note -

- (1) Where one or more motor-cars are owned or hired by the employer and the employee or any member of his household are allowed the use of such motor-car or all or any of such motor-cars (otherwise than wholly and exclusively in the performance of his duties), the value of perquisite shall be the amount calculated in respect of one car in accordance with Sl. No. (1)(c)(i) of the above Table as if the employee had been provided one motor-car for use partly in the performance of his duties and partly for his private or personal purposes and the amount calculated in respect of the other car or cars in accordance with Sl. No. (1)(b) of the above Table as if he had been provided with such car or cars exclusively for his private or personal purposes.
- (2) Where the employer or the employee claims that the motor-car is used wholly and exclusively in the performance of official duty or that the actual expenses on the running and maintenance of the motor-car owned by the employee for official purposes is more than the amounts deductible in Sl. No. 2(ii) or 3(ii) of the above Table, he may claim a higher amount attributable to such official use and the value of perquisite in such a case shall be the actual amount of charges met or reimbursed by the employer as reduced by such higher amount attributable to official use of the vehicle provided that the following conditions are fulfilled:
 - (a) the employer has maintained complete details of journey undertaken for official purpose which may include date of journey, destination, mileage, and the amount of expenditure incurred thereon;
 - (b) the employer gives a certificate to the effect that the expenditure was incurred wholly and exclusively for the performance of official duties.
- (3) The normal wear and tear of a motor-car shall be taken at 10 per cent per annum of the actual cost of the motor-car or cars.

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

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

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

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

The value of travelling, touring, stay and other expenses borne by the employer for any holiday availed by the employee or any member of his household shall be the amount of the expenditure incurred by the employer. This provision applies in respect of trips other than those which are exempt under section 10(5) read with Rule 2B. If the facility is

maintained by the employer and it is not available uniformly to all employees, the value of benefit shall be taken to be the value at which such facilities are offered by other agencies to the public.

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

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

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

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

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

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

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

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

- (a) complete details in respect of such expenditure are maintained by the employer which may, inter alia, include the date of expenditure and the nature of expenditure;

- (b) the employer gives the certificate for such expenditure to the effect that the same - was incurred wholly and exclusively for the performance of official duties;

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

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

If the employer provides uniformly to all employees the use of health club, sports and similar facilities, there will be no taxable perquisite in respect of such facilities. Besides, there will be no taxable perquisite if the club expenditure is incurred wholly and exclusively for business purposes and the following conditions are fulfilled:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Section 10(15)(vii) exempts interest on bonds issued by a local authority or by a State Pooled Finance Entity and notified by the Central Government in the Official Gazette. Accordingly, the Central Government has specified the "Tax-free Pooled Finance

Development Bonds” under Pooled Finance Development Fund Scheme of Government of India, interest from which would be exempt under section 10(15)(vii).

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

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

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

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

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

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

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

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

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

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

The said notification is applicable when the audit under section 142(2A) is directed by an Assessing Officer on or after 1st June, 2007. The expenses of, and incidental to, audit (including the remuneration of the accountant, qualified assistants, semi-qualified and other assistants who may be engaged by such Accountant) should not be less than

Rs.3750 and not more than Rs.7500 for every hour of the period as specified by the Assessing Officer under section 142(2C). Such period shall be specified in terms of the number of hours required for completing the report.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Where,

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

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

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

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

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

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

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

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

CIRCULARS

1. CIRCULAR NO.4/2007 DATED 15.6.2007

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

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

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

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

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

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

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

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

- (i) where a company purchases and sells shares, it must be shown that they were held as stock-in-trade and that existence of the power to purchase and sell shares in the memorandum of association is not decisive of the nature of transaction;
- (ii) the substantial nature of transactions, the manner of maintaining books of accounts, the magnitude of purchases and sales and the ratio between purchases and sales and the holding would furnish a good guide to determine the nature of transactions;

- (iii) ordinarily the purchase and sale of shares with the motive of earning a profit, would result in the transaction being in the nature of trade/adventure in the nature of trade; but where the object of the investment in shares of a company is to derive income by way of dividend etc. then the profits accruing by change in such investment (by sale of shares) will yield capital gain and not revenue receipt.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- (g) furniture; or
- (h) fittings,

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

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

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

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

1. In terms of the provisions of Chapter XII-H of the Income-tax Act, an employer, being a company, is liable to pay Fringe Benefit Tax (FBT) in respect of the fringe benefits provided or deemed to have been provided by it to its employees, directly or indirectly, during the previous year.

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

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

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

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

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

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

$A - B$

Where,

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

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

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

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

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

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

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

4. Determination of the period of holding

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

5. Recovery of FBT by the employer from its employee

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

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

pay the fringe benefit tax in relation to the allotment or transfer of such specified security or sweat equity shares to such employee.

6. Illustration

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

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

Employee R exercises his option on 31st March, 2007 and shares are allotted/transferred to him on 3rd April, 2007. On 25th October, 2007, these shares are sold for Rs.200/- each. On the date of vesting of the option, fair market value of the share was Rs.80/- per share. The tax implication of above situation will be as under:-

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

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

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

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

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

7. Frequently Asked Questions

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Employer will be liable to FBT in India irrespective of whether employees have been charged to tax in different countries or not. An employer cannot claim any credit in India against its FBT liability for taxes paid by employees in other countries.

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

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

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

Act, at the option of the employer?

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

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

No. FBT would not be payable in such cases.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

20. How would the recovery of FBT be treated in the hands of the employer?
Since FBT is not an allowable deduction in computation of the income of the employer, any recovery of FBT will not be treated as income in his hands.
21. What should be the mechanism and timing of recovery of FBT?
The law does not provide for any specific mechanism or timing of recovery of FBT.
22. Is it lawful for the employer to recover FBT with respect to ESOPs granted prior to April 1, 2007?
It would be lawful for the employer to recover FBT with respect to ESOPs granted prior to April 1, 2007, but allotted or transferred to the employee after such date.
23. What will be the date of allotment of an Employee Stock Option?
The date of allotment of an Employee Stock Option shall be the date on which the underlying asset is allotted or transferred to the employee
24. Whether the FBT recovered from the employee would form the cost basis for employee for calculating Capital Gain on subsequent sale of shares?
No. The recovery of FBT from the employee by the employer will not change the cost of acquisition of the shares in the hand of the employee.
25. Will Rule 40C of Income-tax Rules also apply in a case where shares are allotted or transferred to an employee under Employee Stock Purchase Plan, or Employee Stock Option Scheme, or Employee Stock Ownership Plan, or Employee Stock Purchase Scheme, or Employee Stock Option Scheme or Employee Appreciation Rights or Plans?
Rule 40C shall apply in all cases where specified security or sweat equity shares, being shares in a company, are allotted or transferred to an employee under any scheme or plan or otherwise. For the purpose of this circular an Employees Stock Option Plan shall include all such schemes or plans, etc.