

CHAPTER - 01

WEALTH TAX

WEALTH TAX

Wealth Tax is charged for every Assessment Year on the "Net Wealth" of an individual, HUF, Company and certain association of persons, as on a particular date known as 'valuation date'.

ASSESSMENT YEAR (A.Y.)

Assessment year means a period of 12 months commencing from 1st day of April every year.

VALUATION DATE

Valuation date means the 31st March, immediately preceding the Asst. year. Where there is a change in the 'Net Wealth' on the 'Valuation date', it is the Net wealth as at the last moment of the valuation date, which is taxable.

NET WEALTH SEC.2 (M)

Net wealth means Total' Assets minus specified Debt. Total assets includes Deemed assets u/s 4. However no wealth tax is payable on Exempt assets as per section 5. The value of all the taxable assets on the valuation date is clubbed together and is reduced by the amount of debt owed by the assessee. The net wealth so arrived at is charged to tax at the rates specified. The present rate of tax is 1% of the amount by which the net wealth exceeds Rs. 15,00,000. The rate is same for individuals, HUF's and companies.

SECTION 45, NO WEALTH-TAX IS CHARGEABLE IN RESPECT OF

- 1) Any company registered under section 25 of the Companies Act, 1956.
- 2) Any co-operative society;
- 3) Any social club;
- 4) Any political party; and
- 5) A Mutual Fund specified under section 10(23D) of the Income-tax Act.

SECTION 3, CHARGE OF WEALTH-TAX

Subject to the other provisions contained in this Act, there shall be charged for every financial year, a wealth tax in respect of the net wealth on the corresponding valuation date of every individual, Hindu undivided family and company at the rate or rates specified.

Madras high court in case of Halai Menon Association [2000] 244 ITR 0357 has held that Association of persons are not liable to wealth-tax as individual. The reasons given by the court is that the expression "individual" cannot be stretched to include entities which were deliberately omitted and left out of the charging section of the Wealth-tax Act. The supreme court in case of CWT v. Ellis Bridge Gymkhana it has been held that It is only under the Wealth-tax Act that the charge is on "every individual, Hindu undivided family and company" and not on an association of persons or a body of individuals or a firm. If the language of section 3 of the Wealth-tax Act is contrasted with the provisions of other cognate statutes it will clearly appear that the intention of the Legislature was not to treat an association of persons or a body of individuals or a firm as an unit of assessment for the purpose of imposition of wealth-tax.

Now 21AA of the wealth tax provides for assessment of associations of persons in certain special cases and not otherwise. Assessment as an association of persons can be made only when the individual shares of the members of the association in the income or assets or both of the association on the date of its formation or any time thereafter are indeterminate or unknown. It is only in such an eventuality that an assessment can be made on an association of persons, otherwise not. An association of persons cannot be taxed at all under section 3 of the Wealth-tax Act. The Legislature deliberately excluded a firm or an association of persons from the charge of wealth-tax and the word "individual" in the charging section cannot be stretched to include entities which had been deliberately left out of the charge.

SCHEME OF LAW

Wealth tax is chargeable for every Asst. Year in respect of the Net Wealth as on the valuation date, of an individual, HUF and Company, at the flat rate of 1% of the Net Wealth is excess of Rs.15 lakhs. For example if Net Wealth is 16 lakhs then $16 - 15 = 1 \text{ lakh} * 1\% = 1000 \text{ Rs.}$ Is wealth tax liability.

PART II: “ASSETS” DEFINED U/S 2(ea) AS FOLLOWS:

BUILDING OR LAND APPURTENANT	
	Any building or land appurtenant thereto whether used for residential or commercial purposes or as guest-house or otherwise (including a farm houses situated within 25kms. From the local limits of any municipality or a cantonment board).
Exclusion 1	A house meant exclusively for residential purpose and which is allotted by a company to an employee or an officer or a director who is in whole-time employment, having a gross annual salary of less than Rs.5 [FIVE] Lakhs.
Exclusion 2	Any house for residential or commercial purpose which forms part of stock –in-trade
Exclusion 3	Any house occupied by the assessee for the purpose of any business or profession carried on by him.
Exclusion 4	Any residential property that has been let-out for a minimum period of three hundred days in the previous year
Exclusion 5	Any property in the nature of commercial establishments or complexes
MOTOR CARS	
Exclusion 1	Motor cars used by the assessee in the business of running them on hire or
Exclusion 2	As stock-in-trade:
JEWELLERY	
	Jewellery, or any other article made wholly or partly of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals: MEANING OF JEWELLERY Ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stones, and whether or not worked or sewn into any wearing apparel Precious or semi-precious stones, whether or not set in any furniture, utensils or other article or worked or sewn in to any wearing apparel
Exclusion 1	Those used by the assessee as stock-in-trade.
Exclusion 2	Gold Deposit Bonds issued under the Gold Deposit Scheme.
YACHTS BOATS AND AIR CRAFTS.	
Exclusion 1	Those used by the assessee for commercial purpose and held as stock in trade.
URBAN LAND	
	Urban Land” means Land situated in any area which is comprised within the jurisdiction of a municipality or a cantonment board and which has a population of not less than ten thousand according to the last preceding census of which the relevant figures have been published before the valuation date OR In any area within such distance, not being more than 8 kms. From the local limits of any such municipality or cantonment board as may be notified.
Exclusion 1	Land on which construction of a building is not permissible under any law.
Exclusion 2	Land occupied by any building which has been constructed with the approval of the appropriate authority
Exclusion 3	Any unused land held by the assessee for industrial purposes for a period of two years from the date of its acquisition by him.
Exclusion 4	Any land held by the assessee as Stock-in-trade for a period of TEN years from the date of its acquisition by him.
CASH IN HAND	
	Cash in hand, in excess of Rs.50,000 of individuals and HUF’s and in the case of other persons any amount not recorded in the books of accounts.

USED FOR THE PURPOSE OF BUSINESS AND PROFESSION

The assessee-company, which carried on various businesses, owned several buildings, most of which were let to its employees. The rental of the premises was fixed, it did not change with the change of the occupant, and it was deducted from the wages of the employee or employees occupying the premises. Held that, That the income of the assessee from the buildings or lands appurtenant thereto rented out to its employees was income from business and not as "Income from property". [1966] 059 ITR 0152- Commissioner of Income-tax vs. Delhi Cloth and General Mills Co. Ltd. (Punjab High Court)

A bungalow owned by the assessee-company was in the occupation of G and K as employees and directors free of charge. The assessee-company effected repairs to the bungalow and also provided modern amenities including air-conditioners. The questions were whether the income from the bungalow was to be computed as income from business and whether the assessee was entitled to claim allowance for actual repairs and depreciation.

Held that

- 1) In view of the finding of fact by the Tribunal, occupation of the property by G and K for the purpose of effective discharge of their duties vis-a-vis the business of the assessee-company amounted to occupation by the assessee for the purpose of its business and the income therefore had to be assessed as income from business;
- 2) That the assessee was entitled to deduction of actual repairs and depreciation.
- 3) When a house property is occupied as residence by employees or directors, etc., of the assessee-company, if concerned with the promotion of the business of the assessee-company, whether on payment of rent or otherwise, to enable them to discharge their functions efficiently and the letting out of the property is subservient and incidental to the main business of the assessee, such an occupation amounts to occupation and user of the property by the assessee itself for the purpose of its business, even though no business is actually run in such premises. [1994] 210 ITR 0001- CIT vs. Modi Industries Ltd. (Delhi High Court)

BUILDING UNDER CONSTRUCTION

Section 2(ea) refers to any building or land appurtenant thereto whether used for residential or commercial purposes or for the purpose of maintaining a guest-house otherwise including a farm house situated within 25 kms from local limits of any municipality with some exceptions provided therein. Nowhere in the definition of the word 'assets', an incomplete building has been referred to. The charging section of the Act has to be strictly construed and, accordingly, the value of the incomplete building cannot be added in the net wealth of the assessee. In the absence of any provision in the Act for inclusion for value of incomplete building, the building in question is not includible in the computation of the net wealth of the assessee on the relevant valuation date. However land can be subjected to wealth tax on its own merit.

AIRCRAFTS USED FOR BUSINESS PURPOSES

The wordings in section 2(ea) make it clear that there is difference between the term 'commercial purposes' and the term 'used by the assessee in the business of running them on hire'. Wherever the Legislature wanted that a particular asset should be used for hire for claiming exemption, they have specifically mentioned this fact. In other cases, the term 'commercial purposes' has been used to indicate that the asset should be used for the purpose of business and there is no condition that it should be let out on hire. The term 'commercial purposes' has to be distinguished from 'personal purposes'. In other words, if the aircraft, i.e., helicopter, is used for personal purposes, it would be liable to wealth-tax. If it is used for 'commercial purposes', i.e., for business purposes, it would not be chargeable to wealth tax.

In the case of *Amalgamated Electricity Co. Ltd.*, it was held that if the asset is used for doing a business, the object of which is to make a profit, then the asset is used for commercial purposes. It is nowhere laid down that in order to satisfy the requirement of commercial purposes, aircraft should be used as air taxi. One can use it for his own business also to meet the exigencies of the business. Admittedly, it was treated as business asset. The depreciation was allowed on the same. As such, it can be said that the helicopter was used for commercial purposes. It is therefore beyond the ken of wealth-tax.

PART III: INCIDENCE OF TAXATION SEC.6

Incidence of Tax depends on the residential and citizenship status of the assessee and location of assets. The following table summaries this:

	CATEGORY 1	CATEGORY 2
STATUS	INDIVIDUAL, if he is both ordinarily citizen in India AND citizen of India HUF, if it is ordinarily resident in India. COMPANY, if it is Resident in India.	ALL OTHER ASSESSEES
TAXABLE ASSETS	ALL ASSETS Wherever located I.E. In India + Abroad	ASSETS IN INDIA
DEDUCTIBLE DEBTS	ALL DEBTS Wherever located	Debts in India

LOCATION OF THE ASSETS

The question whether a property is located in India or not is one of fact and will have to be decided in the light of available evidence. However, the Central Board of Direct Taxes (CBDT) has given general guidance in this regard as depicted in the table below:

	PROPERTY	LOCATED IN INDIA
1)	Tangible immovable property	If the property LIES in India
2)	Rights or interest in or over Immovable property (otherwise than by way of security) or benefits arising out or immovable property.	If the said immovable property lies in India.
3)	Rights or interest in or over Movable property (otherwise than by way of security).	If the said movable property is LOCATED in India.
4)	Debts	If they are contracted to be repaid in India.
5)	Ships or Aircraft's.	If REGISTERED in India.

PART IV: DEEMED ASSETS: SEC. 4(1) CLUBBING PROVISIONS

In computing the net wealth of an Individual, there shall be included as belonging to that individual the value of assets, which on the valuation date are held.

(i)	By the SPOUSE of such individual to whom such assets have been transferred by the individual, directly or indirectly, otherwise than for adequate consideration or in connection with agreement to live apart, or
(ii)	By a MINOR CHILD, not being a married daughter of such individual, or A minor child suffering from any disability of the nature specified in the sec 80U of the I.T.Act. Clubbing provision shall not apply in respect of such assets as have been acquired by the minor child out of his income referred to in the proviso 64(1A) of the Income-tax Act and which are held by him on the valuation date: Where the assets held by a minor child are to be included in computing the net wealth of an individual, such assets shall be included, (a) where the marriage of his parents subsists, in the net wealth of that parent whose net wealth (excluding the assets of the minor child so includible) is greater; or (b) where the marriage of his parents does not subsist, in the net wealth of that parent who maintains the minor child in the previous year. Where any such assets are once included in the net wealth of either parent, any such assets shall not be included in the net wealth of the other parent in any succeeding year unless the Assessing Officer is satisfied, after giving that parent an opportunity of being heard, that it is necessary so to do

(iii)	By a person or association of persons to whom such assets have been transferred by the individual directly or indirectly otherwise than for adequate consideration for the immediate or deferred benefit or the individual, his or her spouse, or both.
(iv)	By a person or association of persons to whom such assets have been transferred by the individual otherwise than under an IRREVOCABLE TRANSFER.
(v)	By the SON'S WIFE of such individual to whom such assets have been transferred by the individual, directly or indirectly, otherwise than for adequate consideration.
(vi)	By a person or association or persons to whom such assets have been transferred by the individual, directly or indirectly otherwise than for adequate consideration for the immediate or deferred benefit of the son's wife, of such individual.

RELATION SHIP OF HUSBAND AND WIFE

In order to attract the application of clubbing provisions of spouse the relationship of husband and wife must subsist not only at the time of the accrual of income from the assets but also when the transfer of assets is made. The words "wife" and "husband" must be taken in their primary sense which is clearly indicative of a marital relationship. [1963] 049 ITR (S.C.) 0097- Philip John Plasket Thomas vs. CIT (Supreme Court of India)

If H has gifted to W jewellery worth Rs.100,000/- on 1.12.1996 and subsequently H marries w on say 1.1.1997 then the value of jewellery will never be clubbed with the Net wealth of H at any time: even after their marriage. This is because the relationship of husband and wife did not exist on the date of transfer. E.g. (b) if H & W are husband and wife and H gifts jewellery worth Rs.100,000/- to W on 15.12.1997 but dies on 31.12.1997 then (although on 31.3.1997 clubbing did take place) on the valuation date 31st march, 1998 no clubbing will take place since on the valuation date 31.3.98 the relationship of husband and wife does not exist. A widow or widower is not a spouse.

WHAT VALUE TO BE CLUBBED

It may be noted that the value to be clubbed will be the value (of the transferred asset) as on the valuation date irrespective of what its value was when transferred.

Property was sold by assessee to wife for inadequate consideration. There shall be inclusion of income from property sold, in husband's income to the extent of inadequacy of consideration. [1970] 076 ITR 0279 Patwardhan (H.N.) vs. CIT (Bombay High Court)

Where there is Transfer of house property to spouse otherwise than for adequate consideration assessee is deemed to be owner of house property. In this case entirety of income arising to spouse from house property includible in assessee's total income. Principle of proportionality determined by inadequacy of consideration not postulated by section 64. [1988] 173 ITR 0003- CIT vs. Junus Haji Ummer Sait (Kerala High Court)

WHEN ASSET CHANGE ITS FORM

Further the clubbing provisions will apply irrespective of whether the assets are held by the transferee in the original form (i.e. in the same form as he received them) or in any other form on the valuation date. Where the asset transferred by the assessee is disposed of by the transferee & the transferee acquires (with the consideration received) another asset, the value of that new acquired asset as on the valuation date will be clubbed. CWT Vs Kishan Lal Bubna 204 ITR 600 (SC). Reading section 4(1)(a) of the Wealth-tax Act, 1957, there is no doubt that the provision contemplates that where the assets which have been transferred have been converted to some other assets, it is the value of the converted assets on the valuation date that has to be taken into account in computing the net wealth of the transferor assessee. [1993] 204 ITR 0600- CWT vs. Kishan Lal Bubna (Supreme Court of India)

Where there is transfer of assets to spouse or minor child there shall be inclusion of transferred assets in net wealth of assessee if such assets are assets as per section 2(ea) on the valuation date. Such properties transferred need not have been "assets" on the date of transfer. [1978] 115 ITR 0160A Kollankulam (M.G.) vs. CIT (Kerala High Court)

INDIRECT TRANSFER / CROSS TRANSFER

For the purpose of clubbing provision it was not necessary that the same assets belonging to the husband should have reached the wife. The assets might, in the course of being transferred, be changed deliberately into assets of a like value of another person, as happened in this case. A chain of transfers such as those in this case was comprehended by the word "indirectly". That if two transfers were inter-connected and were parts of the same transaction in such a way that they could be said to have been adopted as a device to avoid the implications of

clubbing provision then the case would fall within the section even though one was not in the consideration for the other in the technical sense. Commissioner of Income-tax Vs. Kothari (C.M.) 49 ITR 109.

MINORS INCOME OUT OF SPECIFIED SOURCE

The clubbing provision of sec. 4(1)(a)(ii) will not apply in respect of assets, acquired by the minor child out of income earned by him, from any manual work done by him or from activity involving application of his skill, talent. Specialised knowledge & experience.

If on the valuation date the child already has become a major the value of assets cannot be included in the Net Wealth of the transferor (CIT Vs. Ashokabhai Chimanbhai 56 ITR 42 (SC)). In other words the child should be "minor" on the valuation date.

ACCRETION TO VALUE OF ASSET

Where shares are transferred by an assessee to his spouse and subsequently bonus shares are allotted to her, the bonus shares are an accretion to the assets transferred by the assessee but they cannot be regarded as "assets transferred" by the assessee and the dividend income from those bonus shares cannot be regarded as arising even indirectly from the assets transferred by the assessee and cannot be included in the total income of the assessee. Held that the dividend income on the bonus shares held by the assessee's wife was not taxable in the assessee's hands under section 64 as the bonus shares could not be regarded as "assets transferred" by the assessee. [1983] 142 ITR 0377- CIT vs. Birla (M.P.) (Bombay High Court)

SEC.4 (1)(B): SHARE IN FIRMS OR AOP'S:

Where the assessee is partner in a firm or is a member of an association of persons the value of his interest in the assets of the firm or the association is to be included in his Net Wealth u/s 4(1)(b).

If a person is a partner in a firm on behalf of the HUF then value of his interest in the firm is includible in the Net wealth of HUF.

The value of interest of a minor in a firm (in which he is admitted to the benefits of partnership) is to be included in the net Wealth of that parent whose Net wealth (exclusive of this value) is greater. So ordinarily a minor's share in a firm will be clubbed in the hands of the parents whose Net wealth is higher. However if the marriage of his parents does not subsist then the same will be included in the New Wealth of that parent who maintains the minor child.

SEC 4(1A): HUF CLUBBING PROVISIONS:

When an individual converts **his separate property** into joint family **property of HUF** or transfers the property to the HUF (of which he is a member) otherwise than for adequate consideration then:

- 1) The entire value of the property so converted or gifted will be included in the Net Wealth of the individual and
- 2) Subsequently if the converted or gifted property becomes the subject matter of total or partial partition then the share allotted to the SPOUSE out of the converted or gifted property will be included in the Net Wealth of that individual.

This Sec. Will apply only to conversions or gifts made after 31.12.1969.

SEC.4 (5) IRREVOKABLE TRANSFER

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

Further in order to constitute an irrevocable transfer the following conditions must be satisfied.

- 1) The instrument of transfer must not contain any provisions for the RETRANSFER directly or indirectly over the whole of any part of the assets or income.
- 2) The instrument of transfer must not give the transferor rights to REASSUME power directly or indirectly over the whole or any part of the assets or income.

However, it is stated that an irrevocable transfer includes a transfer, which is not revocable for a period exceeding 6 years or during the lifetime of the transferee.

We have seen above that a transfer not revocable for a period exceeding 6 years is treated as an irrevocable transfer Hence the value of the transferred assets will not be clubbed with the Net wealth of the transferor. However sec.4 (5) states that as soon as the power to revoke arises (say after 7 Years), clubbing will start and the value of the assets will have to be included in the Net wealth of the transferor.

SEC.4 (5A) GIFTS BY BOOK ENTRIES

Where a person makes a gift of money by means of entries in the books of accounts (maintained by him or any other individual, HUF, firm, AOP or BOI with whom he has a business or other connection) the value of such gifts will be includible in his Net Wealth unless he proves to the satisfaction of the AO (Assessing Office) that the money has actually been DELIVERED AT THE TIME ENTRIES WERE MADE.

SEC.4 (7) PROPERTY HELD AS MEMBER OF CO-OPERATIVE HOUSING SOCIETY ETC

Where the assessee is a member of a co-operative housing society company or association of persons and building or part thereof is allotted or leased to him he shall be deemed to be owner of such building or part and its value shall be includible in his Net Wealth. In determining its value however any outstanding installments payable by the assessee to the society, company, or association of persons towards cost of the house is deductible as debt owned.

SEC.4 (8) 53A OF THE TRANSFER OF PROPERTY ACT

A Person:

- a) Who is allowed to take/retain possession of any building or part thereof in part performance of a contract of the nature referred to in **sec.53A of the Transfer of Property Act.**
- b) Who acquires any rights in any building or part thereof by virtue of a transaction of the type referred to in **Sec. 269 UA (f) of the I.T. Act.** Is deemed to be the owner of that building or part and the value thereof would be includible in his Net Wealth.

SEC 33. LIABILITY OF TRANSFEREES OF PROPERTIES IN CERTAIN CASES

Where by reason of the provisions contained in section 4, the value of any assets transferred to any of the persons mentioned in that section have to be included in the net wealth of an individual, the person in whose name such assets stand shall, notwithstanding anything contained in any law to the contrary, be liable, on the service of a notice of demand by the Assessing Officer in this behalf, to pay that portion of the tax assessed on the assessee as is attributable to the value of the asset standing in his name as aforesaid. Provided that where any such asset is held jointly by more than one person, they shall be jointly and severally liable to pay the tax as is attributable to the value of the asset so jointly held.

Where any such person as is referred defaults in making payment of any tax demanded from him, he shall be deemed to be an assessee in default in respect of such sum, and all the provisions of this Act relating to recovery shall apply accordingly.

PART V: EXEMPT ASSETS: SEC.5

SEC.5 (I): PUBLIC CHARITABLE TRUSTS		
	Any property held by the assessee under trust or other legal obligation for any public purpose of a charitable or religious nature in India, is exempt However business assets (subject to some exceptions) will not be exempt.	
SEC.5 (II): COPARCENERCY INTEREST IN HUF		
	Interest of the assessee in coparcenery property of an HUF is exempt.	
SEC.5 (III): RESIDENTIAL BUILDING OF A RULER		
	Any one building used by a Ruler as his official residence immediately before the commencement of the Constitution (26 th Amendment) Act. 1971 is exempt	
SEC.5 (IV): RULER’S JEWELLERY		
	Jewellery in possession of Ruler, which is not his personal property, is fully exempt if it is recognised by the Central Government before 1.4.1957 or the Board after that date.	
SEC.5 (V): FOR PERSON OF INDIAN ORIGIN OR A CITIZEN OF INDIA		
	If any person of Indian origin or a citizen of India who was ordinarily residing in a foreign country, leaves such country and returns to India with an intention of permanently residing in India then he will enjoy exemption on the following assets for the next 7 successive Asst. Years after his return.	
	Money brought in to India	Provided they are brought into India within one-year prior to return to India or thereafter.
	Value of assets brought in to India	
	Value of assets acquired out of moneys brought in to India	
	A person shall be deemed to be of Indian origin if he, or either of his parents or any of his grandparents, was born in undivided India; Moneys standing to the credit of such person in a Non-resident (External) Account in any bank in India on the date of his return to India, shall be deemed to be moneys brought by him into India on that date.	
SEC.5 (VI) ONE HOUSE OR PART OF A HOUSE OR A PLOT OF LAND		
	One house or part of a house or a plot of land belonging to an individual or a Hindu undivided family Provided that wealth-tax shall not be payable by an assessee in respect of an asset being a plot of land comprising an area of five hundred square meters or less. Several self-contained units which are contiguous and situate in the same compound and with common boundaries and having unity of structure could be regarded as one building. The exemption would be available in respect of the value of the entire building, [1992] 197 ITR 0258- CWT vs. Najima Nizar (Mrs.) (Kerala High Court)	

DEBT OWED

NET WEALTH = TOTAL ASSETS – ALLOWABLE DEBTS

A contingent liability is not a debt owed, and cannot be deducted.

A question has arisen regarding the admissibility of deduction of the wealth-tax liability for the purpose of computing the taxable net wealth. The Board has been advised that the liability under the Wealth-tax Act is not a debt owed by the assessee incurred in relation to the assets taxable under the Wealth-tax Act. The liability to wealth-tax is a personal liability of the assessee. Moreover, this liability not a debt incurred by the assessee but is created by the statute. Therefore, no deduction is to be allowed for the wealth-tax liability in the computation of the taxable net wealth of the assessee. [1993] 203 ITR (Stat) 0134- Circular Number: 663

On the death of B, the Maharaja of Gondal, disputes arose between his two sons, viz., V and his younger brother, S. Their mother, the assessee, intervened and gave a letter to S, to the effect that if V did not give in full Rs. 50 lakhs which was the amount B had desired to give S, then S will get the balance of the amount from her.

V paid only Rs. 20 lakhs and S claimed the balance from the assessee. Pursuant to her commitment, the assessee transferred war stock valued at Rs. 11 lakhs to S and also agreed to hand over certain ornaments in full settlement of his claim. The ornaments were not given and disputes arose between S and the assessee which were also eventually settled in writing and by virtue of that settlement the assessee paid a sum of Rs. 10 lakhs to S. The question was whether for the purpose of computing the assessee's net wealth on the valuation dates the liability to pay the balance of Rs. 19 lakhs could constitute a debt owed by the assessee within the meaning of section 2(m) of the Wealth-tax Act, 1957, and was deductible. [1979] 117 ITR 0784- CWT vs. Vijayaba (H.H.), Dowager Maharani Saheb of Bhavnagar Palace (Supreme Court of India)

Held that

- 1) On the facts, that this was a case of a family settlement or family arrangement binding on the parties; the assessee agreed to purchase peace for the family and to pay her son, S, the amount which fell short of Rs. 50 lakhs if her elder son, V, did not pay him and such a consideration was good consideration which brought about an enforceable agreement between the parties;
- 2) The liability of the assessee became enforceable by law,
- 3) The liability of the assessee was created by the family arrangement arrived at between the parties, and even if it was a contingent liability, the contingency did happen and the assessee became liable to pay the sum of Rs. 19 lakhs as a debt.
- 4) The sum of Rs. 19 lakhs was a subsisting debt on the valuation dates and was deductible in computing the assessee's net wealth. [1979] 117 ITR 0784- CWT vs. Vijayaba (H.H.), Dowager Maharani Saheb of Bhavnagar Palace (Supreme Court of India)

The assessee borrowed a sum of Rs. 40,000, from the LIC on the security of his house in which he was residing. Out of this Rs. 30,000 was invested in a fixed deposit in a bank for one year. On the security of the fixed deposit the assessee borrowed monies which he utilised for various purposes. The amount of the loan borrowed was adjusted against the fixed deposits on maturity. In his return for wealth-tax, the assessee claimed deduction of the amount outstanding on the valuation date out of the amount borrowed from LIC. The debt in question was one acquired by the mortgage of the residential house which was not chargeable to wealth-tax thus the debt could not be allowed as a deduction. [1980] 123 ITR 0464- Srinivasan (T.V.) vs. CWT (Madras High Court)

Section 80L can be availed of only by an assessee and as the total income of a husband as defined in s. 2(45) would include the income arising to the wife in respect of which s. 64(1)(iii) would operate, the provisions of SEC. 80L cannot be applied to the income arising to the wife which has to be included in the hands of the husband under s. 64(1)(iii), because, in respect of that income, the wife cannot be considered as the assessee. Consequently, the relief under s. 80L would be available to the husband after the wife's income has been clubbed with his income. [1984] 146 ITR 0627- CIT vs. Ramaswamy (P.N.) (Madras High Court)

The first step to be taken in arriving at the net wealth of the assessee is to take the aggregate value of all his assets which are required to be included in his net wealth in accordance with the provisions of the Act. The assets which are specified in section 5(1) of the Wealth-tax Act, 1957, have to be excluded in arriving at the aggregate value of all his assets for the purpose of section 2(m) of the Act. The aggregate value of all the debts thereafter will be deducted from the aggregate value of all the assets so arrived at. I.E. debts in relation to exempt assets shall not be allowed as deduction. [1996] 217 ITR 0159- CWT vs. Chockalingam (P.R.) (Madras High Court)

The assessee, one of the co-owners of a house having a one third share therein, had received advance rent. That amount remained unadjusted out of the advance received by the assessee was a "debt owed ". [1991] 192 ITR 0163- SHAKTI SIKAND (Delhi High Court)

PART VII SEC.7: VALUATION OF ASSETS:

VALUATION OF IMMOVABLE PROPERTY (PART B SCHEDULE III)

	Actual Rent	X
Add:	Where taxes levied in respect of the property are borne wholly or partly by the tenant-by the amount of the taxes so borne by tenant;	X
Add:	Where expenditure on repairs is borne by the tenant –by one-ninth of the actual rent	X
Add:	Where the owner has accepted any amount as deposit (not being advance rent for three months or less)- by 15 percent of the deposit minus the interest actually paid: (if deposit was outstanding for only part of the previous year 15% p.a. must be calculated for the number of complete months for which deposit was outstanding)	X
Add:	Where the owner has received any amount by way of premium-by the amount obtained by dividing the premium by the number of years of the lease	X
Add:	Where the owner derives any benefit or perquisite as consideration for leasing of the property or any modification of the terms of the lease, by the value of such benefit or perquisite	X

	ACTUAL ANNUAL RENT (a)	X
	MUNICIPAL VALUATION (b)	X
	Where the property is let Actual annual rent or annual ratable value assessed by local authority whichever is higher. <u>[ACTUAL ANNUAL RENT OR MUNICIPAL VALUATION WHICHEVER IS HIGHER]</u>	
	Where the property is not let : Annual ratable value assessed by local authority or if there is no such assessment the amount which the owner can reasonably be expected to receive as annual rent had such property been let.	
	GROSS MAINTAINABLE RENT	X
Less	Municipal Taxes levies	X
Less	15% of GMR	X
	Net Maintainable Rent	X
	CAPITALISE NMR (NMR * 12.5/10/8) (See note no. 1)	X
	If the property is acquired or constructed on or before 31.3.1974 than the Capitalised NMR	
	If the property is acquired or constructed after 31.3.1974 value thereof will be higher of Capitalised NMR or Actual Cost (i.e. actual cost of acquisition/construction (plus cost of improvement, if any) However even for a property acquired/constructed after 31.3.74 the value may be taken as “Capitalised NMR “(Instead of higher of Capitalised NMR & Actual Cost) if the property satisfies BOTH the following requirements (i) The property is a residential house exclusively used by the assesses for his one residential purpose throughout the period of 12 months ending on the valuation date. (ii) Actual cost thereof does not exceed Rs.25 lacs. (Rs.50 lacs for Bombay, Calcutta, Delhi & Madras) It may be noted however that this benefit is available for only ONE such residential house. Thus an assessee having more than one such house may choose any one for this purpose.	
Add:	PREMIUM FOR EXCESS UNBUILT AREA (Note No. 2)	X
Less:	REDUCTION FOR UNEARNED INCREASE IN VALUE OF LAND (Note No. 3)	X

	SEC.7 (2) VALUATION OF SELF OCCUPIED HOUSE: The value of S.O. House may be taken at the Option of the assessee as the value determined in the manner laid down in Schedule III as on the valuation date next following the date on which he become owner of the house or the valuation date relevant to the A.Y. 1971-72 whichever is later. Thus the assessee is given an option to take the old value if he so chooses. However he gets this option only if the house is self occupied (S.O.) in the sense that is it exclusively used by him for residential purposes throughout the period of 12 months immediately preceding the valuation date.	
	Value of the property for the purpose of the wealth tax	X

CAPITALISED NMR (note no 1)

The value of the property is to be taken as Capitalised NMR i.e. NMR * Multiplier factor. The Capitalised NMR is calculated as NMR multiplied by 12.5 or 10 or 8 depending on whether the building is constructed on freehold land and the UN-expired period of lease as on the valuation date. The following table summaries this:

Bldg. Constructed. On	Freehold Land	Leasehold Land		
		Unexpired period of lease of such land on V.D.		
		> Or = 50 yrs.	> 15 < 50 yrs.	< Or = 15 yrs.
Multiplier =	12.5	10	8	Part B of Schedule III Not Applicable.

ADD PREMIUM (FOR EXCESS UNBUILT AREA): (RULE 6) (Note No. 2)

If the un-built area exceeds the specified area the Rule 3 value will be increased by the following Premium percentages.

% Of Excess Area To Aggregate Area	PREMIUM TO BE ADDED
> 05% but < or = 10% of Aggregate Area	20%
>10% but < or = 15% of Aggregate Area	30%
>15% but < or = 20% of Aggregate Area	40%
>20% of Aggregate Area	Part B not Applicable FMV TO CONSIDER

The un-built area of the plot of land (or the vacant plot) should not exceed the specified area. The specified area is

a)	For Bombay, Calcutta, Delhi & Madras	60% of Aggregate Area
b)	For Agra, Ahmedabad, Amristar, Allahabad, Bangalore, Bhopal, Cochin, Hyderabad, Indore, Jabalpur, Jamshedpur, Kanpur, Lacknow, Ludhiana, Madurai, Nagpur, Patna, Pune Sale, Sholapur, Srinagar, Surat Tiruchirapalli, Trivandrum, Baroda & Varanasi MIDDLE LEVEL TOWNS	65% of Aggregate Area
c)	Any other place	70% of Aggregate Area

REDUCTION FOR UNEARNED INCREASE IN VALUE OF LAND (Note No. 3)

Where the property is constructed on land obtained on lease from the Government, a local authority or any authority referred to in clause (20A) of section 10 of the Income-tax Act, and the Government or any such authority is, under the terms of the lease, entitled to claim and recover a specified part of the unearned increase in the value of the land at the time of the transfer of the property, the value of such property as determined shall be reduced by the amount so liable to be claimed and recovered or by an amount equal to fifty per cent. of the value of the property as so determined, whichever is less, as if the property had been transferred on the valuation date. In other words where

- 1) The property is constructed on land obtained on lease from the Government or a Local/Housing Authority
- 2) The Government /authority is entitled to recover a specified part of the unearned increase in value of the land, at the time of transfer of the property.

Then the Rule 3 value will be reduced by the lower of the following 2 amounts:

- i) Amount liable to be recovered by the Government/ authority as aforesaid; or
- ii) 50% of the Rule 3 value.

RESIDUARY RULE

Rule 8 provides that if on the basis of the facts & circumstances of the case the A.O. is of the opinion that it is not practicable to apply the provision of rule 3, then the Valuation will NOT be as per the said RULE 3. However the A.O. will have to take prior approval of the DY.CIT for this purpose. In all such cases where Rule 3 becomes “NOT Applicable” the value of the property will be determined as per Rule, 20.

VALUATION OF ASSETS OF BUSINESS (PART D, SCHEDULE III) (RULE – 14)

If the assessee is carrying on a business for which accounts are maintained by him regularly, the net value of the assets of the business as a whole, having regard to the balance sheet of such business on the valuation date is taken as value of such assets.

For this purpose one has to make the following adjustment:

Assets	Value to be taken
Depreciable assets	Written down value
Non-depreciable assets (other than stock-in-trade)	Book value
Closing stock	Value adopted for the purpose of income tax.

If the value of any asset (referred above) determined according to the provisions of Schedule III exceeds the value given in the table supra by more than 20 percent of the value given in the table (supra), then higher value shall be taken as value of the asset.

The value of an asset not disclosed in the balance sheet, shall be taken to be the value determined in accordance with the provisions of schedule III as applicable to that asset.

INTEREST IN FIRM OR ASSOCIATION OF PERSONS (PART E - SCHEDULE III) (RULE – 15, 16)

The net wealth of the firm or association of persons on the valuation date shall first be determined as if it were the assessee and, thereafter,

		Rs.
A)	That portion of the net wealth of the firm or association as is equal to the amount of its capital shall be allocated among the partners or members in the proportion in which capital has been contributed by them	X
B)	The residue of the net wealth of the firm or association shall be allocated amongst the partners or members in accordance with the agreement of partnership or association for the distribution of assets in the event of dissolution of the firm or association or, in the absence of such agreement, in the proportion in which the partners or members are entitled to share the profits	X
	TOTAL (A + B)	X

Provided that in determining the net wealth of the firm or association for the purposes of this rule, no account shall be taken of the exemptions in section 5.

VALUATION OF LIFE INTEREST - PART F (RULE 17)

The value of the life interest of an assessee shall be arrived at by multiplying the “average annual income” that accrued to the assessee from the life interest by the fraction. “average annual income” [for last three years only] means the average of the gross income derived by the assessee from the life interest during each year of the period ending on the valuation date, reduced by the average of the expenses incurred [the amount of the reduction for such expenses shall, in no case, exceed five per cent. of the average of the annual gross income] on the collection of such income in each of those years.

VALUATION OF JEWELLERY – (PART G SCHEDULE III) (RULE – 18, 19)

The value of jewellery shall be estimated to be the price, which it would fetch if sold in the open market on the valuation date (i.e. fair market value). The following points should also be kept in view

	Statement to be submitted with return	Reference to valuation
Whether the value of jewellery does not exceed Rs. 5,00,000/-	A statement in Form no. O-8A	The Assessing officer may refer the valuation to a valuation officer, if he is of the opinion that the fair market value of the jewellery exceeds the value of jewellery as declared in the return by more than 33 1/3 per cent of the returned value or Rs.50000/-. In such case the value of jewellery shall be in fair market value as estimated by the valuation officer.
Whether the value of the jewellery exceeds Rs.5,00,000/-	A report of a registered valuer in Form No.O-8	The Assessing Officer may refer the valuation to a valuation Officer if he is of the opinion that the value of jewellery declared in the return is less than its fair market value (although it is in accordance with the estimate made by a registered valuer). In such case the value of jewellery shall be the fair market value as estimated by the valuation officer.

Adjustment in value of jewellery for subsequent four assessment year- The value of jewellery determined by the valuation officer for any assessment year (hereinafter referred as the first assessment year) shall be taken to be the value of such jewellery for the subsequent four assessment years subject to the following adjustment:

- a) Where the jewellery includes gold or silver or any alloy containing gold or silver, the market value of such gold or silver or such alloy on the valuation date relevant to the concerned subsequent assessment year will be substituted for the market value of such gold or silver or alloy on the valuation date relevant to the first assessment year:
- b) Where any jewellery or part of jewellery is sold or otherwise disposed of by the assessee or any jewellery or part of jewellery is acquired by him, on or before the valuation date relevant to the concerned subsequent year; the value of the jewellery determined for the first assessment year shall be reduced or increased, as the case may be, and the value as so reduced or increased shall be the value of the jewellery for such subsequent assessment year.

34AB. REGISTRATION OF VALUERS

The Chief Commissioner or Director-General shall maintain a register to be called the Register of Valuers in which shall be entered the names and addresses of persons registered as valuers. Any person who possesses the qualifications prescribed in this behalf may apply to the Chief Commissioner or Director-General in the prescribed form for being registered as a valuer under this section and different qualifications may be prescribed for valuers of different classes of assets.

Every application shall be verified in the prescribed manner, shall be accompanied by such fees as may be prescribed and shall contain a declaration to the effect that the applicant will make an impartial and true valuation of any asset which he may be required to value, furnish a report of such valuation in the prescribed form, charge fees at a rate not exceeding the rate or rates prescribed in this behalf, not undertake valuation of any asset in which he has a direct or indirect interest. The report of valuation of any asset by a registered valuer shall be in the prescribed form and be verified in the prescribed manner.

16A. REFERENCE TO VALUATION OFFICER (DVO PROCEDURE)

For the purpose of making an assessment under this Act, the market value of any asset is to be taken into account in such assessment, the Assessing Officer may refer the valuation of any asset to a Valuation Officer (a) in a case where the value of the asset as returned is in accordance with the estimate made by a registered valuer, if the Assessing Officer is of opinion that the value so returned is less than its fair market value (b) in any other case, if the Assessing Officer is of opinion (i) that the fair market value of the asset exceeds the value of the asset as returned by more than such percentage of the value of the assets as returned or by more than such amount as may be prescribed in this behalf ; or (ii) that having regard to the nature of the asset and other relevant circumstances, it is necessary so to do.

For the purpose of estimating the value of any asset in pursuance of a reference, the Valuation Officer may serve on the assessee a notice requiring him to produce or cause to be produced on a date specified in the notice such accounts, records or other documents as the Valuation Officer may require.

Where the Valuation Officer is of opinion that the value of the asset has been correctly declared in the return made by the assessee he shall pass an order in writing to that effect and send a copy of his order to the Assessing Officer and to the assessee.

Where the Valuation Officer is of opinion that the value of the asset is higher than the value declared in the return made by the assessee, or where the asset is not disclosed or the value of the asset is not declared in such return or where no such return has been made, the Valuation Officer shall serve a notice on the assessee intimating the value which he proposes to estimate and giving the assessee an opportunity to state, on a date to be specified in the notice, his objections either in person or in writing before the Valuation Officer and to produce or cause to be produced on that date such evidence as the assessee may rely in support of his objections. On the date specified in the notice or as soon thereafter as may be, after hearing such evidence as the assessee may produce and after considering such evidence as the Valuation Officer may require on any specified points and after taking into account all relevant material which he has gathered, the Valuation Officer shall, by order in writing, estimate the value of the asset and send a copy of his order to the Assessing Officer and to the assessee.

On receipt of the order from the Valuation Officer, the Assessing Officer shall, so far as the valuation of the asset in question is concerned, proceed to complete the assessment in conformity with the estimate of the Valuation Officer.

PART H OF SCHEDULE III (RULE – 20 AND 21)

It provides that the value of any asset which is not governed by above shall be the price which in the opinion of the A.O. it would fetch if sold in the Open Market on the valuation date.

For the removal of doubts, it is hereby declared that the price or other consideration for which any property may be acquired by or transferred to any person under the terms of a deed of trust or through or under any restrictive covenant in any instrument of transfer shall be ignored for the purposes of determining under any provision of this Schedule, the price such property would fetch if sold in the open market on the valuation date.

WEALTH TAX: 10 MARKS

Question 1: Panditji gives the following particulars in connection with his wealth tax assessment.

1.

Agriculture land in Madras valued at Rs.2,00,000/-.
2.

In July 1991 he has transferred a house property value at Rs.10,00,000 to his mother for her exclusive enjoyment during her life time and reversion thereafter to him. His mother continued to enjoy the interest on the valuation date. The house property was valued at Rs.13,00,000 on valuation date.
3.

An ancestral house property at Rs.7,00,000/- used by him exclusively for residential purposes. His family consists of himself his wife and his minor daughter. Compute the net wealth of Panditji.

Question 2 Shri ‘N’ an individual of Indian Origin was carrying on business in Japan, left Japan in 08.09.03 due to unsettled conditions prevailing there and returned to India with a view to settling down permanently in India. He has submitted the following particulars of his assets and liabilities

i)	He has acquired a Farm House near Delhi out of his funds brought from Japan	12,00,000
ii)	A partial partition of the H.U.F. of which ‘N’ was a coparcener was effected on 1.4.1979. Shree ‘N’ was allotted a bungalow at New Delhi which is being use for his own residence	25,00,000
iii)	Out of personal jewellery kept in India. Shri ‘N’ had gifted jewellery valued at Rs.3,00,000 to Miss ‘P’ at the time of his engagement to her on 15.1.1981. The marriage of ‘N ‘ with ‘P’ took place on 2.1.1982. As on V.D. the jewellery was worth 17 lacs.	3,00,000
iv)	A plot of land was purchased from Delhi development Authority (DDA) for RS.10,00,000 on 1.4.1984. Out of sale proceeds of house property at Ghazibad. Under the terms of the purchase he was required to surrender to DDA 50% of the premium (if earned) at the time of the sale of plot. The fair market value of the plot is ascertained at Rs.25,00,000 on the valuation date.	10,00,000
v)	Shares in Indian Companies	8,00,000
vi)	Cash on Hand. (Represent cash brought by him in India at time of his return to India)	1,25,000
vii)	Loan taken on mortgage of Farm House for the purpose of buying shares	1,00,000
ix)	Loan taken for the purpose of buying Delhi plot	2,00,000

Question 3 ‘N’ who is citizen of India is not ordinary resident in taxable territories. Compute his wealth (give reasons either for including or otherwise) from the following particulars.

- a) He has a house property at Singapore, valued at Rs.38,00,000. Ground floor of his property (Value 28 lacs) has been let out to super bazaar and the first floor portion is used for personal residence (value 10 lacs).
- b) He has kept in fixed deposits Rs.5,50,000/- in an Indian Nationalized Bank Further Rs.75,000/- is lying in Singapore Branch of the same bank.
- c) He owns a property in India, which is let out for residential purposes. The property fetches Rs.10,000/- per month. The Municipal taxes per year amount to Rs.25,000/- & are borne by the tenant.
- d) The Value of his imported jewellery and Motor car was assessed by customs authorities at Rs.3,50,000/- and Rs.8,00,000/- respectively when he landed at Bombay on 02nd May. He had paid customs duty of Rs.8,50,000/- on those goods.
- e) There is an outstanding fine of Rs. 2,00,000/- levied by customs authorities for non-declaration of the above dutiable goods. Appeal against this is pending on the valuation date.
- f) He holds units of the Unit Trust of India- value Rs.3,50,000/-.
- g) Rent deposit received in respect of property mentioned in (c) above Rs.2,00,000/-

Question 4 Disco Ltd. Engaged in the manufacture of fertilizers is an Indian Co. in which public are substantially interested. State how items will be dealt in computing its Net Wealth

1. The Company owns a fleet of Motor Car held & used exclusively for the purposes of business.

- 2. The Company owns a bungalow near its factory, which is in the remote interiors. Since there are no hotels etc. In the said area the company maintains the bungalow specifically for the stay of its employees, executives & directors while they go for duty or work to the factory. The said bungalow however has been treated as “Guest House” in the company’s Income Tax Assessment.
- 3. The Company had acquired land in February 2005 in the vicinity of its aforesaid factory for expanding its manufacturing operation. However due to delay in obtaining various approvals the construction thereon has still not commenced.
- 4. The company owns a huge commercial building in Bombay partly used as its office by the company itself and the balance let out.
- 5. The company owns vast lands in Bombay. However the lands are under reservation and no construction thereon is permitted as per Municipal regulation.
- 6. The Company owns 3 residential flats in Bombay which are occupied as follows:
 - a) By the Chairman (non-working)
 - b) By the Managing Director drawing a gross annual salary of around Rs.6 lakhs.
 - c) By the General Managers, Marketing Drawing a gross annual salary of around Rs.3.75 lakhs.
- 7. The Company’s Balance sheet shows Cash on hand Rs.13 lacs.
- 8. An amount of Rs.2 lacs is due to Dinky Garage P. Ltd. with which the company has an arrangement for repairs and upkeep of its Motor Cars.

Question 5: From the following data furnished by Ravi determine the value of house built on leasehold land.

Annual Value as per Municipal Value	70,000
Rent actually received from tenant (6 months)	27,000
Municipal tax paid by tenant	5,000
Repairs on property borne by tenant	4,000
Refundable deposit collected from tenant as security Deposit which does not carry any interest	2,00,000
The difference between unbuilt area and specified area is	9.5%

Question 6: Under what circumstances can the Assessing Officer make a reference to the valuation officer for the purpose of making an assessment under the Wealth Tax Act ?

Question 7 Rehman is the owner of two residential houses in Ahemadabad both meant to be used for residential purposes by him, and his family (I) the first house was purchased by him in December 1970 for Rs.2 lacs. This was occupied by his friend Mr.Sulaiman free of rent from April to July of the previous year. The value of the house as per schedule III of Wealth Tax Act on the valuation date is Rs. 5 lacs. Its value on the same basis on 31.03.1971 was Rs.1 lacs. (ii) The second house was purchased by him in February 1992 for Rs.8 lacs. Its value as per Schedule III on the valuation date 31.3.92 is Rs.2 Lacs and as on valuation date is Rs.6 lacs. What value will you fix in respect of the two properties while preparing the wealth tax return of Rehman.

Question 8 Mr. Z made a cash gift of Rs. 3 lakhs to Mrs. Z in 1997 Mrs. Z bought jewellery with that money. The value of the jewellery as on valuation date is Rs. 5,20,000. What would be the implication of this in net wealth computation of Mr. Z.

Question 9 Mr.L obtained a loan of Rs.5 lakhs from his friend by mortgaging his house property the loan was outstanding at RS.2 lakhs. The loan was utilized for purchase of shares and securities. Can the amount of unpaid loan of Rs.2 lakhs be claimed as deduction under section 2(m) of the Wealth Tax Act.

Question 10 The Assessing officer made a reference to the valuation officer for valuation of a property. He however assessed the property to Wealth Tax at Rs.20 lakhs without waiting for the report of the valuation officer. On receipt of the valuation report it was found that the property has been valued by the valuation officer at Rs.40 lakhs. The commissioner, acting under section 25(2) of the Wealth Tax Act, set aside the assessment and directed the assessing officer to redo the same. Discuss whether the action of the Commissioner was justified.

Question 11 Sudarshan Builders Ltd., a widely held company owns the following assets

- 1. Land at Bangalore, purchased in 1994, on which a residential complex consisting of 24 flats, to be sold on ownership basis, is under construction for last 48 months;

2. Two office flats at Calcutta purchased for resale in the year 2002
3. Shares of Group Companies, break-up value of which is Rs. 6,40,000
4. Cash at construction site Rs. 3,20,000
5. Residential flat in occupation of company’s whole time director drawing a salary of Rs. 3,80,000 per annum.

Which of the above assets will be liable for wealth tax? Give reasons in brief.

Question 12 Property Company Ltd. has let out a premises w.e.f. 1st October on monthly rent of Rs. 1 lakh. The lease is valid for 10 years and the tenant has made a deposit equivalent to 3 months rent. The tenant has undertaken to pay the municipal taxes of the premises amounting to Rs. 1 lakh. What will be the value of the property under schedule III of the wealth Tax Act for assessment to wealth tax?

Question 13 What are the circumstances under which the Wealth Tax Officer is not required to follow the procedure laid down for evaluation of House Property in rule 3 of Schedule III of the Wealth Tax Act?

Question 14 The recognition granted from assessment year 1982-83 in respect of the heirloom jewelry of a Maharaja was withdrawn on 11-12-2003 when the Fair Market Value was Rs.25 crores. The Fair Market Value of the jewelry as on 31-3-2004 is Rs. 28 crores. Discuss the Wealth-tax liability in this case.

Question 15 A child artist, acting in films, has amassed wealth of Rs.20 lakhs over a few years, which was held in the form of shares by his father and guardian, R. The shares were sold in 1999-2000, resulting in a capital gain of Rs.15 lakhs which was invested in a plot of land. The Wealth-tax Officer proposes to include the value of the plot in the net wealth of R under section 4(1). Is this in order?

Question 16 X is a child artist. He has been admitted to the benefit of A Co. (a partnership firm of A and B) for giving stage performance. He will be entitled for 30 per cent share in the profit. Besides, he will get Rs.2000 per month as salary and 12 per cent simple interest on his capital contribution of Rs.5000.

Question 17 R is the owner of a house, which is constructed on leasehold land acquired from D.D.A. He has let out this house to G for Rs.12,000 p.m. The other terms are as under:

1. G will pay 60% of the municipal taxes and bear the cost of repairs.
2. G will give interest free advance of Rs.2,00,000. This amount will be refunded at the time of vacating the house.
3. G will also pay Rs.50,000 as premium for leasing the property for five years.
4. The annual value assessed by the local authority is Rs.1,00,000 and taxes levied are Rs.15,000.
5. G spent Rs.15, 000 on the repairs of the house.
6. The difference between the unbuilt area and specified area is 14% of the aggregate area.

Find out the value of the house for wealth tax purposes, if the cost of the building (including land) in 1984 was Rs.10,00,000. R had paid Rs.80,000 for the acquisition of the land. As per DDA value of the land is Rs.4,00,000. D.D.A. charges 50% of the unearned increase at the time of transfer of the property. The unexpired period of lease is 85 years. Compute the value of the house property for the purpose of wealth-tax.

Question 18 Kantikar and his wife are partners in a firm A & Co., engaged in manufacture of footwear. Their minor son Rishi has been admitted to the benefits of partnership. The profit-sharing ratios are:

	PROFIT	LOSS
Kantikar	40%	50%
Mrs. Kantikar	30%	50%
Rishi	30%	---

The abridge Balance Sheet of the firm as on valuation date is as under:

CAPITALS & LIABILITIES		ASSETS	
Capitals:			
Kanitkar	15,00,000	Urban house plot	19,60,000
Mrs. Kantikar	10,00,000	Jewellery	3,80,000
Rishi	10,00,000	Housing Complex	34,20,000
Bank Loan	4,58,000	Cash in hand	40,000
Income-tax payable	44,000	Cash at bank	4,30,000

Loan creditors	18,00,000	Stock-in-trade	1,68,000
Trade creditors	<u>5,96,000</u>		
Total	63,98,000	Total	<u>63,98,000</u>

As regards the above Balance Sheet, the following further information are available:

- 1) The urban house plot is of area 490 sq. meters. The bank loan is in respect of this plot. The market value as on valuation date is Rs. 10,000 per sq. metre.
- 2) The housing complex consists of 3 houses of identical area in Delhi, constructed two years back on leasehold land, the lease to expire on 20.1.2040.

The firm carries on business in one of the above three units. The other two residential units have been let out. The pertinent details are:

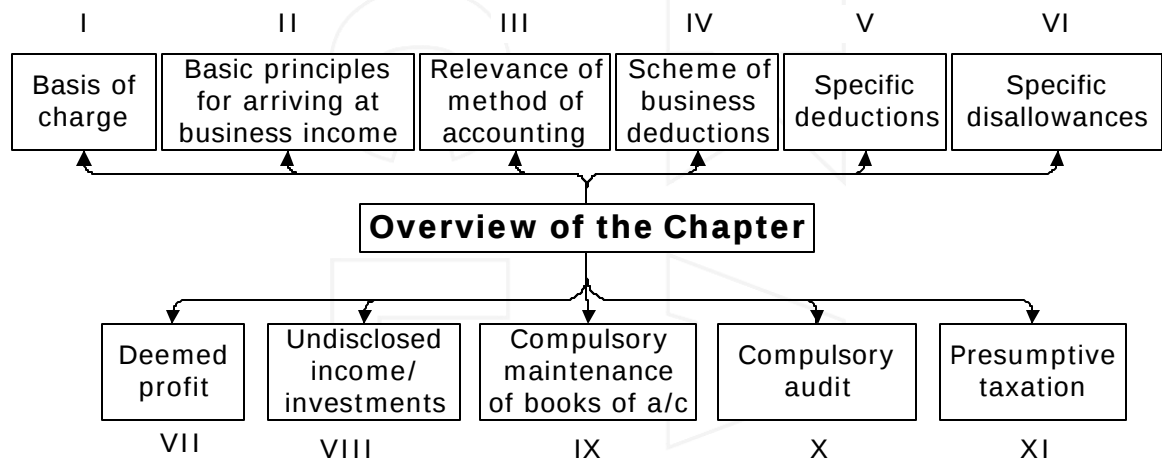
	Unit 1	Unit 2
Let out during the year	10 months	9 months
Rent per month	18,000	18,000
Repair expenses borne by tenant	28,000	18,000
Deposits received from tenants (Interest paid thereon @ 9% p.a.)	6,00,000	6,00,000

The tenant in Unit 2 was running a taxi hire concern and the firm had entered into an agreement with the tenant that he shall provide 2000 kms of free taxi travel to the firm for its business use. The normal taxi fare charged is around Rs. 4 per km. The firm has utilised the 2000 kms. The municipal taxes levied for the whole complex are Rs. 12,000 per annum.

- 3) Loan creditors of Rs. 18,00,000 relate to the above complex.
- 4) The market value of jewellery is Rs. 6,20,000.

Compute the interest of the adult partners and Rishi in the firm M/s. A & Co. as on valuation date for the purpose of computation of net wealth in their respective individual hands. In whose hands will Rishi's net wealth be assessed ?

PROFIT AND GAINS OF BUSINESS OR PROFESSION



SECTION 2 DEFINES IN ITS SUB SECTION

- 2(13) "BUSINESS" includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture.
- 2(36) "PROFESSION" includes vocation.

MEANING OF BUSINESS, TRADE, ADVENTURE IN NATURE OF TRADE.

The word ‘business’ is one of wide import and in fiscal statutes, it must be construed in a broad rather than a restricted sense. The word ‘business’ is not defined exhaustively in the Income-tax Act, but it denotes an activity with the object of earning profit. To say that a business is being carried on, means no more than that profit is to be earned by a process or production. Business, as understood in the income-tax law, connotes some real, substantial and systematic or organised course of activity or conduct with a set purpose. This does not, however, mean that under no circumstances a single transaction can amount to a business transaction. The expression ‘business’ does not necessarily mean trade or manufacture only; it is being used as including within its scope professions, vocations and callings for a fairly long time. The word ‘business’ is one of wide import and it means an activity carried on continuously and systematically by a person by the application of his labour and skill with a view to earning an income.

“Trade” in its primary meaning is the exchanging of goods for goods or goods for money; in its secondary meaning it is repeated activity in the nature of business carried on with a profit motive, the activity being manual or mercantile, as distinguished from the liberal arts or learned professions or agriculture.

When section 2(13) refers to an adventure in the nature of trade, it clearly suggests that the transaction cannot properly be regarded as trade or business. It is allied to transactions that constitute trade or business but may not be trade or business itself. It is characterised by some of the essential features that make up trade or business but not by all of them; and so, even an isolated transaction can satisfy the description of an adventure in the nature of trade

It vests even a single act with character of business. A classic case on this concept is that of the Supreme Court in G. Venkataswami Naidu & Co. where it was held that a single transaction may amount to a plunge into the waters of trade when it is undertaken with profit motive. It is the intention, at the time of acquiring the asset, that would be relevant. While a single transaction with intent to trade would be an adventure, a repetition makes it business.

- 1) Where the transactions were not diversified; nor were they gradual, according to opportunities offered by fluctuating market conditions but were in bulk and almost at a time, which ordinarily were not the characteristics of a business dealing
- 2) That the name the assessee gave to the account, viz., "Account of Rs. 48 lakhs floating in the share market", could not render the dealings in that account into trading transactions if otherwise they were not.
- 3) Since the expression "adventure in the nature of trade", implied the existence of certain elements in the

transactions which in law would invest them with the character of trade or business and the question on that account becomes a mixed question of law and fact, the court can review the Tribunal's finding if it had misdirected itself in law. It is fairly clear that where a person in selling his investment realises an enhanced price, the excess over his purchase price is not profit assessable to tax. But it would be so, if what is done is not a mere realisation of the investment but an act done of making profits. The distinction between the two types of transactions is not always easy to make. Whether the transaction is of one kind or the other depends on the question whether the excess was an enhancement of the value by realising a security or a gain in an operation of profit-making. If the transaction is in the ordinary line of the assessee's business there would hardly be any difficulty in concluding that it was a trading transaction, but where it is not, the facts must be properly assessed to discover whether it was in the nature of trade.

- 4) The surplus realised on the sale of shares, for instance, would be capital if the assessee is an ordinary investor realising his holding; but it would be revenue if he deals with them as an adventure in the nature of trade. The fact that the original purchase was made with the intention to resell at an enhanced price could be obtained is by itself not enough but in conjunction with the conduct of the assessee and other circumstances it may point to the trading character of the transaction.
- 5) For instance, an assessee may invest his capital in shares with the intention to resell them if in future their sale may bring in a higher price. Such an investment, though motivated by a possibility of enhanced value, does not render the investment of a transaction in the nature of trade. The test often applied is, has the assessee made his shares and securities the stock-in-trade of a business. [1970] 077 ITR 0253- Raja Bahadur Kamakhya Narain Singh vs. CIT (Supreme Court of India)

MEANING OF PROFESSION

All professions are businesses but all businesses are not professions. There should be some special qualification of a person apart from skill and ability, which is required in carrying on any activity which could be considered as profession. This could be by having education in a particular system either in a college or university or it may be even by experience. In the case of a broker, the activities are carried on either under a written agreement or even verbal agreement in respect of different constituents and the activities, therefore, would amount to business.

MEANING OF VOCATION

Preaching of sermons in church by representative or employee of church is an integral part of church. Activities of church amount to a vocation. Its income falls under head "profits and gains of business or profession" because profession includes vocation. Church entitled to depreciation on church building. [1984] 145 ITR 0786- All Saints Church vs. CIT (Karnataka High Court)

Clause.2 (36) defined " profession as including " vocation ". Even the dictionary meaning of the word " vocation " is " person's trade or profession". The teaching of Vedanta had been held by the Supreme Court to be a vocation. The preaching of sermons in the church by the representative of the church could not be different from the teaching of Vedanta or any other teaching. The teaching or preaching may be done by a representative or any employee of the church. It did not matter who did it, so long as it was considered to be an integral part of the church. The disciples went to the church and not to the person who taught or preached. The activities of the assessee-church, therefore, amounted to a vocation. The assessee-church was, therefore, entitled to depreciation in respect of the church building. [1984] 145 ITR 0786- All Saints Church vs. CIT (Karnataka High Court)

A vocation is only a way of living or a sphere of activity for which one has special fitness. It is not necessary that such activity should be one indulged in for earning a livelihood before it can be called 'vocation'. Nor can it be said that a person cannot have more than one vocation. A motive for making a profit is not an essential requisite of a vocation. The concept "vocation" broadens the scope of s.28 in the context of the decision of the Supreme Court in P. Krishna Menon v. CIT where even voluntary contributions received by retired civil servant engaged in teaching Vedanta without its being organised activity on his part were held taxable. Even politics is regarded as a profession.

Assessee was propagating religious faith and publishing newspaper. Donations received by assessee from USA for furtherance of his objects is not casual and non-recurring receipt. It is taxable as receipts arising from the carrying on of a vocation. [1985] 156 ITR 0412A George Thomas (K.) (Dr.) vs. CIT (Supreme Court of India)

The appellant, who was till 1953 a lecturer in a college in Kerala, had his education in the USA during 1953 to 1957 and took his Ph. D degree. He associated himself with the Indian Gospel Mission in the USA, which collected money for its working abroad through the Indian Christian Crusade. On returning to India, the

appellant was propagating the ideals of the Indian Christian Crusade and was engaged in a movement for the spread of religion and for fighting the forces of atheism. Later, in 1959, he started publishing a daily newspaper in Malayalam called "Kerala Dhvani". During the accounting periods relevant to the assessment years 1960-61 and 1961-62, the appellant received sums of Rs. 2,90,220 and Rs. 3,63,750 respectively as donations through the Indian Christian Crusade from his friends in USA who believed in the cause which he sponsored and for helping the movement. Held in [1985] 156 ITR 0412A George Thomas (K.) (Dr.) vs. CIT (Supreme Court of India) that the appellant carried on a vocation of practicing against atheism and in the course of such vocation and for the purpose of the same, he received the amounts in question as donations for the furtherance of the objects of his vocation. There was a link between the activities of the appellant and the payments received by him and the link was close enough. The receipts arose to the appellant from the carrying on of his vocation and they were not casual and non-recurring receipts and were taxable. Once a receipt is found to be of a revenue character, that it comes under an exemption is for the assessee to establish.

PROFIT MOTIVE

Profit motive is essential for business. "Business" without profit is not business, "any more than a pickle is candy", as pointed out in State of Andhra Pradesh v. H. Abdul Bakshi & Bros. But it was held that there need be no motive for making profits nor any actual earning of profit in P. Krishna Menon v. CIT. However profit motive can not decide whether it is business income or capital gains because in capital investment there is also profit motive as capital appreciation.

The assessee who was a successful lawyer and an active politician, and who was also for some time the Governor-General of India, Union Minister and Chief Minister of a State, had all along been an author of books and writer of articles to journals. He received Rs. 5,125 from four journals to which he had contributed articles, and Rs. 480 from the All-India Radio, but claimed that these amounts were casual and non-recurring receipts not arising from any business or vocation. Though the amounts in question were not received in pursuance of any contract of employment between the assessee and the journals or the All-India Radio, the writing of books and contributing articles to periodicals and magazines constituted a vocation and as the amounts arose from a vocation. In a case like this even if the assessee did not expect any remuneration for his services, if the amount was really paid on account of the services, though voluntarily, the amount received would be taxable as income. [1963] 050 ITR 0196- Rajagopalachariar (C.) vs. Commissioner of Income-tax (Madras High Court)

DETERMINATION OF HEADS OF INCOME

For a person to have income under the head business one need not be a businessman. Salaried employees, including Government servants who may not be expected to carry on business, may well be liable to be assessed under the head business, if the facts warrant it.

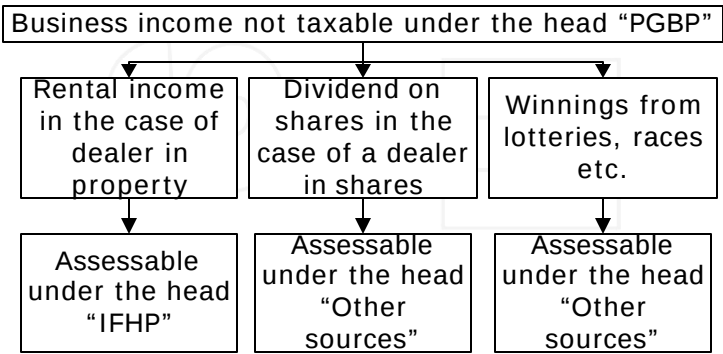
Company was formed for developing landed properties and markets. Income from letting of stalls and shops in market was income from house property. The character of that income was not altered because it was received by a company formed with the object of developing and setting up markets. Nor because of the fact that the company was required to obtain a licence from the Calcutta Municipality to maintain sanitary and other services and for that purpose had to maintain a staff and to incur expenditure did the income become "profits or gains" from business. Nor was the character of the income altered merely because some stalls were occupied by the same occupants and the remaining stalls were occupied by a shifting class of occupants. The primary source of income from the stalls was the occupation of the stalls, and it was a matter of little moment that the occupation which was the source of the income was temporary. If the income from a source falls within a specific head set out, the fact that it may indirectly be covered by another head will not make the income taxable under the latter head. [1961] 042 ITR 0049- East India Housing and Land Development Trust Ltd. vs. CIT (Supreme Court of India)

There was composite letting of building fitted with furniture and fixtures for the purpose of being run as a hotel. Income was derived from lease of the rooms. Question was whether it is income from business or under the head house property. Letting of building was inseparable from letting of furniture and fixtures. The income is not assessable under the head house property. [1964] 051 ITR 0353- Sultan Brothers Pvt. Ltd. vs. CIT (Supreme Court of India)

SECTION 28 -- THE CHARGING SECTION.

The following income shall be chargeable to income-tax under the head “Profit and gains of business or profession”

- (i) The **profits and gains** of any business or profession which was carried on by the assessee at any time during the previous year;
- (ii) Any compensation or other payment due to or received by -
 - (a) Any person, by whatever name called, managing the whole or substantially the whole of the affairs of an Indian company, at or in connection with the termination of his management or the modification of the terms and conditions relating thereto
 - (b) Any person, by whatever name called, managing the whole or substantially the whole or substantially the whole of the affairs in India of any other company, at or in connection with the termination of his office or the modification of the terms and conditions relating thereto
 - (c) Any person, by whatever name called, holding an agency in India for any part of the activities relating to the business of any other person, at or in connection with the termination of the agency or the modification of the terms and conditions relating thereto
 - (d) Any person, for or in connection with the vesting in the Government, or in any corporation owned or controlled by the Government, under any law for the time being in force, of the management of any property or business
- (iii) Income derived by a trade, professional or similar association from **specific services** performed for its members;
- (iiia) Profits on sale of a licence granted under the Imports (Control) Order, 1955, made under the Imports and Exports (Control) Act, 1947 (18 of 1947);
- (iiib) Cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India;
- (iiic) Any duty of customs or excise repaid or repayable as drawback to any person against exports under the Customs and Central Excise Duties Drawback Rules, 1971;
- (iv) The value of any benefit or perquisite, whether convertible into money or to, arising from business or the exercise of a profession;
- (v) Any interest, salary bonus, commission or remuneration, by whatever name called, due to or received by, a partner of a firm from such firm;
- (va) Any sum, whether received or receivable in cash or kind, under an agreement for (a) not carrying out any activity in relation to any business [excluding Capital Gains, compensation, from the multilateral fund of the Montreal Protocol on Substances that Deplete the Ozone Layer under the United Nations Environment Programme, in accordance with the terms of agreement entered into with the Government of India.] or (b) not sharing any know-how, patent, copyright, trade-mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services.
- (vi) Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.



WHEN BUSINESS IS NOT CARRIED ON AT ALL

When an assessee does not carry on business at all, section 28 cannot be applicable and the income that he receives cannot bear the character of profits of business - New Savan Sugar & Gur Refining Co. Ltd. V/s. CIT [1969] 74 ITR 7 (SC)

DIFFERENT VENTURES FORMING PART OF SAME BUSINESS

Whether different ventures carried on by the assessee form part of the same business must depend on the facts and circumstances of each case. It is for the assessee to establish that different ventures constitute part of the same business. Only because an assessee is carrying on business ventures of the same character at different places it is not necessary that the ventures are part of a single business. It has to be seen whether there was any inter-connection, interlacing, interdependence, any unity embracing the ventures, and whether the different ventures were so interlaced and so dovetailed into each other as to make them into the same business. A variety of matters bearing on the unity of the business have to be investigated, such as unity of control and management, conduct of the business through the same agency, the inter-relation of the business, the employment of the same staff to run the business, the nature of the different transactions, the possibility of one being closed without affecting the texture of the other, and so forth - L.M. Chhabda & Sons. V/s. CIT [1967] 65 ITR 638 (SC).

INCOME FROM LETTING/EXPLOITING COMMERCIAL ASSETS

If a commercial asset is not capable of being used as such, then its being let out to others does not result in an income which is the income of the business. But it cannot be said that an asset which was acquired and used for the purpose of the business ceased to be a commercial asset as soon as it was temporarily put out of the use or let out to another person for use in his business or trade. They yield of income by a commercial asset is the profit of the business irrespective of the manner in which that asset is exploited by the owner of the business. He is entitled to exploit it to his best advantage and he may do so either by using it himself personally or letting it out to somebody else - CEPT V/s. Shri Lakshmi Silk Mills Ltd. [1951] 20 ITR 451 (SC).

INTEREST ON SECURITIES

Though for the purpose of computation of the income, interest on securities is separately classified, income by way of interest from securities does not cease to be part of the income from business if the securities are part of the trading assets - CIT V/s. Co Canada Radhaswami Bank Ltd. [1965] 57 ITR 306 (SC)

DIVIDEND INCOME

The mere circumstances that the assessee had shown the dividend income under the head "Income from other sources" in its returns could not in law decide the nature of the dividend income. It had to be determined whether, having regard to the true nature and character of the income, it could be described as income from business, even though it fell for computation under another head - Brooke Bond & Co. Ltd. V/s. CIT [1986] 162 ITR 373 (SC).

UNDERCHARGES

It cannot be laid down that, as a matter of law, any amount which was initially not received as a trading receipt, can never become a trading receipt. Where a del credere agent collected undercharges towards under loading of railway, wagons, but purchasers did not claim their dues from that agent, the unclaimed undercharges constituted trading receipt in the hands of the agent and was chargeable to tax - CIT V/s. Karam Chand Thapar [1996] 88 Taxman 40/222 ITR 112 (SC).

SALE OF BUSINESS ASSETS

In determining whether the gain is realization of mere enhancement of value or is a gain made in an operation of business in carrying out a scheme for profit-making, no uniform rule can be evolved. Where a person disposes of a part or the whole of his assets, the general rule is that the mere change or realisation of an investment does not attract liability to income-tax, but where such a realisation is an act which in itself is a trading transaction, profit earned by sale or conversion is taxable. A transaction of sale may, in a given case, be isolated; in another, it may be intimately related to the normal business of the taxpayer. In the latter class profit arising from the transaction will probably arise out of the taxpayer's business and will be assessable as business profits - Karam Chand Thapar & Bros. (P) Ltd. V/s. CIT [1969] 74 ITR 26 (SC).

BASIC CONDITIONS/PRINCIPLES

Under section 28, the trading loss of a business is deductible in computing the profits earned by a business. However, every loss is not so deductible unless it is incurred in carrying out the operation of the business and is

incidental to the operation. Whether loss is incidental to the operation of a business is a question of fact to be decided on the facts of each case, having regard to the nature of the operations carried on and the nature of the risk involved in carrying them out. The degree of the risk or its frequency is not much relevance but its nexus to the nature of the business is material - CIT V/s. Nainital Bank Ltd. [1965] 55 ITR 707 (SC).

LOSS BY EMBEZZLEMENT/THEFT

If employment of agents is incidental to the carrying on of business, it must logically follow that losses which are incidental to such employment are also incidental to the carrying on of the business. Human nature being what it is, it is impossible to rule out the possibility of an employee taking advantage of his position as such employee and misappropriating the funds of his employer, and the loss arising from such misappropriation must be held to arise out of the carrying on of business and to be incidental to it. And that is how it would be dealt with according to ordinary commercial principles of trading. It should however be emphasised that the loss for which a deduction could be made under section 28 must be one that springs directly from the carrying on of the business and is incidental to it and not any loss sustained by the assessee, even if it has some connection with his business - Badridas Daga V/s. CIT [1958] 34 ITR 10 (SC).

The theory that when once moneys are put into the bank they have got home, and that their subsequent withdrawal from the bank would be de hors the business will be altogether out of place in a business such as banking. It will be a wholly unrealistic view to take of the matter to hold that the realisations have reached the till when they are deposited in the bank, and that marks the terminus of the business activity in money-lending. Therefore, loss due to embezzlement by employee after the money has reached the till in banking/money lending business cannot be out rightly disallowed on the sole ground that it was not incurred in the course of business - Badridas Daga V/s. CIT.

Cash is a stock-in-trade of a banking business and its loss in the course of its business under varying circumstances is deductible as a trading loss in computing the total income of the business. A loss incurred due to dacoity in the banking premises is thus an allowable deduction - CIT V/s. Nainital Bank Ltd. [1965] 55 ITR 707 (SC).

PAYMENT RELATING TO THIRD PARTY'S BUSINESS

In order that a loss may be deductible it must be a loss in the business of the assessee and not payment relating to the business of somebody else which under the provisions of the Act is deemed to be and becomes the liability of the assessee. Thus, where an agent of a non-resident paid the tax liability of the non-resident but was unable to recover it from the non-resident, the agent could not claim the irrecoverable amount as a business loss - CIT V/s. Abdullabhai Abdulkadar [1961] 41 ITR 545 (SC).

LOSS IN ILLEGAL BUSINESS

The taint of illegality of the business cannot detract from the losses being taken into account for the computation of the taxable profits. The tax collector cannot be heard to say that he will bring the gross receipts to tax. He can only tax profits of a trade or a business and that cannot be done without deducting the losses and legitimate expenses of the business. For the purpose of section 28, the losses which have actually been incurred in carrying on a particular illegal business must be deducted before the true figure relating to profits which have to be brought to tax can be computed or determined. But the loss for which deduction is claimed must be one that springs directly from the carrying on of the business and is incidental to it. If this is established, the deduction must be allowed provided that there is no provision against it, express or implied, in the Act - CIT V/s. S.C. Kothari [1971] 82 ITR 794 (SC).

If the activity of smuggling can be regarded as a business, those who are carrying on that business must be deemed to be aware that a necessary incident involved in the business is detection by the customs authorities and the consequent confiscation of currency notes. The confiscation of the currency notes is a loss occasioned in pursuing the business; it is a loss in much the same way as if the currency notes had been stolen or dropped on the way while carrying on the business. It is a loss which springs directly from the carrying on of the business and is incidental to it - CIT V/s. Piara Singh [1980] 124 ITR 40 (SC).

Profits and gains which are liable to be taxed under section 28 are what are understood to be such under ordinary commercial principles. When a claim is made for a deduction for which there is no specific provision in the Act, whether it is admissible or not will depend on whether, having regard to accepted commercial practice and trading principles, it can be said to arise out of the carrying on of the business and to be incidental to it. If that is established, then the deduction must be allowed, provided of course there is no prohibition against it, express or implied, in the Act - Badridas Daga V/s. CIT [1958] 34 ITR 10 (SC).

CONCEPT OF MUTUAL CONCERN

No man can make a profit out of himself. Indian courts, in various cases has said "no man, in my opinion, can trade with himself, he cannot in my opinion make taxable profit by dealing with himself". This proposition which is obvious in respect of an individual is now applied for bodies of individuals, whether it is members club, co-operative institution, mutual benefit fund, a thrift fund or a pool.

Principle of mutuality is available even for companies In the case of CIT v. Royal Western India Turf Club the principle was applied to a race club in respect of moneys received from its members on the ground that incorporation is no bar to the principle of mutuality. Though in this particular case it was held that the company could be denied the benefit of mutuality, it was not because it was incorporated but it was only because it was largely dealing with non-members with the result that its dealings with members could not be isolated and made the subject matter of any separate deduction.

In CWT Rama Varma Club the club owned properties and afforded facilities to members for playing games like badminton, etc. No member had any right or interest in the property. The income was being applied for promoting the objects of the club. On dissolution, surplus if any was to be transferred to a club with similar objects. It was held that the club was not to be assessed as an individual. The implication is that the members do not derive any income and the club's income is exempt under mutuality. The fact that the guests were allowed to be entertained was not similarly considered to be a disqualification.

Such associations have surplus funds which they may invest with banks. Since the bank may not be a member of the association, could it be said that there is violation of the principle of mutuality ? The mere fact that surplus money was kept with third parties, and not with members and banks, cannot vitiate mutuality, especially where commercial character is lacking in such investments. Short term investments pending some long term legitimate use for the association or granting of staff loans cannot be treated as coming in the way of exemption. It may, however, be pointed out that if the amount involved is substantial, the decision could have been otherwise. There should be identity of the contributors and the beneficiaries or participants as they are called. Where the class of persons who have contributed are different from those who benefit from them, there could be no such identity. It is also possible that, some of the items like subscriptions and entrance fees may qualify for exemption on principle of mutuality, while others being service charges may not so qualify, where there are others from whom such charges are levied or where disparity between the contributors and the participants is marked. But it is equally established that there need be no identity in the sense of complete quid pro quo as between the contributors and participants as long as there is a broad indication with no different classes of persons. In other words, there is no stipulation that every contributor must also be a participant.

[1997] 226 ITR 0097- CIT VS. BANKIPUR CLUB LTD. (SUPREME COURT OF INDIA)

The decision of the Supreme Court in CIT v. Bankipur Club Ltd. [1997] 226 ITR 97 has reiterated the general principles which have governed taxation of clubs, associations and other mutual concerns. The principle that no one can make a profit out of himself has long since been found to be applicable to a combination of persons with transactions confined as between themselves, so that there is complete identity between the contributors and the participators. Hence, one would not expect any fresh cases disputing the principle of mutuality and its applicability for tax purposes. But then in Bankipur Club's case [1997] 226 ITR 97 the Revenue sought to make an exception in respect of sale of drinks at the bar on the ground that it was tainted with commerciality having profit motive. The argument of the Revenue was that in cases of clubs and such associations, admission fee, subscriptions, etc., may be non-taxable but not commercial transactions and that it is not every receipt of such mutual association, which can have the character of mutuality. The Supreme Court found that the activities undertaken by these clubs by and large partake of the nature of the "usual privileges, advantages, convenience and accommodation". It would, therefore, not have the character of income.

[2000] 243 ITR 0089- CHELMSFORD CLUB VS. COMMISSIONER OF INCOME-TAX (SC)

In this case, though it was accepted that the club is a mutual association with benefits restricted to members, the Delhi High Court drawing support from observations made by it in an earlier judgement in CIT v. Delhi Gymkhana Club Ltd. [1985] 155 ITR 373 had inferred that in view of the statutory provision requiring assessment of property income on notional basis, such income if assessable under the head "Property" may well be taxable. The Supreme Court held that if the club were not a mutual association, it may well be liable on notional income, but since it is a mutual association, there can be no liability. It was pointed out that the decision in CIT v. Bankipur Club Ltd. [1997] 226 ITR 97 (SC) amply supported this view. The principle of mutuality cannot be diluted with reference to the head of income under which it may fall to be assessed. Property income of such club, even if it is only deemed income, is governed by the principle of mutuality.

The assessee, a members' club, provided recreational and refreshment facilities exclusively to its members and their guests. Its facilities were not available to non-members. The club was run on "no profit no loss" basis in that the members paid for all their expenses and were not entitled to any share in the profits. Surplus, if any, was used for maintenance and development of the club. The club house was owned by the assessee. The assessee claimed that it was a mutual concern and so the annual letting value of the club house was not assessable. Held that the assessee's business was governed by the doctrine of mutuality. It was an admitted fact that the business of the assessee did not come within the scope of business. It was not only the surplus from the activities of the business of the club that was excluded from the levy of income-tax, even the annual value of the club house, as contemplated in section 22 of the Act, would be outside the purview of the levy of income-tax.

[1961] 041 ITR 0495- DELHI STOCK EXCHANGE ASSOCIATION LTD. VS. CIT (SUPREME COURT OF INDIA)

Company was doing stock exchange business. Admission fees received from members and their authorised assistants and profits were distributed to shareholders. Mutuality was lacking and the fees were assessable to tax. Since as the body of trading members who paid the entrance fees and the shareholders among whom the profits of the company were distributed were not identical and the element of mutuality was lacking, the company carried on a business whose profits were taxable and, therefore, the admission fees received from members were taxable in its hands.

CHIT FUND TREATMENT AS MUTUAL CONCERN.

Under the system a chit company organises various groups of subscribers, all making monthly contributions with such monthly collections being offered either on lot or auction basis to one of them. Where the lot system is followed, the lucky winner gets the amount subject to deduction for the services of the foreman the organiser. Where it is an auction, chit, the amount which the highest bidder agrees to forego is the amount which is distributed to the other members, subject again to deduction of foreman's commission. In an auction chit, therefore, the early bidder is a loser as the gross amount, which he gets on the total contribution, is less and would in essence represent the interest for the funds borrowed by him. For an investor, who is prepared to wait, he gets a larger amount by way of dividend than what he has contributed with the result that his gain, that is the difference between what he has contributed and what he has received, represents the surplus. Even where the chit is organised by a chit company, its role is only as that of a foreman. But the difference between the amount contributed and the amount received has given rise to controversies which is very much alive and is pending litigation in a number of cases.

POINTS TO BE NOTED FOR MUTUAL CONCERN

- 1) The transfer fee is not liable to tax provided the co-operative society does not carry on any business, and the transfer fee is meant for the benefit of the members of the co-operative society.
- 2) The participators in the profit are members; but the contributors to such profit are non-members who are the buyers of the books. There is no identity between the contributors and the participants. Therefore, the profits derived from the sales to the members is not exempt but taxable.
- 3) The principle may not apply where the residential accommodation is not confined to members. In such cases, the rent is taxable under the head Income from house property. Even if the income is treated as business income, it would not be exempt, because only some of the members occupy the accommodation, and there is no identity between the contributors and the participants. Supreme Court in CIT v. Bankipur Club Ltd it has been held that the income from the guest houses received from the members of the club for their use and the use of their guests is entitled to exemption from tax on the principle of mutuality.
- 4) There is no reason why a mutual organisation formed as a company should not be treated as a mutual association.
- 5) If the object is charitable, a mutual association like a trade association can claim exemption under section 11 where the surplus was to use only for public benefit and not to be distributed to its members. If the surplus is to be shared between members, it could claim exemption on grounds of mutuality, if other conditions like participants and contributors are both members with no dealings with outsiders.

SEC 44A. SPECIAL PROVISION FOR DEDUCTION IN THE CASE OF TRADE, PROFESSIONAL OR SIMILAR ASSOCIATION.

Where the amount received during a previous year by any trade, professional or similar association other than an association or institution referred to in clause (23A) of section 10 from its members, whether by way of subscription or otherwise (not being remuneration received for rendering any specific services to such

members) falls short of the expenditure incurred by such association during that previous year (not being expenditure deductible in computing the income under any other provision of this Act and not being in the nature of capital expenditure) solely for the purposes of protection or advancement of the common interests of its members, the amount so fallen short (hereinafter referred to as deficiency) shall be allowed as a deduction in computing the income of the association assessable for the relevant assessment year under the head "Profits and gains of business or profession" and if there is no income assessable under that head or the deficiency allowable exceeds such income, the whole or the balance of the deficiency, as the case may be, shall be allowed as a deduction in computing the income of the association assessable for the relevant assessment year under any other head.

In computing the income of the association effect shall first be given to any other provision of this Act under which any allowance or loss in respect of any earlier assessment year is carried forward and set off against the income for the relevant assessment year. The amount of deficiency to be allowed as a deduction under this section shall in no case exceed one-half of the total income of the association as computed before making any allowance under this section. This section applies only to that trade, professional or similar association the income of which or any part thereof is not distributed to its members except as grants to any association or institution affiliated to it.

SPECULATIVE BUSINESS IS DISTINCT BUSINESS. EXPL 2 TO SEC. 28

Where speculative transactions carried on by an assessee are of such a nature as to constitute a business, the business (hereinafter referred to as "speculation business") shall be deemed to be distinct and separate from any other business.

SEC.43(5) - MEANING OF SPECULATIVE TRANSACTION

Is a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scripts

Provided that for the purposes of this clause – following transactions are to be excluded

- 1) A contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchandising business to guard against loss through future price fluctuations in respect of his contracts for actual delivery of goods manufactured by him or merchandise sold by him; or
- 2) A contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuations; or
- 3) A contract entered into by a member of a forward market or a stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against loss which may arise in the ordinary course of his business as such member.
- 4) An eligible transaction in respect of trading in derivatives carried out in a recognised stock exchange;

“ELIGIBLE TRANSACTION” MEANS ANY TRANSACTION,—

(A) carried out electronically on screen-based systems through a stock broker or sub-broker or such other intermediary registered under section 12 of the Securities and Exchange Board of India Act and

(B) which is supported by a time stamped contract note issued by such stock broker or sub-broker or such other intermediary to every client indicating in the contract note the unique client identity number allotted under any Act and permanent account number allotted under this Act;

SCOPE OF THE DEFINITION - ‘SPECULATIVE TRANSACTION’

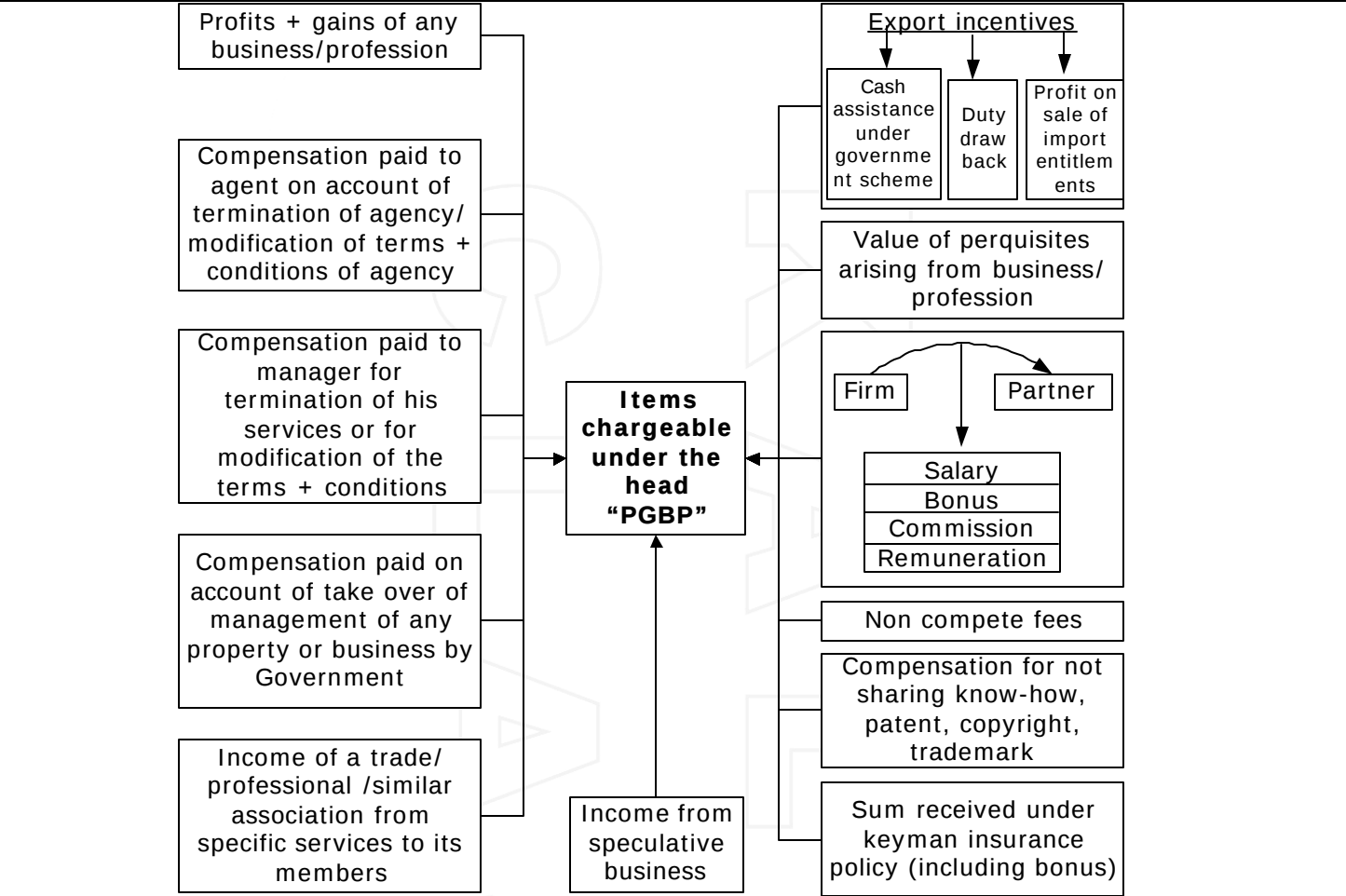
In common parlance connotes an intention to speculate, gamble, take a chance or risk. The Act however provides a very simple and objective test for determining whether a transaction is a speculative transaction or not. Under this definition, all that has to be found out is whether the contract was periodically or ultimately settled by actual delivery, transfer or otherwise. If the goods or commodities in respect of which the contracts were entered into were actually taken delivery of pursuant to the contract, it would not be a speculative transaction, even though the commodity or scrip may be a highly speculative one by its very nature and even though at the time when the contracts were entered into the parties might have had no idea of taking delivery at all. On the other hand, if the contract is settled otherwise than by actual delivery, then it will be a speculative transaction notwithstanding that the nature of the commodity was not one lending itself to possibilities of

speculation or that the intention of the parties at the time of entering into the contract might have been to take actual delivery but this intention could not be effectuated for one reason or the other - M.R.Dhawan V/s. CIT [1979] 119 ITR 412 (Delhi).

Assessee was a member of an association for speculation in coconut oil. It speculated on its own. It also received orders from its constituents, who were not members of the association, to speculate on their behalf. But as only members could deal with the association, actually no such purchase or sale was made through the association in the name of that party, though there were other purchases or sales in forward transactions by the respondent itself. The dates for settlement as also the rates at which the transactions were entered into were settled. On the relevant date settlement was made, profit being either paid to or received from the party having regard to the rates obtaining on that day. On each such transaction, the respondent also received a commission from the party on whose behalf the transaction was done. The respondent claimed to set off such commission against its speculation losses. Held that the commission received by the respondent could not be set off against the speculation losses, because there was no element of speculation whatever in the commission income received by the respondent. The commission was independent of any fluctuation in the market and no risk was involved in earning it. The commission had to be treated not as a profit from the speculation business but as profit from the business as a broker, and the assessee was not entitled to have the commission receipts assessed under the head "speculation business". [1969] 074 ITR 0754- CIT VS. PANGAL VITTAL NAYAK AND CO. P. LTD. (SC)

There was loss in illegal transactions and the question was whether it can be taken into account in computing profits of same business of the assessee or not. However if the business in which the loss was sustained was the same as the business in which the profit was derived, then the loss had to be taken into account while computing the profits of the business. The assessee was not entitled to a set-off the loss from illegal transaction against its profit in speculative transactions. [1971] 082 ITR 0794- CIT VS. KOTHARI (S.C) (SUPREME COURT OF INDIA)

A transaction cannot be described as a "speculative transaction" within the meaning of 43(5), where there is a breach of the contract and a dispute between the parties damages are awarded as compensation by an arbitration award. What is really settled by the award of such damages and their acceptance by the aggrieved party is the dispute between the parties. Section 43(5), however, speaks of a settlement of the contract, and a contract is settled when it is either performed or the promise dispenses with or remits, wholly or in part, the performance of the promise made to him or accepts, instead of it, any satisfaction which he thinks fit. [1983] 144 ITR 0057A CIT VS. SHANTILAL P. LTD. (SUPREME COURT OF INDIA)



SEC. 29 INCOME UNDER THIS HEAD, HOW COMPUTED.

The income referred to in section 28 shall be computed in accordance with the provisions contained in sections 30 to [43D].

NATURE OF EXPENDITURE IS IMMATERIAL

For allowing deductions under sections 30 to 36, it is immaterial whether the expenditure is capital or revenue in nature. Section 37(1) being a residual provision, it cannot be taken aid of unless and until it is established that none of the provisions of section 30 to 36 are applicable to a given case. Simply because the assessee contends that the expenditure is revenue in character and not capital, it cannot be said that the assessee cannot be permitted to contend or bring its case within any of the provisions of sections 30 to 36, which provide for deduction pertaining to specific items of expenditure

SEC.30: RENT, RATES, REPAIRS AND INSURANCE FOR BUILDINGS

In respect of rent, rates, taxes, repairs and insurance for premises, used for the purposes of the business or profession, the following deductions shall be allowed.

If assessee is	Deduction allowed
Tenant	The rent paid for such premises; and further if he has undertaken to bear the cost of repairs to the premises, the amount paid on account of such repairs. Any sums paid on account of land revenue, local rates or municipal taxes. The amount of any premium paid in respect of insurance against risk of damage or destruction of the premises.
Owner	The amount paid by him on account of current repairs to the premises. Any sums paid on account of land revenue, local rates or municipal taxes. The amount of any premium paid in respect of insurance against risk of damage or destruction of the premises.

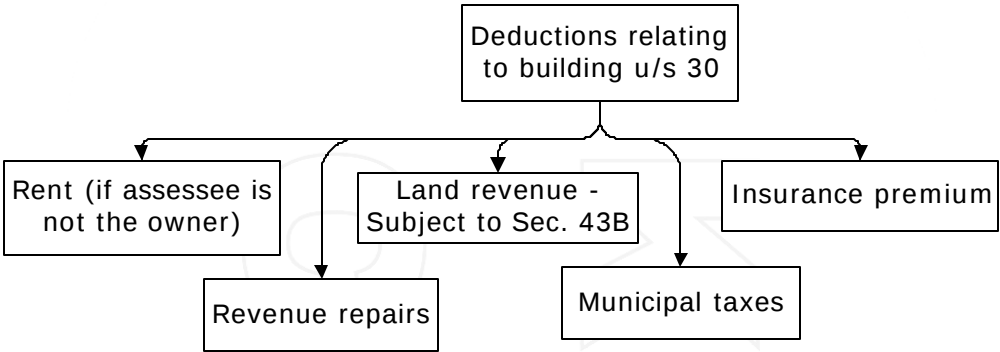
Explanation. For the removal of doubts, it is hereby declared that the amount paid on account of the cost of repairs and the amount paid on account of current repairs shall not include any expenditure in the nature of capital expenditure.

Today such capital expenditure will be governed by explanation 1 to section 32 .Where the business or profession of the assessee is carried on in a building not owned by him but in respect of which the assessee holds a lease or other right of occupancy and any capital expenditure is incurred by the assessee for the purposes of the business or profession on the construction of any structure or doing of any work, in or in relation to, and by way of renovation or extension of, or improvement to, the building, then, the provisions of depreciation shall apply as if the said structure or work is a building owned by the assessee.

THE PROPOSITIONS THAT EMERGE FROM THE DECIDED CASES ARE

- 1) The amount should be paid on account of current repairs.
- 2) ‘Current repairs’ means repairs undertaken in the normal course of user for the purpose of preservation, maintenance or proper utilisation or for restoring it to its original condition.
- 3) ‘Current repairs’ do not mean only petty repairs or repairs necessitated by wear and tear during the particular year.
- 4) Such repairs should not being into existence nor obtain a new or different advantage.
- 5) Neither the quantum of expenditure nor the fact that in the process of repairs there was substantial replacement of the parts of the machine or ship, is decisive of the true nature of the expenditure.
- 6) The original cost of the asset is not at all relevant for ascertainment of the true nature of the expenditure on repairs.
- 7) The replacement cost of the asset may however at times be used as an indicator of the true character of the expenditure. If the expenditure on repairs added to the WDV or disposal value exceeds the replacement cost of the asset, a presumption is possible that it is not a revenue expenditure but expenditure of capital nature. Such a presumption, of course, would be rebuttable.
- 8) The expression ‘current’ preceding ‘repairs’ appears to have been used by the Legislature with a view to restricting the allowance to expenditure incurred for preservation and maintenance thereof in its current state, in contradistinction to that incurred on any improvement or on addition thereto - CIT V/s. Chowgule & Co. (P) Ltd. [1995] 214 ITR 523 (Bom.)

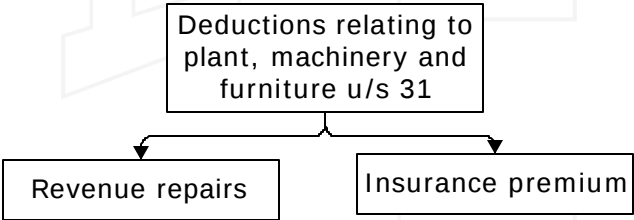
The respondent-firm owing several collieries carried on business in coal. One of the collieries was requisitioned for military use and occupied for thirteen years. During that period the respondent continued carrying on its business in coal working the other collieries and also incurred expenditure on payment of surface rent, minimum royalty and salaries for the watch and ward staff, which was allowed as business expenditure. Upon derequisition the assessee incurred an expenditure in renovating the building, reconditioning the machinery and clearing the land of debris accumulated over a number of years. This amount was spent on the staff and labour by way of salaries and wages and stores, machinery repairs, etc., for the purpose of putting the machinery in working order and bringing the colliery to a state where the mining operations could be resumed. Repairs in such a case was not current repairs and repairs which were not "current repairs" could be considered for deduction under general section. No new asset was brought into existence nor was an advantage for the enduring benefit of the business acquired by the expenditure, and the expenditure was revenue in character. [1980] 122 ITR 0049A CIT VS. KALYANJI MAVJI AND CO. (SUPREME COURT OF INDIA)



SEC.31: REPAIRS AND INSURANCE OF MACHINERY, PLANT AND FURNITURE

In respect of repairs and insurance of machinery, plant or furniture used for the purposes of the business or profession, the following deductions shall be allowed

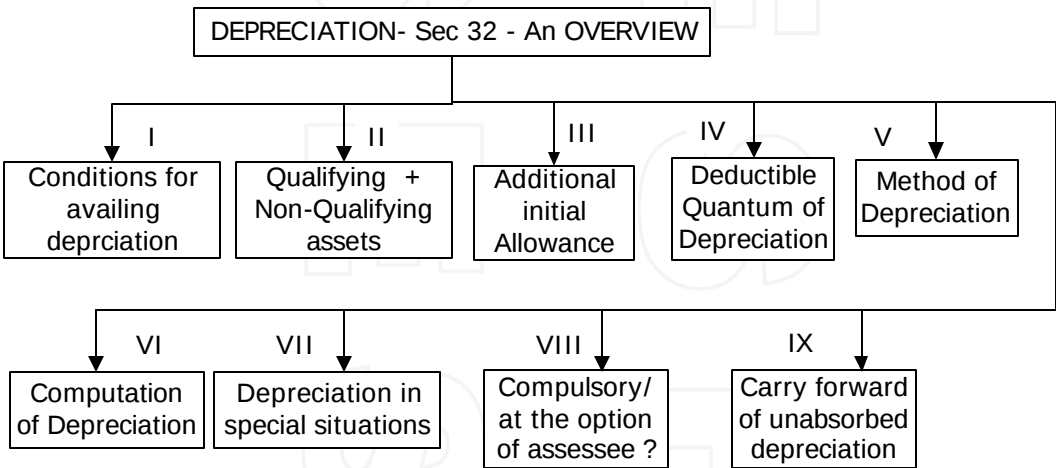
- 1) The amount paid on account of current repairs thereto; (Explanation. For the removal of doubts, it is hereby declared that the amount paid on account of current repairs shall not include any expenditure in the nature of capital expenditure.)
- 2) The amount of any premium paid in respect of insurance against risk of damage or destruction thereof.



SEC.32 DEPRECIATION

In respect of depreciation of Buildings, machinery, plant or furniture, being tangible assets OR intangible assets being Know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets acquired on or after the 1st day of April, 1998,

Which is Owned, wholly or partly, by the assessee and used for the purposes of the business or profession, then such percentage as may be prescribed on the written down value of block of assets, deductions shall be allowed.



MEANING OF BUILDING

Depreciation is not allowable on the cost of the land on which a building is erected but only on the cost of the superstructure. The word "building" means structures and does not include the site. [1967] 065 ITR 0377- CIT VS. ALPS THEATRE (SUPREME COURT OF INDIA)

The proper view-point from which one must approach the question of interpretation of the term "factory

building", with respect to depreciation allowable under the Income-tax Act and Rules, would be to look at the operative words functionally as intending to provide for wear and tear of depreciable assets. Therefore, one must exclude from consideration judicial interpretation of the term "factory", occurring in other enactments such as the Factories Act, 1948. A canteen, by virtue of its purpose and function, is susceptible to a higher rate of wear and tear than ordinary buildings, although the wear and tear may not approach the high rate which would affect parts of a building where plant and machinery and other moving parts engaged in the process of manufacture are fixed. This is because, a canteen as such is a place, which a large assemblage of people who might be described as a floating population, constantly put to use. It is also subject to recurrent cleaning, washing and other processes which inevitably bring about a higher rate of wear and tear. The second reason is that a canteen where cooking and other preparations are carried on either in the kitchen or elsewhere, can be regarded in the strictest sense of the term, as a place where manufacture is carried on, although, in normal parlance, we do not refer to the process of cooking as a process of manufacture. But, whatever expression we might employ to describe the culinary process, there is no doubt whatever that the use of fuel and other reforms of energy in that part of the canteen, would have the same damaging effect on the life of the building as a regular manufacturing process would by the use of plant or machinery. In cases where modern mechanical processes are adopted in a kitchen or canteen for the purpose of cooking meals and making other preparations, the analogy of a manufacturing process would be more apparent. Moreover, it is common knowledge and also part of the statute law governing the running of factories, that every factory has within its precincts a canteen run for the benefit of the workers employed therein. In this respect, the canteen must be considered as a part and parcel of the factory premises and the canteen building must be regarded as a factory building. A canteen building is, therefore, in the proper sense of the term, a "factory building" for the purpose of depreciation allowance. [1980] 126 ITR 0347- CIT vs. Engine Valves Ltd. (Madras High Court)

Roads laid within factory premises as links or providing approach to the buildings to carry on the business activity of the assessee are "buildings" within the meaning of section 32. Depreciation is admissible on the capital expenditure incurred thereon as "building". Equally, drains also would be an integral part of the building for convenient enjoyment of the factory. Depreciation would be available in the same manner on expenditure incurred in laying drains. [1992] 196 ITR 0149A CIT vs. Gwalior Rayon Silk Manufacturing Co. Ltd. (Supreme Court of India)

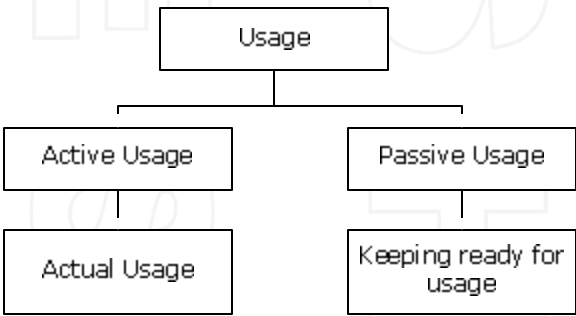
Depreciation was allowable in respect of the temple building constructed within the premises of the assessee. [1996] 221 ITR 0123B CIT vs. Associated Flour Mills P. Ltd. (Gauhati High Court)

SEC.43(3) DEFINITION OF THE WORD PLANT

"Plant" includes ships, vehicles, books, scientific apparatus and surgical equipment used for the purposes of the business or profession but does not include tea bushes or livestock or buildings or furniture and fittings.

"Plant" was not necessarily confined to an apparatus which was used for mechanical operations or process or was employed in mechanical or industrial business. But in order to qualify as "plant ", the particular article had to have some degree of durability. The test to be applied was: Did the article fulfil the function of a plant in the assessee's trading activity ? Was it a tool of his trade with which he carried on his business ? If the answer was in the affirmative, it would be a " plant ". [1986] 157 ITR 0086 Scientific Engineering House (Pvt.) Ltd. vs. CIT (Supreme Court of India)

MEANING OF "USED FOR THE PURPOSE OF BUSINESS OR PROFESSION"



capable of a larger and a narrower interpretation. If the expression ‘used’ is construed strictly, it can be taken as connoting or requiring the active employment or the actual working of a machinery, plant or building in the business. On the other hand, the wider meaning will include not only cases where the machinery, etc., is actively employed but also cases where there is, what may be described as, a passive user of the same in the business. The word ‘used’ in this section may be given a wider meaning and embraces passive as well as active user.

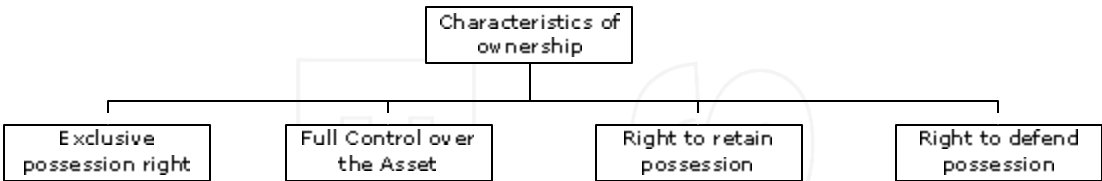
The assessee owned a sugar mill. The Assessing Officer denied depreciation in respect of the factory, plant and machinery as there was no production and no user of machinery during the year. The Tribunal upheld the claim of the assessee on the basis of passive user by keeping the machinery in readiness. On a reference held, that the expression "used" should have a wider meaning so as to include not only actual but also passive user and depreciation was allowable. [1996] 221 ITR 0857- CIT vs. India Tea and Timber Trading Co. (Gauhati High Court)

The assessee-company which owned two cotton ginning and pressing factories and two other concerns, owning in all four presses, entered into a pooling agreement. As the agreement clearly provided that, although two out of the four presses which were directly in the pooling arrangement were to remain idle while the two presses worked, the owners of those presses which were idle had to keep them ready for use at any time and the contingency for their use could also, upon the terms of the agreement, arise at any time and having regard to the above meaning of the word "used", it is clear that even these presses which remained under forced idleness were in use during the entire period of the year. [1971] 079 ITR 0613- Whittle Anderson Ltd. vs. CIT (Bombay High Court)

Where the material on record showed that (i) the trucks in question were used by the assessee for the purpose of his business; (ii) the said trucks were used for the business of the assessee during the relevant years as well as earlier and later years; (iii) during the relevant assessment years, some of these trucks were under repair. Held, that the vehicles continued to be in use for the business of the assessee even though the same were under repair. The assessee was entitled to depreciation in respect of them. [1996] 217 ITR 250 Commissioner of Income-tax Vs. Agrawal (G.N.) (Individual)

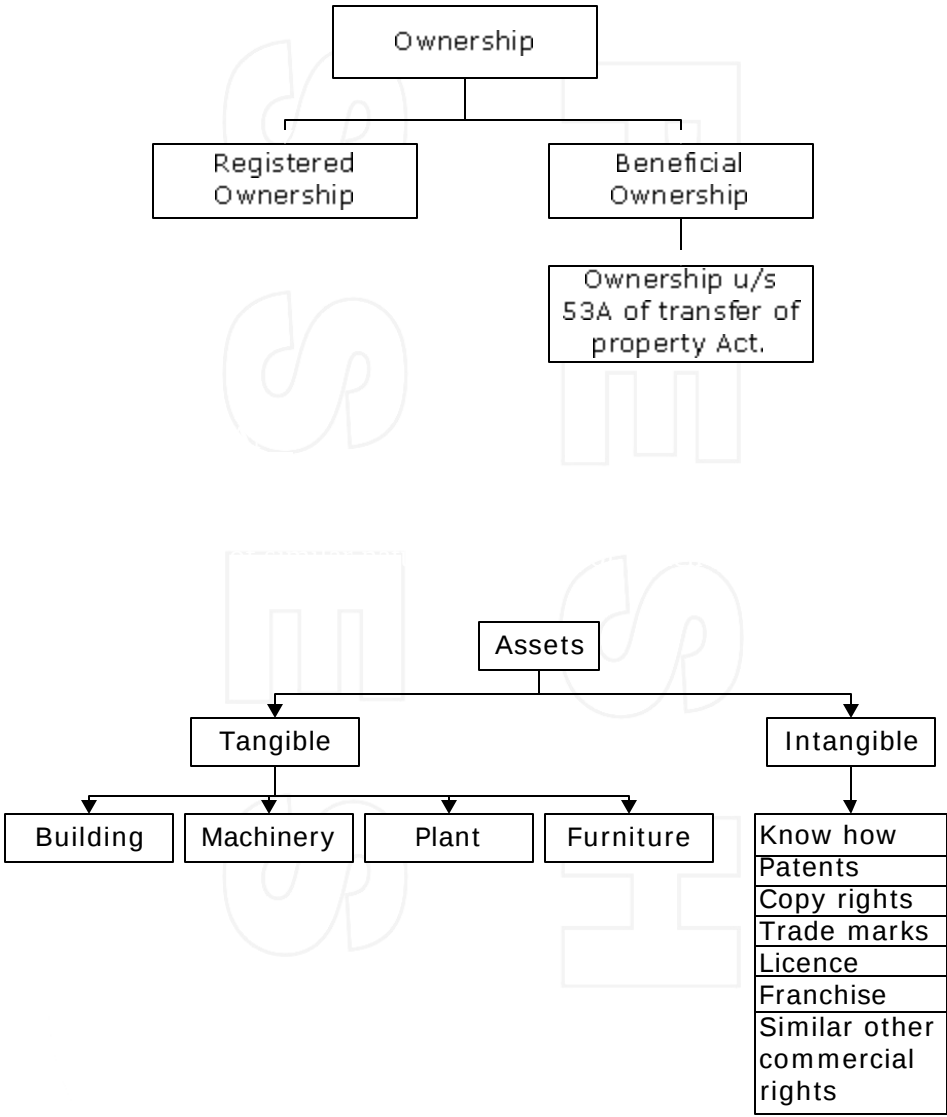
Section 32(1) lays down two conditions to be satisfied by an assessee before claiming any depreciation. These two conditions are, firstly, that the plant and machinery must be owned by the assessee and, secondly, the plant and machinery must be used for the purposes of business of the assessee. In certain cases of a pooling arrangement or where plant and/or machinery is kept as standby to provide against breakdown, even a passive user may entitle the assessee to claim depreciation under section 32 because in both these cases, the machinery is kept ready for use in the factory. Where the factory of the assessee remained under lock-out throughout the two previous years during the lock-out period, the plant and machinery had not been actually used for the purposes of the business. Held, that depreciation under section 32 of the Act was not allowable on such plant and machinery. [1994] 206 ITR 0682- CIT vs. Oriental Coal Co. Ltd. (Calcutta High Court)

MEANING OF OWNER, ALSO INCLUDES BENIFICIAL OWNER



part payment of the consideration.

Section 32 of the Act allows certain deductions, one of them being depreciation of buildings, etc., owned by the assessee and used for the purposes of the business or profession. The terms ‘own’, ‘ownership’ and ‘owned’ are generic and relative terms. They have a wide and also a narrow connotation. The term owned as occurring in section 32(1) of the Income-tax Act must be assigned a wider meaning. Anyone in possession of property in his own title exercising such dominion over the property as would enable others being excluded there from and having the right to use and occupy the property and/or to enjoy its usufruct in his own right would be the owner of the building though a formal deed of title may not have been executed and registered as contemplated by the Transfer of Property Act, the Registration Act, etc. ‘Building owned by the assessee’, the expression as occurring in section 32(1) of the Income-tax Act, means the person who having acquired possession over the building in his own right uses the same for the purposes of the business or profession though a legal title has not been conveyed to him consistently with the requirements of laws such as the Transfer of Property Act and the Registration Act, etc. Generally speaking depreciation is an allowance for the diminution in the value due to wear and tear of a capital asset employed by an assessee in his business. The very concept of depreciation suggests that the tax benefit on account of depreciation legitimately belongs to one who has invested in the capital asset and is utilising the capital asset and thereby losing gradually the investment caused by wear and tear, and would need to replace the same by having lost its value fully over a period of time. It is well-settled that there cannot be two owners of the property simultaneously and in the same sense of the term. The intention of the Legislature in enacting section 32 of the Act would be best fulfilled by allowing deduction in respect of depreciation to the person in whom for the time-being vests the dominion over the building and who is entitled to use it in his own right and is using the same for the purposes of his business or profession. Assigning any different meaning would not subserve the legislative intent. [1999] 239 ITR 0775W Mysore Minerals Ltd. vs. Commissioner of Income-tax (Supreme Court of India)



SEC.43(6) - “WRITTEN DOWN VALUE” IN RELATION OF BLOCK OF ASSET MEANS

BLOCK	The aggregate of the written down values of all the assets falling within that block of assets at the beginning of the previous year.	X
Add	By the ACTUAL COST of any asset falling within that block, ACQUIRED during the previous year	X
Less	By the MONEYS PAYABLE in respect of any asset falling within that block, which is SOLD or discarded or demolished or destroyed during that previous year together with the amount of the scrap value, if any, However, that the amount of such reduction does not exceed the written down value as so increased.	X
Less	In the case of a slump sale, decrease by the actual cost of the asset falling within that block as reduced by,	
	Actual Cost	X
	Less: Amount of depreciation that would have been allowable to the assessee for any assessment year.	X
	However, that the amount of such decrease does not exceed the written down value.	== X
	Written Down Value	----- X
Less	Depreciation for the year	X
	Closing Written Down Value	X

SEC.43(6) - TREATMENT OF TRANSFER IN CASE OF SUCCESSION

Explanation 1 - When in a case of succession in business or profession, an assessment is made on the successor under sub-section (2) of section 170 the written down value of any asset or any block of assets shall be the amount which would have been taken as its written down value if the assessment had been made directly on the person succeeded to.

SEC.43(6) - TREATMENT OF TRANSFER BY HOLDING TO SUBSIDIARY OR IN SCHEME OF AMALGAMATION

Explanation 2 - Where in any previous year, any block of assets is transferred -

- (a) By a holding company to its subsidiary company or by a subsidiary company to its holding company and the conditions of clause (iv) or, as the case may be, of clause (v) of section 47 are satisfied; or
- (b) By the amalgamating company to the amalgamated company in a scheme of amalgamation, and the amalgamated company is an Indian company,

The actual cost of the block of assets in the case of the transferee-company or the amalgamated company, as the case may be, shall be the written down value of the block of assets as in the case of the transferor-company or the amalgamating company for the immediately preceding previous year as reduced by the amount of depreciation actually allowed in relation to the said preceding previous year.

SEC.43(6) - TREATMENT OF TRANSFER IN SCHEME OF DEMERGER

Explanation 2A - Where in any previous year, any asset forming part of a block of assets is transferred by a demerged company to the resulting company, then, notwithstanding anything contained in clause (1), the written down value of the block of assets of the demerged company for the immediately preceding previous year shall be reduced by the **WRITTEN-DOWN VALUE OF THE ASSETS** transferred to the resulting company pursuant to the demerger.

Explanation 2B. - Where in a previous year, any asset forming part of a block of assets is transferred by a demerged company to the resulting company, then, notwithstanding anything contained in clause (1), the written down value of the block of assets in the case of the resulting company shall be added by the **WRITTEN DOWN VALUE OF THE TRANSFERRED ASSETS** of the demerged company immediately before the demerger.

MEANING OF "MONEYS PAYABLE"

It includes any insurance, salvage or compensation moneys payable in respect thereof and where the building, machinery, plant or furniture is sold, the price for which it is sold.

MEANING OF "SOLD"

"sold" includes a transfer by way of exchange or a compulsory acquisition under any law for the time being in force but does not include a transfer, in a scheme of amalgamation, of any asset by the amalgamating company to the amalgamated company where the amalgamated company is an Indian company or in a scheme of amalgamation of a banking company.

ASSETS IN THE SCHEME OF CORPORATISATION OF RSE EXPL. 5

Where in a previous year, any asset forming part of a block of assets is transferred by a recognised stock exchange in India to a company under a scheme for corporatisation approved by the Securities and Exchange Board of India, the written down value of the block of assets in the case of such company shall be the written down value of the transferred assets immediately before such transfer.

DEPRECIATION ON IMPORTED MOTOR CARS

With effect from assessment year 2002-2003 the depreciation on Imported motor cars is available. However motor cars should have been acquired on or after 01-04-2001 only.

ASSETS USED FOR LESS THAN 180 DAYS

Where any asset falling within a block of assets is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period of less than one hundred and eighty days in that previous year, the deduction under this clause in respect of such asset shall be restricted to fifty per cent of the amount calculated at the percentage prescribed under this clause in the case of block of assets comprising such asset

APPORTIONMENT OF DEPRECIATION IN CASE OF SUCCESSION

The aggregate deduction, in respect of depreciation allowable to the predecessor and the successor in the case of succession referred to in clause (xiii) and clause (xiv) of section 47 or section 170 or to the amalgamating company and the amalgamated company in the case of amalgamation, or to the demerged company and the resulting company in the case of **demerger**, as the case may be, shall not exceed in any previous year the deduction calculated at the prescribed rates as if the succession or the amalgamation or the demerger, as the case may be, had not taken place, and such deduction shall be apportioned between the predecessor and the successor, or the amalgamating company and the amalgamated company, or the demerged company and the resulting company, as the case may be, in the ratio of the number of days for which the assets were used by them.

DEEMED BUILDING - EXPLANATION TO SECTION 32

Where the business or profession of the assessee is carried on in a building not owned by him but in respect of which the assessee holds a lease or other right of occupancy and any capital expenditure is incurred by the assessee for the purposes of the business or profession on the construction of any structure or doing of any work in or in relation to, and by way of renovation or extension of, or improvement to, the building, then, the provisions of this clause shall apply as if the said structure or work is a building owned by the assessee.

NOW DEPRECIATION IS MANDATORY

Explanation 5 to 32 clarify that the provisions relating to depreciation shall apply whether or not the assessee has claimed the deduction for depreciation in computing his total income. I.e. It clarifies that in computing the profits and gains of business or profession for any previous year, deduction of depreciation under section 32 shall be mandatory.

ADDITIONAL DEPRECIATION 32(ia)

In the case of any new machinery or plant (other than ships and aircraft), which has been acquired and installed after the 31st day of March, 2002, by an assessee engaged in the business of manufacture or production of any article or thing, a further sum equal to fifteen per cent. of the actual cost of such machinery or plant shall be allowed as deduction

ADDITIONAL DEPRECIATION OF FIFTEEN PER CENT. SHALL BE ALLOWED TO

Additional depreciation shall be increased from fifteen per cent to twenty per cent. The conditions relating to industrial undertaking being new or substantial expansion mentioned earlier and the requirements of furnishing details of machinery or plant and report of an accountant are omitted.

In the case of any new machinery or plant (other than ships and aircraft), which has been acquired and installed after the 31st day of March, 2005, by an assessee engaged in the business of manufacture or production of any article or thing, a further sum equal to twenty per cent of the actual cost of such machinery or plant shall be allowed as deduction under clause (ii)

Provided that no deduction shall be allowed in respect of—

- 1) Any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person; or
- 2) Any machinery or plant installed in any office premises or any residential accommodation, including accommodation in the nature of a guest-house; or
- 3) Any office appliances or road transport vehicles; or
- 4) Any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head “Profits and gains of business or profession” of any one previous year;’;

SEC.43 (1) MEANING OF ACTUAL COST

“ACTUAL COST” means the actual cost of the assets to the assessee, reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority.

ORDINARY MEANING OF ACTUAL COST

The ordinary dictionary meaning of the word ‘actual’ is ‘existing in fact or fact as opposed to imaginary or past state of things’. Likewise the dictionary meaning of the word ‘cost’ is ‘what is laid out or suffered to obtain anything’. The phrase ‘actual cost’, therefore, plainly indicates that the section is intended to confine the relief to an aggregate equal to the sum of money which the person has expended out of his own resources, called cost, of which the burden has ultimately fallen upon him. In other words, what a person expends on machinery seems to be the actual cost to him of acquiring and installing that machinery. The word ‘cost’ is not synonymous with ‘price’. Besides the price of machinery or plant, it takes in many other items of expenditure such for instance as freight, warehouse or insurance charges, legal expenses incurred in connection with its acquisition and interest incurred before the commencement of production on capital contributed or borrowed to acquire such asset. In other words, in determining the actual cost of a fixed asset, all expenditure necessary to bring such asset into existence and to put it in working condition may legitimately be taken into account.

As the expression ‘actual cost’ has not been defined, it should be construed in the sense in which no commercial man would misunderstand it. For this purpose, it would be necessary to ascertain the connotation of the expression in accordance with the normal rules of accountancy prevailing in commerce and industry. The accepted accountancy rules for determining cost of fixed assets is to include all expenditure necessary to bring such asset into existence and to put them in working condition - *Challapalli Sugars Ltd. v. CIT* [1975] 98 ITR 167 (SC).

Assessee purchased existing residential building for use for commercial purposes. Charges paid for conversion for commercial purposes and additional commercialisation charges for putting up multi storeyed structure several times original area after demolition of original building. Additional commercial charges paid for additional space form part of actual cost of building and is entitled to depreciation. [1998] 231 ITR 0741- *CIT vs. Hindustan Times Ltd.* (Supreme Court of India)

The manner of repayment of a loan cannot affect the cost of the assets acquired by the assessee. What is the actual cost depends on the amount paid by the assessee to acquire the asset. The amount may have been borrowed by the assessee. But even if the assessee did not repay the loan it will not alter the cost of the asset. If the borrower defaults in repayment of a part of the loan, the cost of the asset will not change. What has to be borne in mind is that the cost of an asset and the cost of raising money for purchase of the asset are two different and independent transactions. [1998] 231 ITR 0285- *CIT vs. Tata Iron and Steel Co. Ltd* (Supreme Court of India)

EXPLANATIONS TO SECTION 43(1) MEANING OF ACTUAL COST**ASSETS USED FOR THE PURPOSE OF SCIENTIFIC RESEARCH - EXPLANATION 1**

Where an asset is used in the business after it ceases to be used for scientific research related to that business and a deduction has to be made on account of depreciation in respect of that asset, the actual cost of the asset to the assessee shall be the actual cost to the assessee as reduced by the amount of any deduction allowed under section 35.

ASSETS ACQUIRED BY MEANS OF GIFT WILL AND INHERITANCE - EXPLANATION 2

Where an asset is acquired by the assessee by way of gift or inheritance, the actual cost of the asset to the assessee shall be the actual cost to the previous owner.

ASSETS EARLIER USED BY THE OTHER PERSON FOR THE PURPOSE OF BUSINESS OR PROFESSION - EXPLANATION 3

Where, before the date of acquisition by the assessee, the assets were at any time used by any other person for the purposes of his business or profession and the [Assessing] Officer is satisfied that the main purpose of the transfer of such assets, directly or indirectly to the assessee, was the reduction of a liability to income-tax (by claiming depreciation with reference to an enhanced cost), the actual cost to the assessee shall be such an amount as the [Assessing] Officer may with the previous approval of the [Deputy] Commissioner, determine having regard to all the circumstances of the case.

ASSETS RE-ACQUIRED - EXPLANATION 4

Where any asset which had once belonged to the assessee and had been used by him for the purposes of his business or profession and thereafter ceased to be his property by reason of transfer or otherwise, is re-acquired by him, the actual cost to the assessee shall be

- (i) The actual cost to him when he first acquired the asset as reduced by -
The amount of depreciation that would have been allowable to the assessee for any assessment year commencing on or after the 1st day of April, 1988, as if the asset was the only asset in the relevant block of assets; or
- (ii) The actual price for which the asset is re-acquired by him, whichever is less.

SALE AND LEASE BACK - EXPLANATION 4A

Where before the date of acquisition by the assessee (hereinafter referred to as the first mentioned person), the assessee (hereinafter referred to as the first mentioned person), the assets were at any time used by any other person (hereinafter referred to as the second mentioned person) for the purposes of his business or profession and depreciation allowance has been claimed in respect of such assets in the case of the second mentioned person and such person acquires on lease, hire or otherwise assets from the first mentioned person, the, notwithstanding anything contained in Explanation 3, the actual cost of the transferred assets, in the case of first mentioned person, shall be the same as the written down value of the said assets at the time of transfer thereof by the second mentioned person.

CAPITAL ASSET USED FOR THE PURPOSE OF BUSINESS - EXPLANATION 5

Where a building previously the property of the assessee is brought into use for the purpose of the business or profession the actual cost to the assessee shall be the actual cost of the building to the assessee, as reduced by an amount equal to the depreciation calculated at the rate in force on that date that would have been allowable had the building been used for the aforesaid purposes since the date of its acquisition by the assessee.

TRANSFER BY A HOLDING TO ITS SUBSIDIARY COMPANY AND VICE-A-VERSA - EXPLANATION 6

When any capital asset is transferred by a holding company to its subsidiary company or by a subsidiary company to its holding company, then, if the conditions of clause (iv) or, as the case may be, of clause (v) of section 47 are satisfied, the actual cost of the transferred capital asset to the transferee -company shall be taken to be the same as it would have been if the transferor-company had continued to hold the capital asset for the purposes of its business.

TRANSFER IN A SCHEME OF AMALGAMATION - EXPLANATION 7

Where, in a scheme of amalgamation, any capital asset is transferred by the amalgamating company to the amalgamated company and the amalgamated company is an Indian company, the actual cost of the transferred

capital asset to the amalgamated company shall be taken to be the same as it would have been if the amalgamating company had continued to hold the capital asset for the purposes of its own business.

TRANSFER IN A SCHEME OF DEMERGER - EXPLANATION 7A

Where, in a demerger, any capital asset is transferred by the demerged company to the resulting company and the resulting company is an Indian company, the actual cost of the transferred capital asset to the resulting company shall be taken to be the same as it would have been if the demerged company had continued to hold the capital asset for the purpose of its own business. Provided that such actual cost shall not exceed the written down value of such capital asset in the hands of the demerged company.

INTEREST ON THE CAPITAL BORROWED - EXPLANATION 8

For the removal of doubts, it is hereby declared that where any amount is paid or is payable as interest in connection with the acquisition of an assets, so much of such amount as is relatable to any period after such asset is first put to use shall not be included, and shall be deemed never to have been included, in the actual cost of such assets.

TREATMENT OF MODVAT - EXPLANATION 9.

For the removal of doubts, it is hereby declared that where an asset is or has been acquired on or after the 1st day of March, 1994, by an assessee, the actual cost of asset shall be reduced by the amount of duty of excise or the additional duty leviable under section 3 of the Customs Tariff Act, 1975 (51 of 1975), in respect of which a claim of credit has been made and allowed under the Central Excise Rules, 1944.

TREATMENT OF SUBSIDY - EXPLANATION 10.

Where a portion of the cost of an asset acquired by the assessee has been met directly or indirectly by the Central Government or a State Government or any authority established under any law or by any other person, in the form of a subsidy or grant or reimbursement (by whatever name called), then, so much of the cost as is relatable to such subsidy or grant or reimbursement shall not be included in the actual cost of the asset to the assessee:

Provided that where such subsidy or grant or reimbursement is of such nature that it cannot be directly relatable to the asset acquired, so much of the amount which bears to the total subsidy or reimbursement or grant the same proportion as such asset bears to all the assets in respect of or with reference to which the subsidy or grant or reimbursement is so received, shall not be included in the actual cost of the asset to the assessee."

Explanation 10 provides that where a portion of the cost of an asset acquired by the assessee has been met directly or indirectly by the Central Government or a State Government or any authority established under any law or by any other person, in the form of a subsidy or grant or reimbursement (by whatever name called), then, so much of the cost as is relatable to such subsidy or grant or reimbursement shall not be included in the actual cost of the asset to the assessee. Cost incurred/payable by the assessee alone could be the basis for any tax allowance. This Explanation further provides that where such subsidy or grant or reimbursement is of such nature that it cannot be directly relatable to the asset acquired, so much of the amount which bears to the total subsidy or reimbursement or grant the same proportion as such asset bears to all the assets in respect of or with reference to which the subsidy or grant or reimbursement is so received, shall not be included in the actual cost of the asset to the assessee.

TREATMENT OF FOREIGN ASSETS BROUGHT IN INDIA - EXPLANATION 11

Where an asset which was acquired outside India by an assessee, being a non-resident, is brought by him to India and used for the purposes of his business or profession, the actual cost of the asset to the assessee shall be the actual cost to the assessee, as reduced by an amount equal to the amount of depreciation calculated at the rate in force that would have been allowable had the asset been used in India for the said purposes since the date of its acquisition by the assessee.

This Explanation provides that in case an asset, which was acquired outside India by an assessee, being a non-resident, is brought by him to India and used for the purposes of his business or profession, the actual cost of the asset to the assessee shall be the actual cost to the assessee, as reduced by an amount equal to the amount of depreciation calculated at the rate in force that would have been allowable had the asset been used in India for the said purposes since the date of its acquisition by the assessee.

ASSETS IN SCHEME OF CORPORATISATION OF RECOGNISED STOCK EXCHANGE - EXPLANATION 12

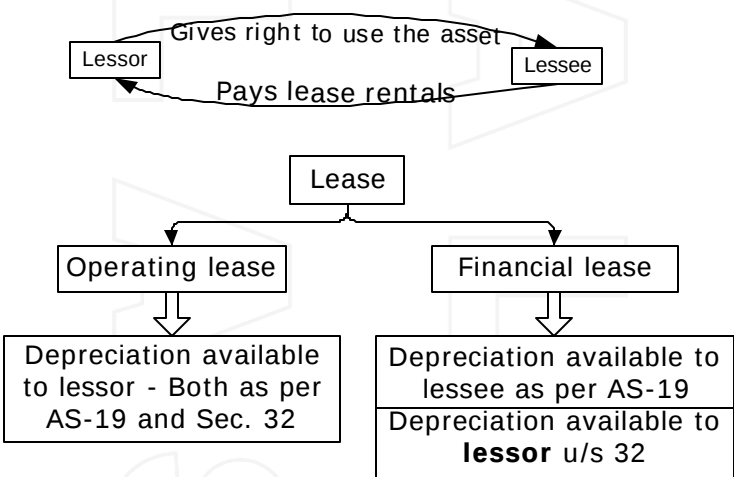
Where any capital asset is acquired by the assessee under a scheme for corporatisation of a recognised stock exchange in India, approved by the Securities and Exchange Board of India, the actual cost of the asset shall be

deemed to be the amount which would have been regarded as actual cost had there been no such corporatisation.

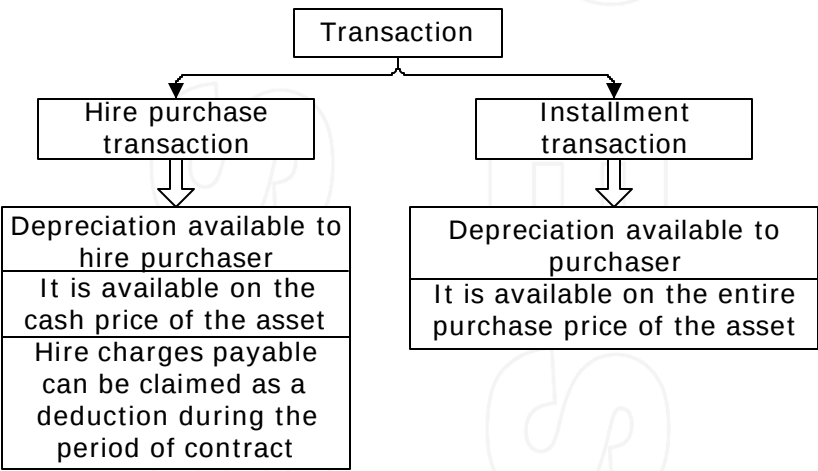
ADJUSTMENT CONSEQUENTIAL TO CHANGE IN RATE OF FOREIGN EXCHANGE TO BE ON ACTUAL PAYMENT ONLY SECTION 43A.

The new section 43A has been substituted by the Finance Act, 2002, to come into force from April 1, 2003, i.e., with effect from the assessment year 2003-04. The object of the amendment is to rationalize the provisions to the effect that where a capital asset has been acquired from a foreign country, the addition or deduction from the actual cost of the asset on account of change in the rate of exchange in any previous year will be allowed to be made only on actual payment by the assessee towards the cost of the asset or repayment of the foreign loan or interest, irrespective of the method of accounting employed by the assessee.

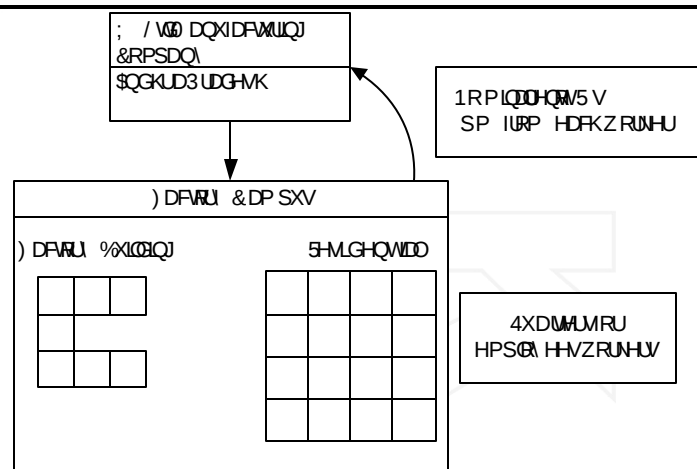
OPERATING LEASE V/S FINANCE LEASE



HIRE PURCHASE V/S INSTALLMENT SALE



DEPRECIATION ON ASSETS USED BY EMPLOYEES



When occupation of residential quarters by the assessee’s employees is subservient to and necessary for the business, the property is considered as occupied by owner for the purpose of his business. Depreciation is, therefore, allowable on such buildings. Similarly, fans, air-conditioners, refrigerators, furniture, etc., provided by the assessee-employer at the quarters of employees are considered to have been used wholly for the purpose of employer’s business and depreciation is admissible.

DEPRECIATION FOR ASSETS OF AN UNDERTAKING ENGAGED IN GENERATION OR GENERATION AND DISTRIBUTION OF POWER

In the case of assets of an undertaking engaged in generation or generation and distribution of power, such percentage on the actual cost thereof to the assessee as may be prescribed. I.E. ON STRAIGHT LINE METHOD.

TERMINAL DEPRECIATION IN CASE OF SLM SYSTEM OF DEPRECIATION.

In the case of any building, machinery, plant or furniture in respect of which depreciation is claimed and allowed and which is sold, discarded, demolished or destroyed in the previous year (other than the previous year in which it is first brought into use), the amount by which the moneys payable in respect of such building, machinery, plant or furniture, together with the amount of scrap value, if any, fall short of the written down value thereof. Provided that such deficiency is actually written off in the books of the assessee.

SEC. 41(2) TREATMENT ON SALE OF ASSETS ON WHICH SLM SYSTEM OF DEPRECIATION PREVAILS (BALANCING CHARGE)

Where any building, machinery, plant or furniture, Which is owned by the assessee, In respect of which depreciation is claimed on SLM basis; and Which was or has been used for the purposes of business, is sold, discarded, demolished or destroyed and the moneys payable in respect of such building, machinery, plant or furniture, as the case may be, together with the amount of scrap value, if any, exceeds the written down value, so much of the excess as does not exceed the difference between the actual cost and the written down value shall be chargeable to income-tax as income of the business of the previous year in which the moneys payable for the building, machinery, plant or furniture became due.

Explanation.--Where the moneys payable in respect of the building, machinery, plant or furniture referred to in this sub-section become due in a previous year in which the business for the purpose of which the building, machinery, plant or furniture was being used is no longer in existence, the provision of this sub-section shall apply as if the business is in existence in that previous year.

SEC. 172 SHIPPING BUSINESS OF NON RESIDENTS

Section 172 deals with shipping business of non-residents. The scheme of section 172 is that every time a ship belonging to or chartered by a non-resident makes a voyage from a port in India, carrying passengers, live-stock, mail or goods, shipped at the airport, 7 1/2 per cent [172(4)] of the amount paid or payable on account of the carriage of the passengers etc. is taken as the income and tax levied on such income at the rate applicable to a foreign company. The assessment and the payment is to be made before the ship is granted the port clearance. The exception is that in suitable cases the ship may be allowed to leave, provided satisfactory arrangements are made to ensure that the return is filed within 30 days of the departure of the ship and for payment of taxes. Under section 172(7), the non-resident owner or charter is allowed to claim before the end of the relevant assessment year that he be assessed on his total income of the previous year and the tax payable on the basis

thereof be determined in accordance with other provisions of the Act. When such a claim is made and an assessment is made thereupon, the tax paid under section 172(4) by the non-resident owner or charterer would be treated as a payment in advance of the tax leviable for that assessment year before determining the amount of tax finally due. It may be noted that under section 172(7), the choice is entirely that of the non-resident taxpayer to be assessed under the other provisions of the Act. The payment made under section 172(4) by a non-resident ship owner is a payment of tax on actual assessments under that section and it is not a payment of advance tax within the meaning of the Income-tax Act there being no advance tax liability within the scheme of section 172.

OTHER INCOME IS ASSESSABLE IN INDIA

It cannot be contended that because there is this special provision of 172 for the imposition and recovery of tax from a non-resident ship-owner, this special provision will exclude the operation of the general provisions contained in section 5 of the Act. The case of a non-resident who receives or is deemed to have received in India income in any year or on whose behalf such income is received from whatever source derived, is covered by section 5(2) of the Act and if freight for the carriage of goods to India includes any amount chargeable to tax as income, such income is certainly received in India and is chargeable under section 5(2). [1971] 081 ITR 0162- CZECHOSLOVAK OCEAN SHIPPING INTERNATIONAL JOINT STOCK CO. VS. INCOME-TAX OFFICER (CALCUTTA HIGH COURT)

DEAD FREIGHT IS NOT TAXABLE

"Dead freight" is not freight, that is, a payment made on account of carriage of goods, but it is in reality damages for breach of contract. It is in effect and substance unliquidated compensation for the loss of freight, an amount recoverable in the place and stead of freight. It is not freight at all properly so called and it is merely called as such for convenience. Therefore, any payment made on account of "dead freight" cannot be treated as payment on account of carriage of goods in a ship. It is, in fact, payment by way of damages for non-carriage of goods on account of the charterer's failure to fulfil his obligation to provide freight. [1977] 107 ITR 0837-COMMISSIONER OF INCOME-TAX VS. PESTONJI BHICAJEE (GUJ)

CHARTER PARTY CONTRACT IS NOT ASSESSABLE IN INDIA

The Aluminium Co. of Canada, a non-resident company, had entered into a charter-party with the owners of a ship on a time charter. The ship called at an Indian port where it was loaded with the company's own goods and the ship left for Canada. The amount which the company was required to pay to the owners of the ship was not payable "on account of" the carriage of goods to the owners of the ship within the meaning of section 172(2) of the Income-tax Act, 1961. The company paid hire charges to the owners of the ship and since it loaded the ship with the company's own goods, the company received nothing on account of carriage of the goods. Neither the owners of the ship nor the company, therefore, received any amount "on account of" the carriage of the goods. No tax was, therefore, exigible under section 172(2). [1978] 113 ITR 0307- UNION OF INDIA VS. GOSALIA SHIPPING P. LTD. (SC)

[1995] 215 ITR (STAT) 0116-CIRCULAR NUMBER: 723

The provisions of section 172 are to apply, notwithstanding anything contained in the other provisions of the Act. Therefore, in such cases, the provisions of sections 194C and 195 relating to tax deduction at source are not applicable. The recovery of tax is to be regulated, for a voyage undertaken from any port in India by a ship, under the provisions of section 172. There would, however, be cases where payments are made to shipping agents of non-resident ship-owners or charterers for carriage of passengers, etc., shipped at a port in India. Since the agent acts on behalf of the non-resident ship-owner or charterer, he steps into the shoes of the principal. Accordingly, the provisions of section 172 shall apply and those of sections 194C and 195 will not apply.

SEC. 44B PROFITS AND GAINS OF SHIPPING BUSINESS IN THE CASE OF NON-RESIDENTS.

In the case of an assessee, being a non-resident, engaged in the business of operation of ships, a sum equal to seven and a half per cent of the aggregate of the amounts specified shall be deemed to be the profits and gains of such business

The specified amounts :—

- 1) The amount paid or payable (whether in or out of India) to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India; and
- 2) The amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

The amount shall include the amount paid or payable or received or deemed to be received, as the case may be, by way of demurrage charges or handling charges or any other amount of similar nature.

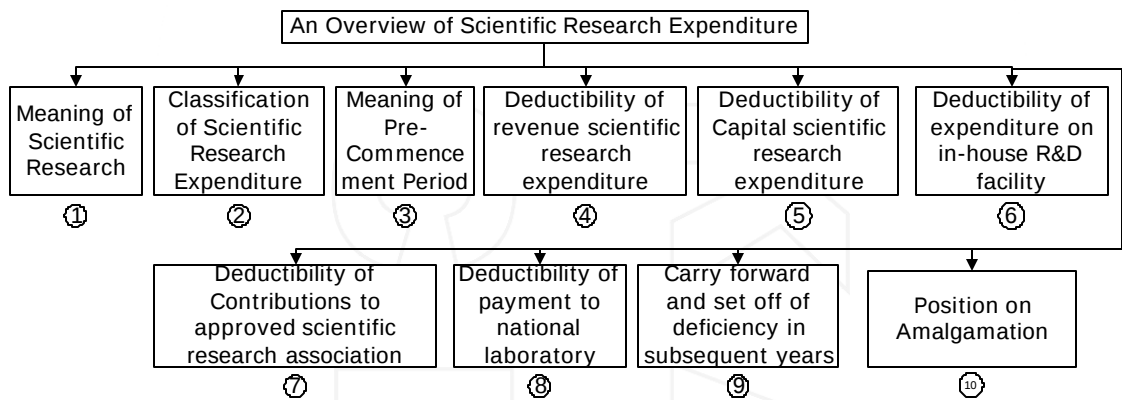
44BBA. PROFITS AND GAINS OF THE BUSINESS OF OPERATION OF AIRCRAFT IN THE CASE OF NON-RESIDENTS.

In the case of an assessee, being a non-resident, engaged in the business of operation of aircraft, a sum equal to five per cent. of the aggregate of the amounts specified shall be deemed to be the profits and gains of such business.

The specified amounts

- (a) The amount paid or payable (whether in or out of India) to the assessee or to any person on his behalf on account of the carriage of passengers, live-stock, mail or goods from any place in India ; and
- (b) The amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage or passengers, live-stock, mail or goods from any place outside India.

SEC.35: EXPENDITURE ON SCIENTIFIC RESEARCH



In respect of expenditure on scientific research, the following deductions shall be allowed -

- 1) Any expenditure (not being in the nature of capital expenditure) laid out or expended on scientific research related to the business.
- 2) An amount equal to one and one-fourth times of any sum paid to a scientific research association which has as its object the undertaking of scientific research or to a university, college or other institution to be used for scientific research:
- 3) An amount equal to one and one-fourth times of any sum paid to a university, college or other institution to be used for research in social science or statistical research: (Kalpesh Classes Tel. 23820676)
- 4) In respect of any expenditure of a capital nature on scientific research related to the business carried on by the assessee,

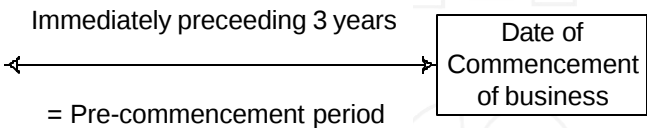
With a view to induce more investment for research and development activities, It is provided for a weighted deduction of one and one-fourth times of such sums paid. The Act also vests the authority for approval, for the purposes of above clauses, in the Central Government instead of the prescribed authority.

NO DEDUCTION FOR ACQUISITION OF LAND

No deduction shall be admissible in respect of any expenditure incurred on the acquisition of any land, whether the land is acquired as such or as part of any property, after the 29th day of February 1984.

TREATMENT OF PRE COMMENCEMENT S/R EXPENDITURE

Where any capital or revenue expenditure has been incurred before the commencement of the business, the aggregate of the expenditure so incurred within the three years immediately preceding the commencement of the business shall be deemed to have been incurred in the previous year in which the business is commenced.



SEC.35(2AA): CONTRIBUTION TO A NATIONAL LABORATORY OR A UNIVERSITY OR AN INDIAN INSTITUTE OF TECHNOLOGY.

Where the assessee pays any sum to a National Laboratory or a University or an Indian Institute of Technology or a specified person with a specific direction that the said sum shall be used for scientific research undertaken under a programme approved in this behalf by the prescribed authority, then -

- 1) There shall be allowed a deduction of sum equal to one and one-fourth times the sum so paid; and
- 2) No deduction in respect of such sum shall be allowed under any other provision of this Act:

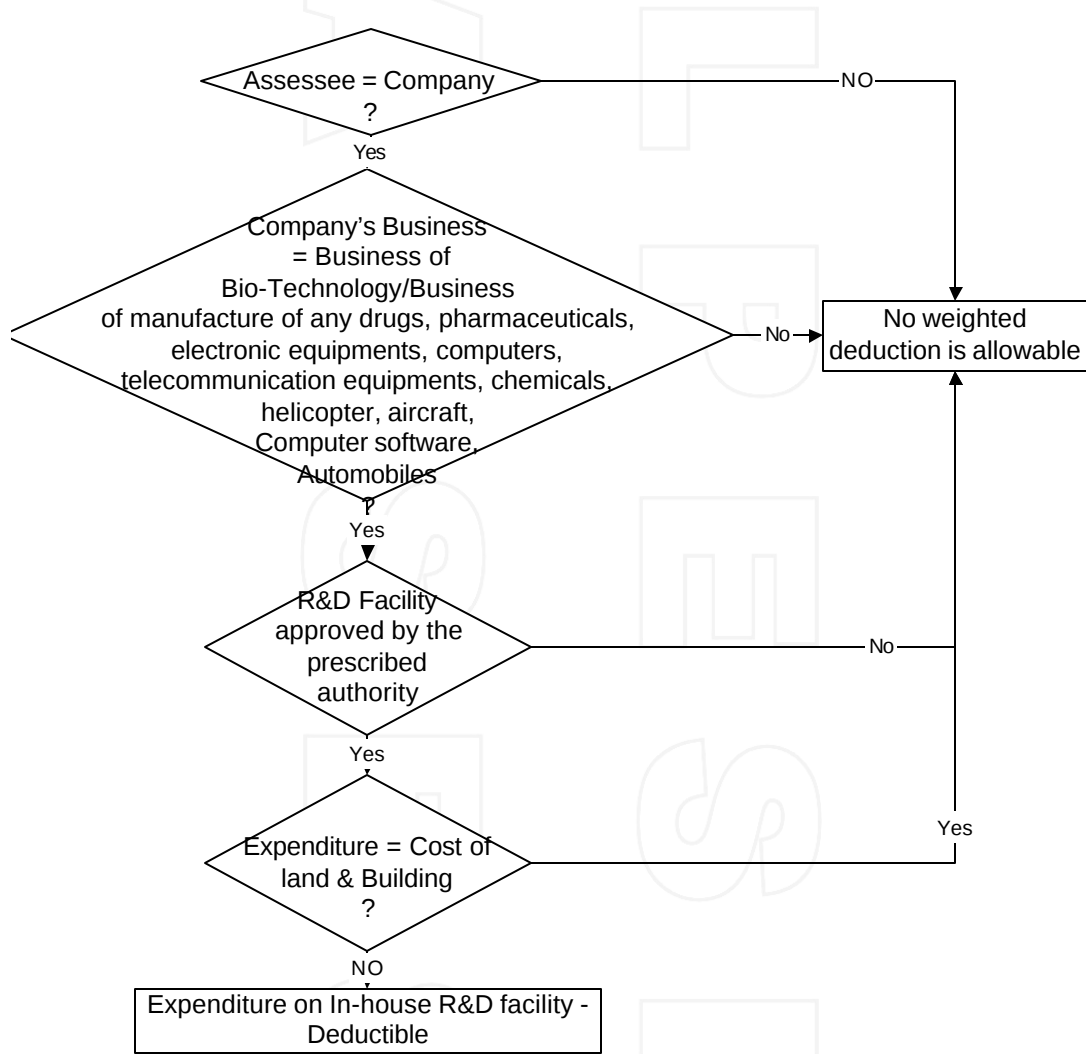
SEC.35(2AB): EXPENDITURE ON IN HOUSE SCIENTIFIC RESEARCH

- 1) Where a company engaged in the business of bio-technology or in the business of manufacture or production of any drugs, pharmaceuticals electronic equipments, computers, telecommunication equipments, chemicals or any other article or thing notified by the Board incurs any expenditure on scientific research (not being expenditure in the nature of cost of any land or building) on in house research

- and development facility as approved by the prescribed authority, then, there shall be allowed a deduction of a sum equal to one and half times of the expenditure so incurred.
- 2) Expenditure on scientific research shall include expenditure incurred on clinical trial, regulatory approval and filing of patent.
 - 3) No deduction shall be allowed in respect of the expenditure mentioned in clause (1) under any other provision of this Act.
 - 4) No company shall be entitled for deduction under clause (1) unless it enters into an agreement with the prescribed authority for co-operation in such research and development facility and for audit of the accounts maintained for that facility.
 - 5) The prescribed authority shall submit its report in relation to the approval of the said facility to the Director General in such form and within such time as may be prescribed.
 - 6) No deduction shall be allowed in respect of the expenditure refer-red to in clause (1) which is incurred after the 31st day of March, 2007.

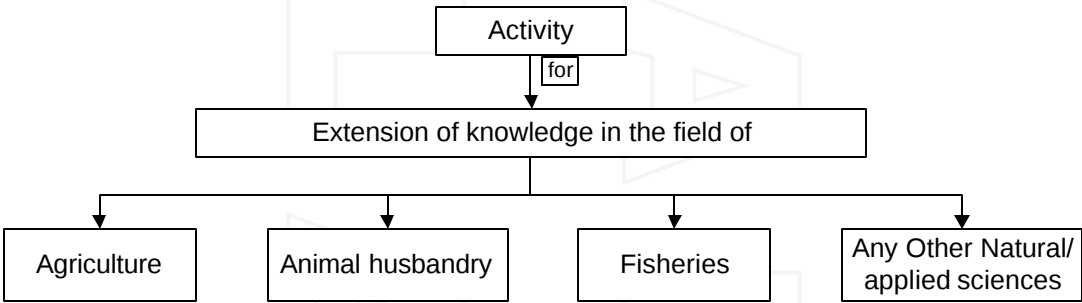
WEIGHTED DEDUCTION RESTRICTED

Due to difficulties experienced by the prescribed authority in monitoring and auditing such expenses in the case of a large number of such companies, upon requests from the industries and the Department of Scientific and Industrial Research, the Finance Minister introduced a new clause (5) in the said sub-section (2AB) which restricts the tax benefit up to 31-3-2005.



SEC.43(4) MEANING OF SCIENTIFIC RESEARCH ACTIVITY

- (i) “SCIENTIFIC RESEARCH” means any activities for the extension of knowledge in the fields of natural or applied science including agriculture, animal husbandry or livestock;
- (ii) References to expenditure incurred on scientific research include all expenditure incurred for the prosecution, or the provision of facilities for the prosecution, of scientific research, but do not include any expenditure incurred in the acquisition of rights in, or arising out of, scientific research;
- (iii) References to scientific research related to a business or class of business include -
 - (a) Any scientific research which may lead to or facilitate an extension of that business or, as the case may be, all businesses of that class;
 - (b) Any scientific research of a medical nature which has a special relation to the welfare of workers employed in that business or, as the case may be, all businesses of that class;



ROYALTY PAYMENT FOR RIGHTS ARISING OUT OF SCIENTIFIC RESEARCH

Assessee an Indian company subsidiary of a foreign company entered in to an agreement with foreign company for specified period for use of processes, scientific data, patents and trade marks. Price was paid to foreign company as a percentage of sale price of products towards technical services, research work, cost of materials used in research and royalties. Question was whether it was allowable as scientific research expenditure or not and if not whether it was allowable as revenue expenditure or not. (Must visit kalpeshclasses.com for downloading material for PE2 and Final)

Decided that The contribution was not allowable as expenditure laid out or expended on scientific research. Payment made to recoup another person for expenditure or scientific research incurred by that other person, even if it might ultimately benefit the assessee, was, unless it was carried on for or on behalf of the assessee, not expenditure laid out or expended on scientific research related to the business of the assessee. However, the contribution was allowable as business expenditure. The assessee did not under the agreement become entitled exclusively even for the period of the agreement, to the patents and trade marks of the Swiss company; it had merely access to the technical knowledge and experience in the pharmaceutical field which the Swiss company commanded. [1968] 069 ITR 0692- CIT vs. Ciba of India Ltd. (Supreme Court of India)

AGENCY CONDUCTING RESEARCH

Scientific research need not be carried on by assessee itself. Assessee was manufacturing rayon yarn, etc. plant set up for manufacture of pulp from bamboo and the amount was paid to foreign company for research on pulping of bamboo and conversion of pulp into yarn. Research was undertaken pertained to substitution of existing raw material by another. The research undertaken was "related to" business of assessee and the expenditure on research is allowable deduction. That for claiming the deduction under section 35(1)(i) research must have been carried on by the assessee itself, is not borne out by the phraseology of the statutory provision. The assessee can claim the deduction even if the research is carried on by some other person on behalf of the assessee. Activities of the assessee in the years in which the expenditure was incurred were, inter alia, the manufacture of rayon yarn and the research activity pertained to a substitution of the raw material currently being used. Even assuming that the present activities alone were to be considered, the research undertaken must be properly regarded as being " related to " the business of the company. Therefore, the assessee was entitled to the allowance in respect of the research expenses incurred by it. [1983] 140 ITR 0143B CIT vs. National Rayon Corporation Ltd. (Bombay High Court) In other words where the assessee paid some money to a foreign company for carrying out research related to the assessee’s business and the foreign company carried out the research on behalf of the assessee, the sum paid to the foreign company was deductible. (Kalpesh Classes Tel. 23820676)

RECOUPMENT OF EXPENDITURE

Payment made to reimburse another person for expenditure on scientific research incurred by that other person, even if it ultimately benefits the assessee, is not deductible unless the research is carried on for or on behalf of the assessee - CIT V/s. Ciba of India Ltd. [1968] 69 ITR 692 (SC) (Must visit kalpeshclasses.com for downloading material for PE2 and Final)

MEANING OF ‘RELATED TO BUSINESS’

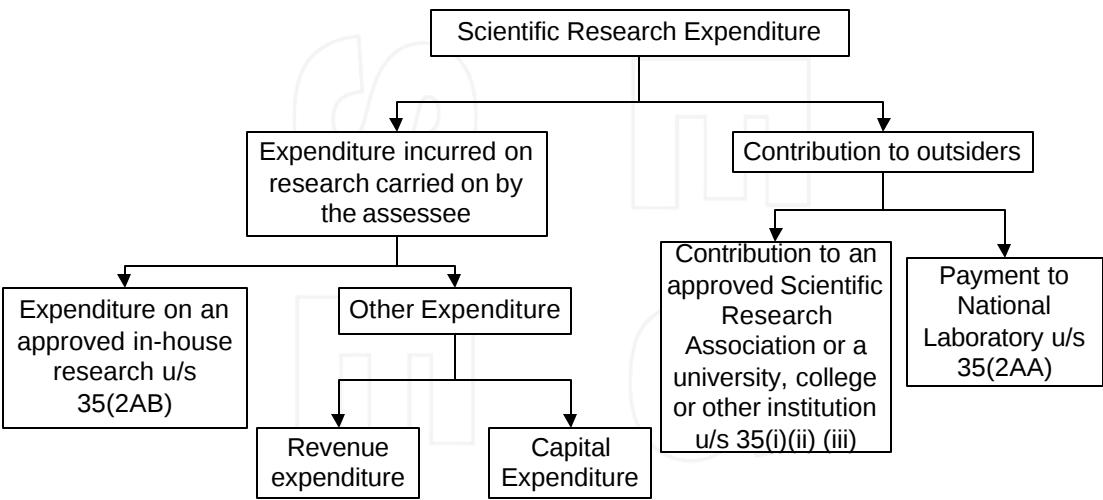
The expression ‘related to business’ must be interpreted in a narrow manner, namely, related to the present manufacturing activities of the assessee. Thus, where the assessee who was all along using imported wood pulp for the manufacture of rayon incurred expenditure on research for making pulp out of bamboo since it proposed to set up a plant for making bamboo pulp, the expenditure on such research could not be disallowed on the ground that it did not relate to the present manufacturing activity of the assessee - CIT V/s. National Rayon Corporation ..

EXPENDITURE ON CONSTRUCTION OF ROADS

It is well-settled that roads as links or providing approach to the building are necessary adjuncts to such building and are to be treated at par with such buildings for the purpose of depreciation under section 32. On the same analogy, approach road to research laboratories of the assessee is a necessary adjunct to such research laboratories and expenditure incurred on the construction thereof has to be treated at par with the expenditure on the construction of the research laboratories themselves. The requirement of section 35(1)(iv) gets fulfilled if the road has been constructed by the assessee with the sole object of providing approach road to its research laboratories. It is immaterial that the same might also be used as approach road to some other buildings of the assessee. The expenditure incurred on the construction of approach road was thus allowable as deduction under section 35(1)(iv) - CIT V/s. Sandoz (India) Ltd. [1994] 74 Taxman 225 (Bom.)

PAYMENT ON BEHALF OF SCIENTIFIC RESEARCH ASSOCIATION

Rent paid on behalf of an institution for research in social science or statistical research for the building in which research is to be carried on is admissible as a deduction under section 35). An institution concerned in research has also to have a building and incur expenditure in retaining it. So, any payment towards the rent of the building would be payment towards the research. In any event, to the extent that the rent has been paid, additional funds would be available to the institution for carrying on research. [1986] 157 ITR 0199B CIT vs. Bharat Ram Charat Ram P. Ltd. (Delhi High Court)

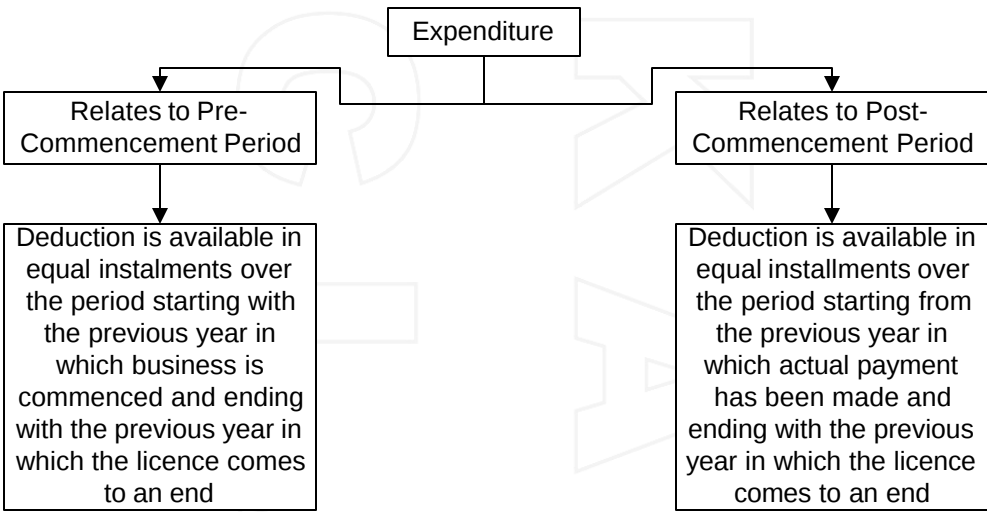


41 (3) DEEMED INCOME ON SALE OF ASSETS USED FOR THE SCIENTIFIC RESEARCH

Where an asset representing expenditure of a capital nature on scientific research is sold, without having been used for other purposes, and the proceeds of the sale together with the total amount of the deductions made, the amount of the deduction exceed the amount of the capital expenditure the excess, or the amount of the deductions so made, whichever is the less, shall be chargeable to income-tax as income of the business or profession of the previous year in which the sale took place.

Explanation.--Where the moneys payable in respect of any asset referred to in this sub-section become due in a previous year in which the business is no longer in existence, the provisions of this sub-section shall apply as if the business is in existence in that previous year.

SEC.35ABB: EXPENDITURE FOR OBTAINING LICENCE TO OPERATE TELECOMMUNICATION SERVICES



In respect of any expenditure, being in the nature of capital expenditure, incurred for acquiring any right to operate telecommunication services either before the commencement of the business to operate telecommunication services or thereafter at any time during any previous year and for which payment has actually been made to obtain a licence, there shall, subject to and in accordance with the provisions of this section, be allowed for each of the relevant previous years, a deduction equal to the appropriate fraction of the amount of such expenditure.

MEANING OF “RELEVANT PREVIOUS YEARS”

“Relevant previous years” means, in a case where the licence fee is actually paid before the commencement of the business to operate tele-communication services, the previous years beginning with the previous year in which such business commenced; in any other case, the previous years beginning with the previous year in which the licence fee is actually paid.

In order to clarify that the deduction is allowable in respect of the entire capital expenditure incurred and actually paid by the assessee, whether before the commencement of the business or thereafter, section 35ABB provide that in a case where the licence fee is actually paid before the commencement of the business, the “relevant previous years” would mean the previous years beginning with the previous year in which such business commenced and the subsequent previous year or years during which the licence is in force. The Act also provides that no deduction under section 32 shall be available for such expenditure for the same year or any subsequent previous years.

MEANING OF “APPROPRIATE FRACTION”

“Appropriate fraction” means the fraction the numerator of which is one and the denominator of which is the total number of the relevant previous years.

MEANING OF “PAYMENT HAS ACTUALLY BEEN MADE”

“Payment has actually been made” means the actual payment of expenditure irrespective of the previous year in which the liability for the expenditure was incurred according to the method of accounting regularly employed by the assessee.

In order to give a fillip to the telecom sector, the section provides that any capital expenditure, incurred by an assessee on the acquisition of any right to operate telecom services and for which payment has actually been made to obtain a license, will be allowed as deduction in equal installments over the period for which the license remains in force. It further provides that where the license is transferred and proceeds of the transfer are less than the expenditure remaining unallowed, a deduction equal to the expenditure remaining unallowed as reduced by the proceeds of transfer, shall be allowed in the previous year in which the licence has been transferred. It also provides that where the licence is transferred and proceeds of the transfer exceed the amount of expenditure remaining unallowed, the excess amount shall be chargeable to tax as profits and gains of business in the previous year in which the licence has been transferred. It further provides for amortisation of unallowed expenses in a case where a part of licence is transferred and to which provisions of sub-section (3) do

not apply. The provisions of sub-sections (2), (3) and (4) pertaining to transfer shall not apply in relation to a transfer in a scheme of amalgamation whereby the licence is transferred by the amalgamating company to the amalgamated company, the latter being an Indian company.

TREATMENT IN CASE WHEN RIGHTS ARE TRANSFERRED

If the licence to operate telecommunication services is transferred and the proceeds of the transfer are less than expenditure incurred remaining unallowed, a deduction equal to expenditure remaining unallowed as reduced by proceeds of the transfer shall be allowed in the year of transfer. But where the proceeds of the transfer exceed the amount of expenditure incurred remaining unallowed, the difference between expenditure incurred and the amount of such expenditure remaining unallowed shall be chargeable to tax. Where the proceeds of transfer are not less than the expenditure incurred remaining unallowed, no deduction shall be allowed in the previous years subsequent to transfer.

TRANSFER OF RIGHTS IN CASE OF DEMERGER

Said provisions relating to transfer of licence shall not be applicable in the case of demerged company and the provisions of the section allowing deduction of expenditure incurred for obtaining the licence shall be applicable to the resulting company as it would have applied to demerged company.

NO BENEFIT OF DEPRECIATION

Where a deduction for any previous year is claimed and allowed in respect of any expenditure, no deduction shall be allowed under section 32 for the same previous year or any subsequent previous year.

Provision in brief –

- (a) Capital expenditure incurred and actually paid, to obtain a licence, for operating telecom service can be amortized.
- (b) The amortization can be over a period for which the licence is in force beginning from the year of payment. Accordingly, with reference to each payment in different year(s), there would be a different period of amortization.

To illustrate: ‘T’ Limited has obtained a licence to operate telecom service in the financial year 1997-98. The aggregate licence fee is Rs.100. In the first year Rs.30 is payable. In the second and third years Rs.15 and Rs.16, respectively, are payable. In the fourth and fifth years Rs.22 and Rs.17, respectively, are payable. As per the provision the amortization of the expenditure would be as follows:

		Year of Amortisation				
Year of payment	Amount	1997-98	1998-99	1999-00	2000-01	2001-02
1997-98	30	6	6	6	6	6
1998-99	16	-	4	4	4	4
1999-2000	15	-	-	5	5	5
2000-2001	22	-	-	-	11	11
2001-2002	17	-	-	-	-	17
		6	10	15	26	43

TELECOMMUNICATION SERVICES, INTER ALIA, INCLUDE THE FOLLOWING.

Voice, i.e. basic telephone, Telex communication, Data communication, Image communication, Value added services which can include, Cellular, Paging, E-mail, Voice mail, Audio Text Service, Video Text Service, Video conference, Radio paging.

SEC.35AC: EXPENDITURE ON ELIGIBLE PROJECTS OR SCHEMES.

Tax concession for financing schemes for promoting social and economic welfare of the people

Section 35AC provides that where an assessee incurs any expenditure by way of payment of any sum to a public sector company or a local authority or to an association or institution approved by the National Committee for carrying out any eligible project or scheme, he shall be allowed a deduction of the amount of such expenditure incurred during the previous year. Explanation under this section defines ‘eligible project or scheme’ to mean a project or a scheme for promoting the social and economic welfare of, or uplift of, the public, as the Central Government may, by notification in the Official Gazette, specify in this behalf on the recommendations of the National Committee. The section, however, does not confer any power on the National

Committee in explicit terms to withdraw the approval granted to an association or an institution, or to recommend to the Central Government the de-notification of an eligible project or a scheme.

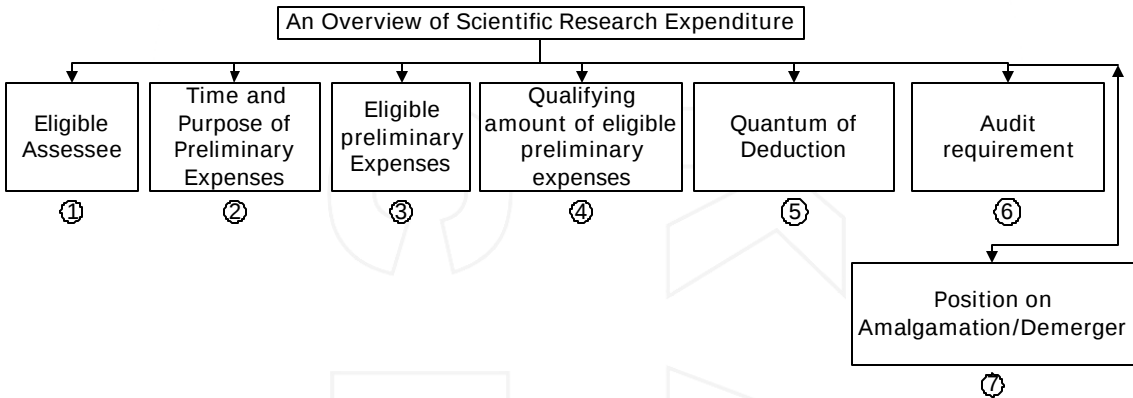
It is now provided with effect from the assessment year 2003-2004 that if the National Committee withdraws the approval or withdraws the notification granting approval to the project or scheme, the entire amount of contribution or donation received by the public sector company or authority or association or institution, as the case may be, in reference of which a certificate has been furnished by it, shall be deemed to be the income of the company or authority or association or institution, as the case may be, of the year in which such approval or notification is withdrawn, and will be taxed at the maximum marginal rate as if such income was not exempt under any provision of the Act. Similarly, if a deduction has been claimed by a company in respect of any expenditure incurred directly on the eligible project or scheme, the approval for which is withdrawn by the National Committee, the amount of deduction shall be deemed to be the income of the year in which such approval is withdrawn and shall be taxed at the maximum marginal rate.

SEC.35CCA: EXPENDITURE BY WAY OF PAYMENT TO ASSOCIATIONS AND INSTITUTIONS FOR CARRYING OUT RURAL DEVELOPMENT PROGRAMMES.

35CCA provide that sums paid by a taxpayer to any association or institution to be used for carrying out any programme of rural development will be allowed as a deduction in computing the taxable profits.

The deduction under the new section 35CCA will not be allowed unless (a) the association or institution has as its object the undertaking of programmes of rural development, (b) the association or institution is for the time being approved in this behalf by the prescribed authority, and (c) the programme of rural development for which such sums are paid has been approved by the prescribed authority, to be notified by the Central Board of Direct Taxes. The prescribed authority will not grant approval to any association or institution for more than three years at a time. (Kalpesh Classes Tel. 23820676)

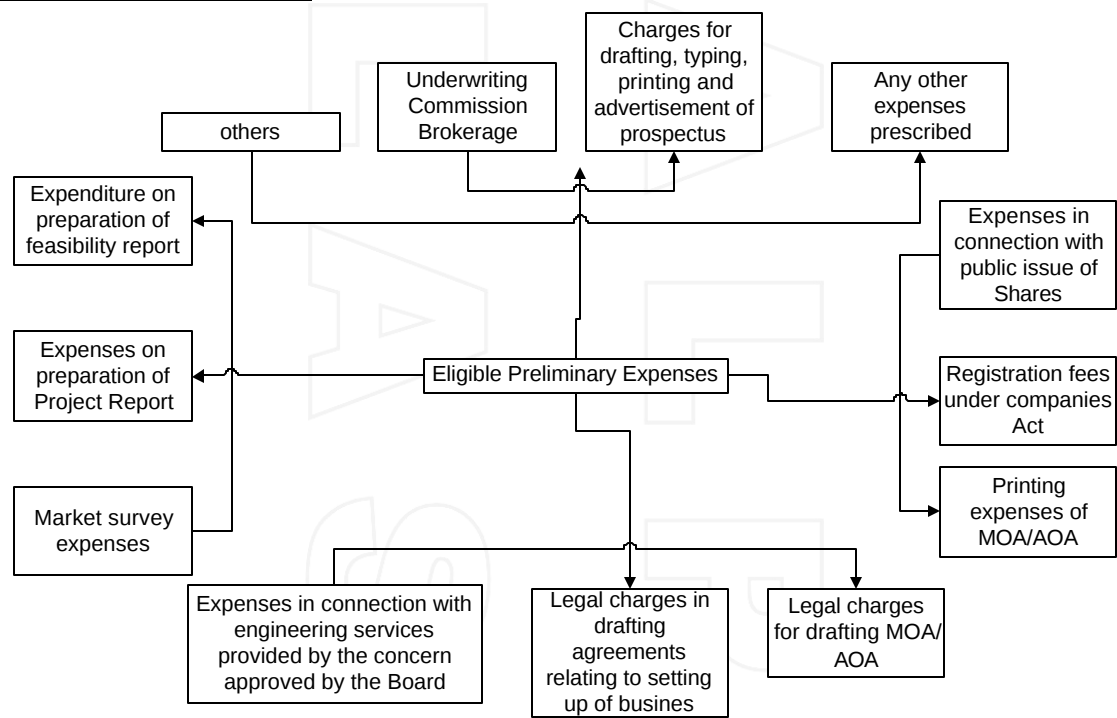
SEC.35D: AMORTISATION OF CERTAIN PRELIMINARY EXPENSES



WHO AND WHEN QUALIFIES FOR DEDUCTION	
35(1)	Where an assessee, being an Indian company or a person (other than a company) who is resident in India , incurs, any expenditure Before the commencement of his business; or After the commencement of his business, in connection with the extension of his Industrial undertaking or in connection with his setting up a new industrial unit,
AMOUNT OF DEDUCTION	
35(2)	Shall be allowed a deduction of an amount equal to one-fifth of such expenditure for each of the Five successive previous years beginning with the previous year in which the business commences or, as the case may be, the previous year in which the extension of the industrial undertaking is completed or the new industrial unit commences production or operation.
QUALIFYING EXENDITURE	
35(3)	(a) Expenditure in connection with (i) Preparation of feasibility report; (ii) Preparation of project report; (iii) Conducting market survey or any other survey necessary for the business of the assessee; (iv) Engineering services relating to the business of the assessee. (b) Legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting up or conduct of the business of the assessee; (c) Where the assessee is a company, also expenditure (i) By way of legal charges for drafting the Memorandum and Articles of Association of the company; (ii) On printing of the Memorandum and Articles of Association; (iii) By way of fees for registering the company under the provisions of the Companies Act, 1956 (1 of 1956); (iv) In connection with the issue, for public subscription, of shares in or debentures of the company, being underwriting commission, brokerage and charges for drafting, typing, printing and advertisement of the prospectus; (d) Such other items of expenditure (not being expenditure eligible for any allowance or deduction under any other provision of his Act) as may be prescribed.
MAXIMUM QUALIFYING AMOUNT	
35(4)	Where the aggregate amount of the expenditure exceeds an amount calculated at five per cent (a) Of the cost of the project, or (b) Where the assessee is an Indian company, at the option of the company, of the capital employed in the business of the company, the excess shall be ignored. (Must visit kalpeshclasses.com for downloading material for PE2 and Final)
CONDITION OR AUDIT FOR PERSON OTHER THAN COMPANY	
35(5)	Where the assessee is a person other than a company or a co-operative society, no deduction shall be admissible unless the accounts of the assessee for the year or years in which the expenditure is incurred have been audited by an accountant as defined in the Explanation below sub-section (2) of section 288, and the assessee furnishes, along with his return of income for the first year in which the deduction under this section is claimed, the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed.

TREATMENT IN CASE OF DEMERGER	
35(5A)	Where the undertaking of an Indian company which is entitled to the deduction is transferred, to another company in a scheme of demerger, No deduction shall be admissible in the case of the demerged company for the previous year in which the demerger takes place; and The provisions of this section shall, as far as may be, apply to the resulting company, as they would have applied to the demerged company, if the demerger had not taken place. Sub-section (5A) is inserted in section 35D to provide similar provisions for the scheme of demerger where the resulting company will be able to claim amortisation of preliminary expenses as if demerger had not taken place. (Kalpesh Classes Tel. 23820676)

ELIGIBLE EXPENSE SEC. 35(3)



Provisions of section 32(2) and 72 shall apply in relation to deductions allowable for capital expenses under this clause as they apply in relation to deductions allowable in respect of depreciation.

35D(2) of the Income-tax Act starts with the words " where the assessee is a company, also expenditure ", which read with sub-clause (iv), viz., " in connection with the issue, for public subscription of shares in or debentures of the company, being underwriting commission, brokerage and charges for drafting, typing, printing and advertisement of the prospectus", indicates that the word "being" used there is " illustrative and not restrictive ". The word " being " would include the last stage in connection with the issue of shares, namely, even refund of the amount of over subscription. [1986] 162 ITR 0819W CIT vs. Shree Synthetics Ltd. (Madhya Pradesh High Court) (Must visit kalpeshclasses.com for downloading material for PE2 and Final)

On general principles, the income-tax law does not permit the deduction of capital expenditure, except to the extent permitted by the statute. The concept of amortisation in income-tax law involves the write off of capital expenditure either in whole or over a period of years. The word "survey" occurring in section 35D(2)(a)(iii) of the Act should be understood in the context of the nature of the business carried on by the assessee. There is no point in attributing a mere dictionary meaning to this word. The word "survey" does not mean a mere onlooking or overlooking of what happened, but would also include attracting customers to a particular spot demonstrating to them the utility and value of the assessee's products and studying therefrom the business possibilities or determining the action necessary to extend the business. Expense incurred by the assessee by way of advertisement expenses, and by way of subsidy to farmers' field extension programme, farmer dealer meeting, etc., and soil test expenses should be allowed as admissible deductions under section 35D. The Tribunal rightly came to the conclusion that on warehouse and other handling charges and depreciation no deduction under section 35D could be allowed. [1994] 209 ITR 0174E Madras Fertilizers Ltd. vs. CIT (Madras High Court)

EXPENDITURE ON ISSUE OF GDR

The assessee claimed deduction in respect of expenditure incurred on issue of Global Depository Shares (GDS) to non-residents. The Commissioner (Appeals) disallowed the claim under section 37 on the ground that it was capital expenditure, and under section 35D on the ground that the expenditure was neither incurred in connection with extension of its industrial undertaking nor for setting up of a new industrial undertaking. Held in Appellate Tribunal the provisions of section 35D are attracted only if the expenditure is incurred (i) before the commencement of business (ii) if incurred after the commencement of business, it is incurred either for extension of its industrial undertaking or for setting up of a new industrial undertaking. The expenditure incurred for other purposes of business is not allowable deduction under section 35D.

A perusal of the prospectus showed that the expenditure was not to be incurred either in connection with the extension of any industrial undertaking or for setting up a new industrial undertaking. Any capital expenditure for existing business or for extension of existing business does not fall within the ambit of section 35D. There was no material on record to establish that share capital raised was utilized for setting up of a new unit or in connection with the extension of its industrial undertaking. It is the settled legal position that burden is on the assessee to prove that the expenditure incurred falls within the parameter of the provisions allowing the deduction. Thus deduction was not allowed to assessee.

INTEREST EARNED / PAID IN PRE-COMMENCEMENT PERIOD

One of the controversies on which courts have taken contrary views is the treatment to be accorded to interest earned on deposits, whether it is abatement of capital cost or chargeable income. Interest has always been considered as a flow and, therefore, income as distinguished from a fund with the character of capital. Yet, the Supreme Court in *Challapalli Sugars Ltd. v. CIT* [1975] 98 ITR 167 had taken the view that for purposes of determining the actual cost for allowance of depreciation and development rebate, interest paid on amounts borrowed for the purpose of such depreciable assets could be treated as part of the cost. For coming to this conclusion, the Supreme Court relied upon the concept of capitalisation of interest as understood in textbooks in Accountancy as by Pickles, Spicer and Pegler and Cropper, Morris and Fison. Statement of Auditing Practice issued by the Institute of Chartered Accountants of India and certain English precedents relating to company law practice were also cited for this conclusion.

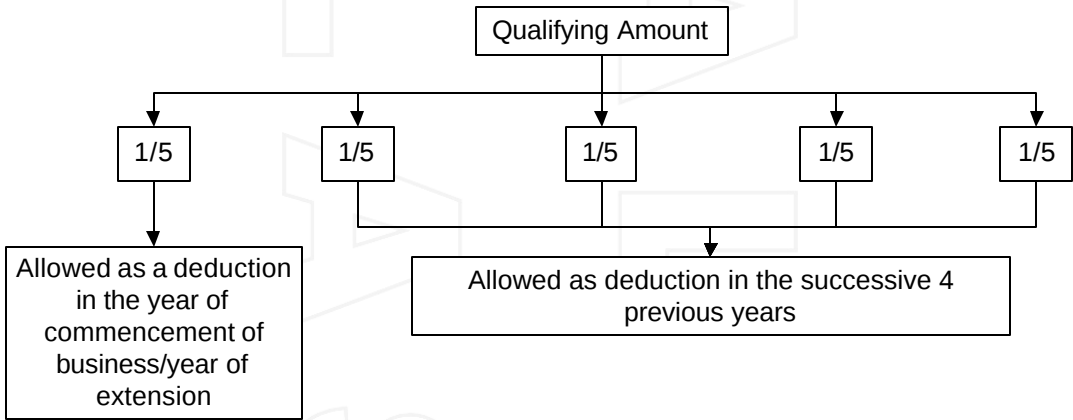
But what applied to interest payments in *Challapalli Sugars'* case, [1975] 98 ITR 167 (SC), was found inapplicable to interest receipts in *Tuticorin Alkali Chemicals and Fertilisers Ltd. v. CIT* [1997] 227 ITR 172, a judgment rendered by three judges. It found that even though the practice of capitalising receipt was recognised by the Institute of Chartered Accountants of India, it came to the conclusion that whether a particular receipt constitutes taxable income has to be decided according to the principles of law and not in accordance with accountancy practice. The Supreme Court observed: "Accounting practice cannot overrule section 56 or any other provisions of the Act". As was pointed out by Lord Russell in the case of *BSC Foot Wear Ltd.* [1970] 77 ITR 857 (CA), income-tax law does not march step by step in the foot-prints of the accountancy profession. In *Challapalli Sugars'* case [1975] 98 ITR 167 (SC), though accountancy principles were referred to and commercial practice was recognised, the interpretation of the expression "actual cost" was one of the factors which had prompted the conclusion apart from accounting practice. This decision was rendered on a direct reference by the Tribunal to the Supreme Court in view of the conflicting views of the High Courts.

WHETHER INCOME-PRE-OPERATIVE RECEIPTS ARE ON CAPITAL ACCOUNT

An important decision has been rendered by the Supreme Court in *CIT v. Bokaro Steel Ltd.* [1999] 236 ITR 315 dealing with an issue of receipt in a business which is yet to be set up. In the matter of interest received on short-term deposits, the Supreme Court had earlier decided in *Tuticorin Alkali Chemicals and Fertilizers Ltd. v. CIT* [1997] 227 ITR 172 that it had to be assessed as income and could not be treated as an abatement of capital cost as claimed on the basis of converse inference from a decision of the Supreme Court in *Challapalli Sugars Ltd. v. CIT* [1975] 98 ITR 167. This decision had given rise to a sense of regret as it made a departure from accounting principles and had also imposed a burden on a business in the making by taxing what is purely incidental to the act of setting up such business. It was apprehended that though the decision related to interest, it would have application even for other miscellaneous receipts, but there is a silver lining in the decision of the Supreme Court in *CIT v. Bokaro Steel Ltd.* [1999] 236 ITR 315 in that the Supreme Court has found a different solution in respect of miscellaneous receipts like income received from contractors by way of rent, interest on advance payments to them, machinery hire and royalty for excavation of stones used for construction work. There was also interest receipt which, however, did not come up before the Supreme Court so that the Supreme Court observed that this issue relating to interest was not before it and that, at any rate, it is already covered by

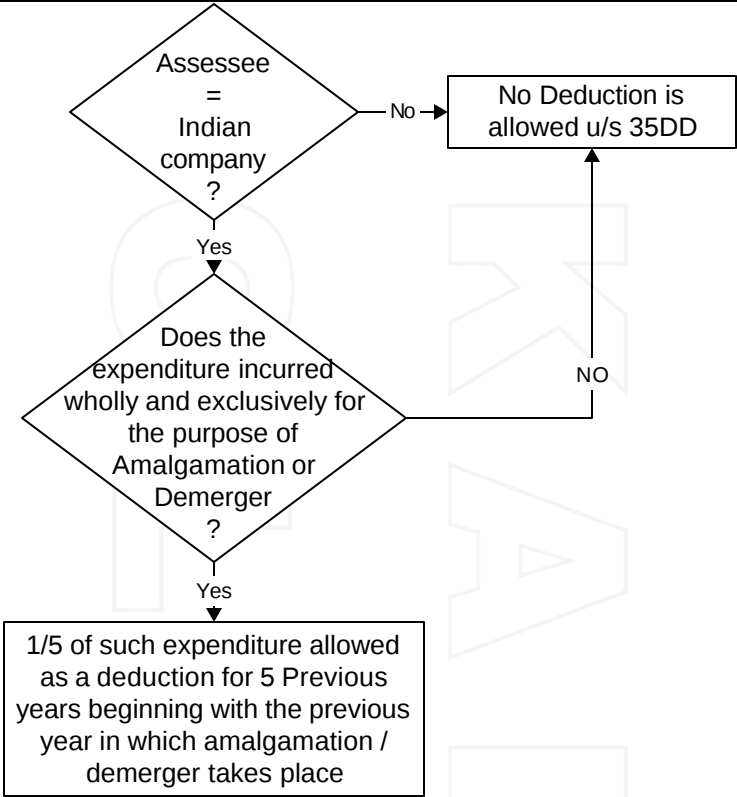
Tuticorin Alkali Chemicals' case. However, in respect of other miscellaneous receipts it found that the reliance placed in Tuticorin Alkali Chemical's case was misconceived. The observation in that case that the rental income of a company received by it even before commencement of business may be taxable, it was explained, was not applicable to receipts which are inextricably linked with the setting up of the capital structure of the assessee. The Supreme Court in Bokaro Steel Ltd.'s case points out to the parallel in Challapalli Sugars' case, an argument which failed in Tuticorin Alkali's case. It was felt that accountancy rule which would treat such payments and receipts during construction period as on capital account should prevail. The judgment also makes a reference to the concept of real income though it was not a basis for its conclusion. This unexceptionable decision in Bokaro Steel's case, with respect, would mean that the decision in Tuticorin Alkali's case would require reconsideration at a future date so as to harmonise the inference in contingencies similar to the one arising in Tuticorin Alkali Chemical's case with the conclusion arrived in Challapalli Sugars' case and now Bokaro Steel's case.

OVER VIEW OF DEDUCTION



SEC. 35DD - AMORTISATION OF EXP. IN CASE OF AMALGAMATION OR DEMERGER

Where an assessee, being an Indian company, incurs any expenditure, on or after the 1st day of April, 1999, wholly and exclusively for the purposes of amalgamation or demerger of an undertaking, the assessee shall be allowed a deduction of an amount equal to one-fifth of such expenditure for each of the five successive previous years beginning with the previous year in which the amalgamation or demerger takes place. No deduction shall be allowed in respect of the expenditure mentioned here under any other provision of this Act.



SEC. 35DDA - EXPENDITURE ON VRS

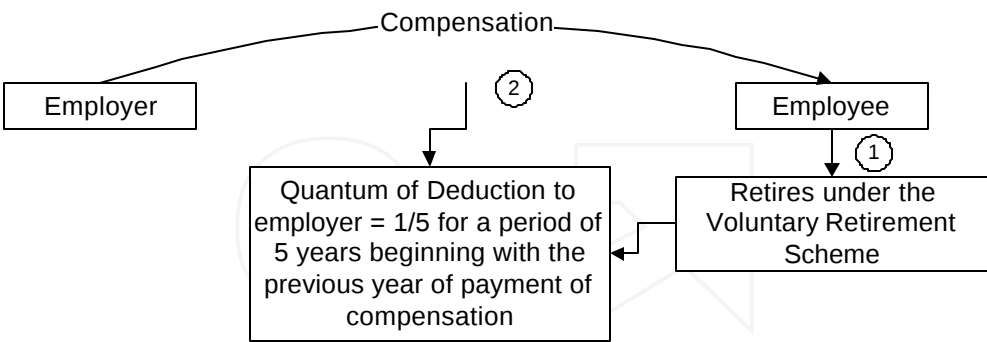
The whole expenditure incurred by the assessee in making payment to the employee in connection with his voluntary retirement either in the year of retirement or in any subsequent year, each part payment being entitled to deduction in five equal annual instalments beginning from the year in which such part payment is made to the employee.

Where an assessee incurs any expenditure in any previous year by way of payment of any sum to an employee in connection with his voluntary retirement, in accordance with any scheme or schemes of voluntary retirement, one-fifth of the amount so paid shall be deducted in computing the profits and gains of the business for that previous year, and the balance shall be deducted in equal instalments for each of the four immediately succeeding previous years. (Kalpesh Classes Tel. 23820676)

THE AMORTISATION OF EXPENDITURE INCURRED ON VOLUNTARY RETIREMENT SCHEMES, IS BEING EXTENDED TO THE SUCCESSOR-ENTITY

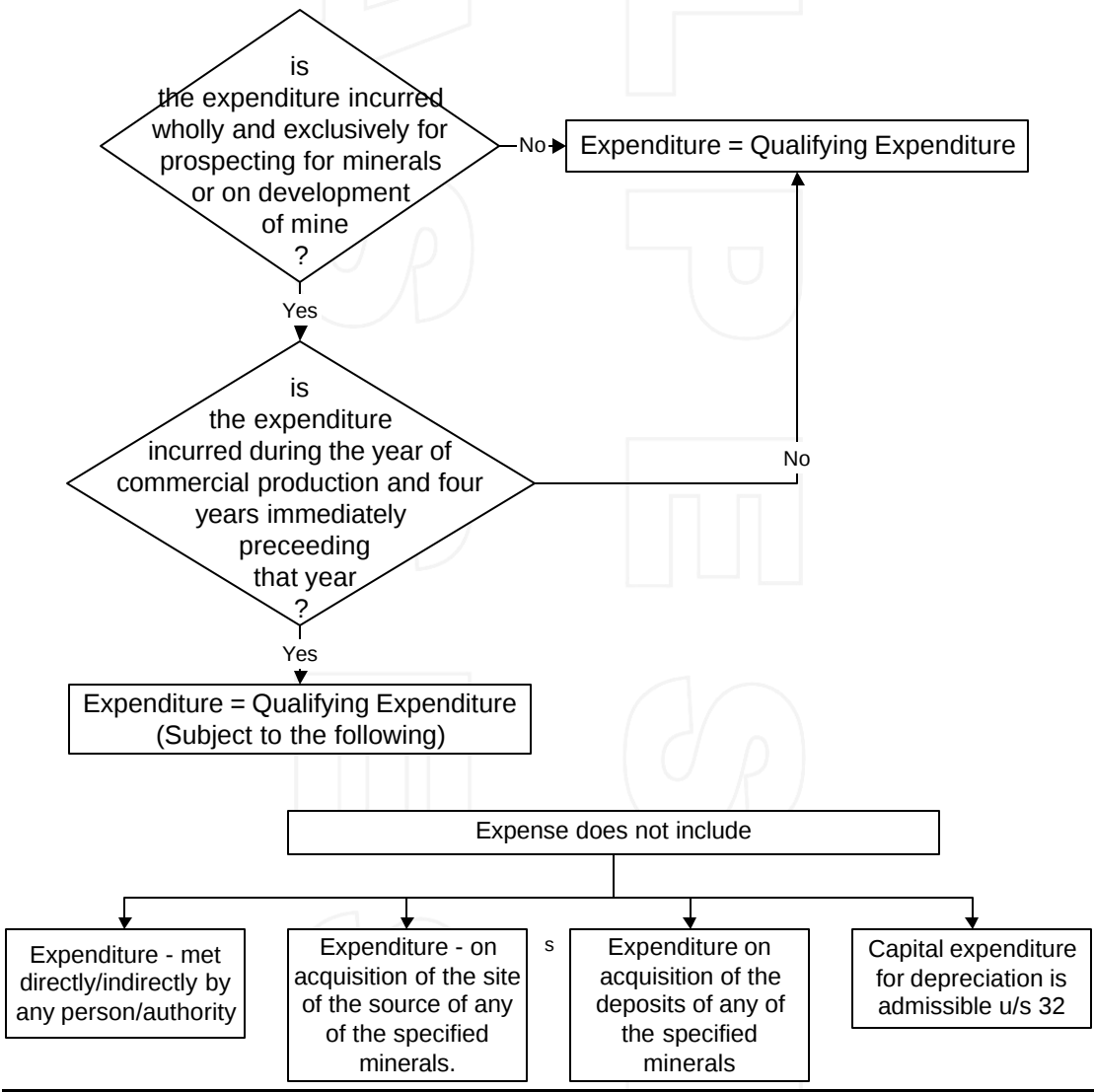
- 1. Undertakings of Indian companies getting amalgamated with another Indian company in a scheme of amalgamation before the expiry of the five-year period.
- 2. Undertakings of Indian companies transferred to another company in a scheme of demerger before the expiry of the five-year period.
- 3. Reorganisation of business during the five-year period leading to a firm being succeeded by a company (and fulfilling the conditions laid down in section 47(xiii)), or a proprietary concern being succeeded by a company [and fulfilling conditions laid down in section 47(xiv)] before the expiry of the five-year period

In all the above situations, the resulting/ successor entity will be entitled to benefit of deduction for the unexpired period. This benefit has been given retrospective effect with effect from the assessment year 2001-2002. In the year of transfer, no deduction shall be allowed to the amalgamating company / demerged company / firm / proprietary concern. (Must visit kalpeshclasses.com for downloading material for PE2 and Final)



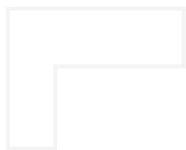
SEC. 35E DEDUCTION FOR EXPENDITURE ON PROSPECTING, ETC., FOR CERTAIN MINERALS.

Where an assessee, being an Indian company or a person (other than a company) who is resident in India, is engaged in any operations relating to prospecting for, or extraction or production of, any mineral and incurs, any specified expenditure (preliminary expense during previous year or 4 years preceeding that and other then capital expense) the assessee shall, in accordance with and subject to the provisions of this section, be allowed for each one of the relevant previous years a deduction of an amount equal to one-tenth of the amount of such expenditure.



UNABSORBED EXPENSE (carry forward for 10 years)

The amount of the instalment relating to any relevant previous year, to the extent to which it remains unallowed, shall be carried forward and added to the instalment relating to the previous year next following and deemed to be part of that instalment, and so on, for succeeding previous years, so, however, that no part of any instalment shall be carried forward beyond the tenth previous year as reckoned from the year of commercial production.



SEC. 36(1)(I) - INSURANCE PREMIUM

The amount of any premium paid in respect of insurance against risk of damage or destruction of stocks or stores used for the purposes of the business or profession.

LIFE INSURANCE PREMIUM

Where a firm took out life insurance policies on its partners with the object of providing for payments to outgoing partners or to legal heirs of deceased partners, the premium paid on such policies was not deductible under section 36(i) - CIT V/s. Khodidas Motiram Panchal [1986] 161 ITR 99 (Guj.).

Sec.36(1)(ia) - The amount of any premium paid by a federal milk co-operative society to effect or to keep in force an insurance on the life of the cattle owned by a member of a co-operative society, being a primary society engaged in supplying milk raised by its members to such federal milk co-operative society;

Sec.36(1)(ib) - The amount of any premium paid by cheque by the assessee as an employer to effect or to keep in force an insurance on the health of his employees under a scheme framed in this behalf by the General Insurance Corporation of India formed under section 9 of the General Insurance Business (Nationalisation) Act, 1972 (57 of 1972) and approved by the Central Government;

SEC.36(1)(III): INTEREST ON BORROWED CAPITAL

The amount of the interest paid in respect of capital borrowed for the purposes of the business or profession.

Explanation - Recurring subscriptions paid periodically by shareholders, or subscribers in Mutual Benefit Societies which fulfil such conditions as may be prescribed, shall be deemed to be capital borrowed within the meaning of this clause.

Provided that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset for extension of existing business or profession (whether capitalised in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.

INTEREST V/S EXPENDITURE ON BORROWED MONEY

The appellant obtained a loan of Rs. 40 lakhs from the Industrial Finance Corporation secured by a charge on its fixed assets. In connection therewith it spent a sum of Rs. 84,633 towards stamp duty, registration fees, lawyer's fees, etc., and claimed this amount as business expenditure. Held, that the amount spent was not in the nature of capital expenditure and was laid out or expended wholly and exclusively for the purpose of the assessee's business and was therefore allowable as a deduction. The act of borrowing money was incidental to the carrying on of business, the loan obtained was not an asset or an advantage of enduring nature, the expenditure was made for securing the use of money for a certain period, and it was irrelevant to consider the object with which the loan was obtained. Obtaining capital by issue by shares is different from obtaining loan by debentures. A loan obtained cannot be treated as an asset or advantage for the enduring benefit of the business of the assessee. [1966] 060 ITR 0052A India Cements Ltd. vs. CIT (Supreme Court of India)

MEANING OF "FOR THE PURPOSE OF BUSINESS"

Subba Rao, J. Explained the significance of the expression "for the purpose of business" in CIT V/s. Malayalam Plantations Ltd. [1964] 53 ITR 140 (SC) in the following words:

The expression 'for the purpose of the business' is wider in scope than the expression 'for the purpose of earning profits'. Its range is wide: it may take in not only the day-to-day running of a business but also the rationalisation of its administration and modernisation of its machinery; it may include measures for the preservation of the business and for the protection of its assets and property from expropriation, coercive process or assertion of hostile title; it may also comprehend payment of statutory dues and taxes imposed as a pre-condition to commence or for carrying on of a business; it may comprehend many other acts incidental to the carrying on of a business. However wide the meaning of the expression may be, its limits are implicit in it. The purpose shall be for the purpose of the business, that is to say, the expenditure shall be for the carrying on of the business and the assessee shall incur it in his capacity as a person carrying on the business.

The interest paid on monies borrowed, which are utilised for payment of dividends to the shareholders of a company, is entitled to deduction under section 36(1)(iii) of the Income-tax Act, 1961, as the payment of dividend is part of the business of a company and one of its purposes and must be regarded as included in the connotation of the expression "for the purpose of the business" within the meaning 36(1)(iii). Further, the expression "for the purpose of the business" may take into account not only the day to day running of the

business but several other matters. [1986] 161 ITR 0516A CIT vs. Belapur Co. Ltd. (Bombay High Court)

BASIC REQUISITES

For a claim for deduction of interest under section 36(1)(iii), all that is necessary is that, first, the money, that is capital, must have been borrowed by the assessee; secondly, it should have been borrowed for the purpose of the business, profession or vocation of the assessee; and thirdly, the assessee should have paid the amount as an allowance under that clause. This clause makes no distinction between the capital borrowed in order to acquire a revenue asset and the amount borrowed to acquire a capital asset. It also does not say that borrowing of capital should have been necessary for the purpose of the business, so as to hold that deduction cannot be allowed if the assessee had sufficient money at the time of borrowal. The interest paid is also not subject to the test of reasonableness. When the ITO finds that the borrowal was not illusory or colourable and that the capital was borrowed by the assessee for the purpose of the business and the amount of interest was paid, then the claim for deduction has to be allowed - Ram Kishan Oil Mills V/c. CIT [1965] 56 ITR 186 (MP); CIT V/s. Sundaram Fasteners Ltd. [1984] 149 ITR 773 (Mad.).

TEST OF 'SAME BUSINESS'

Which is appropriate for set-off of carried forward losses, is not appropriate for purpose of claiming interest on borrowed capital where business in respect of which borrowing has been made, has been sold. Where assessee running jewellery business and also business of exhibition of cinematographic films, obtained loan for construction of cinema theatre and Tribunal's finding was that business carried on by assessee as jeweller's and business of running cinema theatre were composite, interest on such loan had to be treated as a deduction under section 36(1)(iii) even after business of running theatre had been closed - Veecumsees V/s. CIT [1996] 86 Taxman 243(SC).

BORROWAL INVESTED IN TAX-FREE SECURITIES

It would not be correct to say that if a part of the profits of a business was not taxable, no expenditure incurred for the purpose of earning those profits could be allowed as a deduction. Thus, where a bank utilises part of the deposits mobilised by it no investment in tax-free securities, interest paid by the bank on such part is also deductible even though the relevant investment did not yield any taxable income - CIT V/s. Indian Bank Ltd. [1965] 56 ITR 77 (SC).

MEANING OF 'CAPITAL'

The expression 'capital' in the context in which it occurs means money and not any other asset, for interest is payable on capital borrowed and interest becomes payable on a loan of money and not on any other asset acquired under a contract - Bombay Steam Navigation Co. [1953] (P) Ltd. V/s. CIT [1965] 56 ITR 52 (SC).

Preference share capital is a contribution to the capital of a company by its subscribers or shareholders and is not a "borrowing" by the company subject to payment of interest. For the same reason the dividend which is paid to such shareholders is to be paid only out of the profits earned by the company. In common parlance it can be equated with the share income derived by the shareholders out of the profits of the company. Therefore, the dividend sought to be paid cannot be equated with or treated as "interest" paid on borrowed capital. Therefore, the liability on account of dividend paid on preference shares cannot be allowed as deduction treating it as interest paid on borrowed capital under section 36(1)(iii) of the Income-tax Act, 1961. A novel claim to treat preference shares as borrowings, so that dividend thereon could be claimed as a deduction under section 36(1)(iii) as interest on borrowed capital was not found acceptable in Kirloskar Electric Co. Ltd. v. CIT (No. 1) [1997] 228 ITR 674 and 676 (Kar). The argument in favour of the claim was that there is an assured return on such investment, but the High Court found that such dividend can be paid only out of profits and that the shares themselves are part of the capital of the company and cannot, therefore, be treated as borrowing. The claim was, therefore, considered "to be devoid of any merit and needs to be rejected outright". [1997] 228 ITR 0674-Kirloskar Electric Co. Ltd. vs. Commissioner of Income-tax (No. 1) (Karnataka High Court)

BORROWALS DIVERTED TO MEET PERSONAL/NON-BUSINESS OBLIGATION

Where an assessee carrying on money-lending and other business promised a donation to an institution and paid a part of the donation by drawing from his overdraft account in a bank and treated the balance in his books as debt due to the institution, interest paid on the overdraft as well as the interest debited on the debt portion would not qualify for deduction, since the borrowings were made to meet the personal obligation of the assessee and not any obligation of his business - Madhav Prasad Jatia V/s. CIT [1979] 118 ITR 200 (SC).

Where money borrowed by a company was advanced to its directors free of interest and it was found that the act was a matter of business prudence and that there were no positive materials to show that the money borrowed had been utilised for non-business purposes, the revenue authorities would not be justified in disallowing a portion of the interest paid by the company - CIT V/s. Coimbatore Salem Transport (P) Ltd. [1966] 61 ITR 480 (Mad.)

BORROWALS FOR PAYMENT OF TAXES

Interest on moneys borrowed for payment of income tax is not deductible

Interest paid by firm on moneys borrowed for meeting the income tax liability of its partners is not deductible- Roopchand Chabildass & Sons V/s. CIT [1967] 63 ITR 166 (Mad.)

Interest paid on money borrowed for payment of advance tax is not deductible - Maharajadhiraj Sir Kameshwar Singh V/s. CIT [1961] 42 ITR 774 (Pat.)

SEC.36(1)(iii): ZERO COUPON BONDS

It provide for deduction for the discount on a zero coupon bond on pro rata basis to be calculated in the manner as may be prescribed. Decuction is pro rata amount of discount on a zero coupon bond having regard to the period of life of such bond calculated in the manner as may be prescribed.

“discount” means the difference between the amount received or receivable by the infrastructure capital company or infrastructure capital fund or public sector company issuing the bond and the amount payable by such company or fund or public sector company on maturity or redemption of such bond.

“period of life of the bond” means the period commencing from the date of issue of the bond and ending on the date of the maturity or redemption of such bond.

“infrastructure capital company” and “infrastructure capital fund” shall have the same meanings respectively assigned to them in 10(23G).

SEC.36(1)(IV): CONTRIBUTION TOWARDS A RECOGNISED PROVIDENT FUND OR AN APPROVED SUPERANNUATION FUND

Any sum paid by the assessee as an employer by way of contribution towards a recognised provident fund or an approved superannuation fund, subject to such limits as may be prescribed for the purpose of recognising the provident fund or approving the superannuation fund, as the case may be; and subject to such conditions as the Board may think fit to specify in cases where the contributions are not in the nature of annual contributions of fixed amounts or annual contributions fixed on some definite basis by reference to the income chargeable under the head “Salaries” or to the contributions or to the number of members of the fund.

SEC.36(1)(V) CONTRIBUTION TOWARDS AN APPROVED GRATUITY FUND

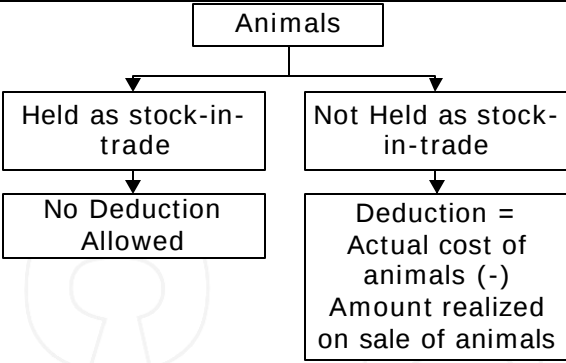
Any sum paid by the assessee as an employer by way of contribution towards an approved gratuity fund created by him for the exclusive benefit of his employees under an irrevocable trust.

SEC.36(1)(VA) CONTRIBUTION TOWARDS AN APPROVED FUND (X) OF CLAUSE (24) OF SECTION 2 APPLY

Any sum received by the assessee from any of his employees to which the provisions of sub-clause (x) of clause (24) of section 2 apply, if such sum is credited by the assessee to the employee’s account in the relevant fund or funds on or before the due date.

SEC.36(1)(VI): DEDUCTION ON ACCOUNT OF ANIMALS

In respect of animals which have been used for the purposes of the business or profession otherwise than as stock-in-trade and have died or become permanently useless for such purposes, the difference between the actual cost to the assessee of the animals and the amount, if any, realised in respect of the carcasses or animals).



SCOPE OF PROVISION

The expression ‘have died or become permanently useless’ is not certainly one where the application of the ejusdem generis rule is possible. Therefore, the words ‘have become permanently useless’ must receive their plain and ordinary meaning. Thus, where an assessee carrying on the manufacture of serum sold the animals after stoppage of business, the resultant loss is allowable - Union Drug Co. Ltd. V/s. CIT [1974] 93 ITR 91 (Cal.)

The assessee, an owner of race horses, claimed the loss arising on the sale of a race horse, as a deduction under section 36(1)(vi), on the ground that the horse had to be withdrawn from the races since the certificate granted had been revoked by the race club authorities and the horse had become permanently useless for the purpose of the racing business. The fact that the licence granted had been revoked was sufficient evidence that the horse had become permanently useless for participating in races and hence for the purpose of the business of racing. 36(1)(vi) applied only with reference to the business carried on by the assessee and the Tribunal was wrong in holding that the assessee must discontinue the business in order to be entitled to the allowance under that section. The assessee was, therefore, entitled to the deduction. [1980] 125 ITR 0750- Venkatasubba Reddiar (K.S.) vs. CIT (Madras High Court) in other words Where an owner of race horses was forced to sell one such horse due to revocation of the certificate granted to that horse by the race club authorities, there could be no doubt about the horse having become ‘permanently useless’ for the purpose of the business of ‘racing’, and hence the resultant loss was allowable

SEC.36(1)(VII): DEDUCTION ON ACCOUNT OF BAD DEBTS.

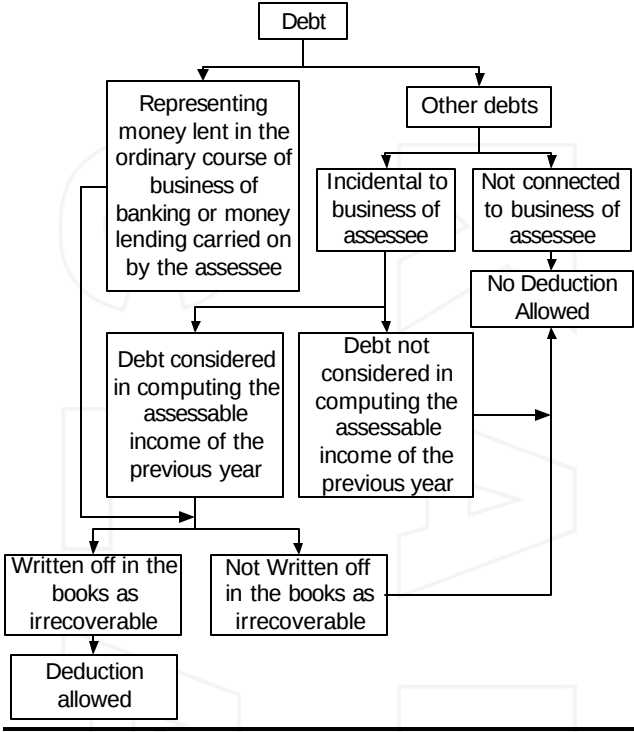
Subject to the provisions of sub-section 36 (2), the amount of any bad debt or part thereof which is **written off** as **irrecoverable** in the accounts of the assessee for the previous year.

Section 36(1)(vii) of the Income-tax Act provides for a deduction in the computation of taxable profits of the amount of any debt or part thereof which is established to have become a bad debt in the previous year. This allowance is subject to the fulfilment of the conditions specified in sub-section (2) of section 36.

Explanation : for the purpose of this clause any bad debt or part thereof written off as irrecoverable in the accounts of the assessee shall not include any provision for bad and doubtful debt.

SEC.36(2): IN MAKING ANY DEDUCTION FOR A BAD DEBT OR PART THEREOF, THE FOLLOWING PROVISIONS SHALL APPLY -

- 1) No such deduction shall be allowed unless such debt or part thereof has been **taken into account** in computing the income of the assessee of the previous year in which the amount of such debt or part thereof is written off or of an earlier previous year, or represents money lent in the ordinary course of the business of banking or money-lending which is carried on by the assessee;
- 2) If the amount ultimately recovered on any such debt or part of debt is less than the difference between the debt or part and the amount so deducted, the deficiency shall be deductible in the previous year in which the ultimate recovery is made.



SEC.36(1)(VII) & SEC.36(2) READ TOGETHER

Primary conditions - Four conditions govern the grant of deduction towards bad debt under section 36(1)(vii), namely -

- 1) The debt or loan should be in respect of a business which is carried on by the assessee in the relevant accounting year;
- 2) The debt should have been taken into account in computing the income of the assessee for the accounting year or for an earlier accounting year or should represent money lent in the ordinary course of his business of banking or money-lending;
- 3) The amount of debt or loan or part thereof which is claimed as a deduction should be established to have become bad in the accounting year; and
- 4) The amount should be written off as irrecoverable in the accounts of the assessee for that accounting year in which the claim for deduction is made for the first time - Sarangpur Cotton Mfg. Co. Ltd. V/s. CIT [1983] 143 ITR 166 (Guj.)

DEBT IS SOMETHING MORE THAN AN ADVANCE, WHICH IS RELATED TO AND RESULTS FROM ASSESSEE’S BUSINESS.

Before a debt can become bad or doubtful it must first be a debt. A debt is an outstanding which if recovered would have swelled the profits. It is not money handed over to someone for purchasing a thing which that person has failed to return even though no purchase was made. In this section a debt means something more than a mere advance. It means something which is related to business or results from it - A.V. Thomas & Co. Ltd. v. CIT [1963] 48 ITR 67 (SC).

The assessee who carried on the manufacture of sugar used to advance seedlings, fertilisers and money to sugarcane growers under an agreement by which the growers agreed to sell the next crop of the sugarcane grown by them exclusively to the assessee at current market rates and to have the advances adjusted towards the price of the sugarcane to be delivered to the company. In a certain year owing to drought the sugarcane growers could not grow sugarcane and the advances remained unrecovered. A Committee appointed by the Government recommended that the assessee should ex gratia forgo some of its dues. The assessee accordingly waived its right in respect of Rs. 2,87,422 and claimed this amount as a deduction. So far as the assessee-company was concerned it was merely making a forward arrangement for the next year's crops and paying an amount in advance out of the price and there was no element of a capital investment in making the advance and the loss incurred by the assessee was, therefore, a loss on the revenue side and was deductible. [1962] 046 ITR 0649-CIT vs. Mysore Sugar Co. Ltd. (Supreme Court of India) (Must visit kalpeshclasses.com for downloading material for PE2 and Final)

Assessee was in the business of financing film producers and distributors had entered in to contract for share of profits in exploitation and exhibition of a particular picture. Provided that if picture not exhibited within stipulated time distributor to return all moneys advanced with interest. There was failure on part of distributor and moneys advanced was irrecoverable. The debt was in respect of and incidental to the business which was carried on by the appellant in the relevant year, it was found that it had become irrecoverable in the relevant accounting year, and the amount had actually been written off as irrecoverable in the books of the appellant. Therefore, all the conditions for the grant of the allowance were satisfied. [1967] 065 ITR 0403- Bharucha (B.D.) vs. CIT (Supreme Court of India)

WHETHER AND WHEN A DEBT BECOMES 'BAD'

Whether a debt has become bad and if so when, is a conclusion of fact depending upon the circumstances and the materials brought on record and there is no general rule or universal test which will apply to all cases and in all circumstances. A debt cannot be written off as bad and irrecoverable if on the material available it could be shown that there was a possibility of recovering the same.

The events that take place after the debt is written off cannot in any way affect the question of allowability of a bad debt. The debtor company may flourish or flounder but that has no bearing on the question whether at the time of write off the assessee had any ray of hope left for the recovery of the debt- Karam Chand Thapar & Bros. (Coal Sales) Ltd. V/s. CIT [1992] 62 Taxman 214 (Cal.)

DEBT MUST BE INCIDENTAL TO BUSINESS

A debt is allowable only when it is a debt and it arises out of and is an incident to the trade. Except in money lending trade, debt can only be so described if they are due from the customers for goods supplied or are loans to constituents or are transactions of a similar kind. In every case, the test is, was the debt due as an incident to the business; if it is not of that character it will be a capital loss - CIT V/s. Abdullabhai Abdulkadar [1961] 41 ITR 545 (SC).

A company in Montreal (Canada) provided the assessee with technical know-how, engineering services, etc. The agreement between the two companies provided for an annual retainer fees. There was no condition or stipulation that the fee would be payable by the assessee without TDS. The assessee had credited a total fee of Rs. 2,50,808 in favour of the Montreal company for a period of seven years. The Income-tax Officer treated the assessee as being in default in respect of the amount of tax liable to be deducted from the payments made to the Montreal company. The assessee paid the sum of Rs. 1,24,199 towards such tax and asked the Montreal company for reimbursement. The Montreal company refused to reimburse the amount on the ground that it was bound neither morally nor contractually to meet the obligation of the Indian tax liability. The assessee wrote off the amount and the question was whether the sum was deductible either as a bad debt or as business expenditure. The amount which the assessee was bound to deduct from the payment made to the Montreal company and which it failed to recover from that company could not be regarded as a bad debt and the payment made under a statutory obligation because the assessee was in default could not constitute expenditure laid out for the purpose of the assessee's business. [1971] 079 ITR 0514- Indian Aluminium Co. Ltd. vs. CIT (Supreme Court of India)

SURETY DEBTS

A businessman may have to stand surety for some one in order to get monies for his own business. There may be a custom of the business by which that may be the only method whereby he could get money for the purpose of his own business. If he is to discharge a surety debt and if any such custom is established, it would be a business debt. If the assess has made a payment, not voluntarily but to discharge a legal obligation which arises from his business, he would be entitled to have the amount deducted as a bad debt - CIT V/s. Birla Bros. (P) Ltd.

The respondent, a private company, carried on the business of banking and financing and also of managing agency. Starch Products Ltd., was one of the various companies managed by the respondent. Starch Products Ltd., had appointed a selling agent and the respondent stood guarantee for a loan of Rs. 6 lakhs which was advanced by a bank to the selling agent of the managed company. The selling agent failed to pay the loan which at the relevant time stood at Rs. 5,60,199. This amount was paid by the respondent pursuant to the guarantee and, thereafter, the respondent treated the selling agent as its debtor for the amount. The selling agent went into liquidation and the respondent, not being able to recover any part of that amount, wrote off the sum of Rs. 5,60,199 in its accounts and claimed deduction thereof as a bad debt. Neither the memorandum of association of the respondent, nor the managing agency agreement contained any provision whereby it could be said that the guaranteeing of the loan to the selling agent was done in the course of the managing agency business. Nor was

there even material to show that the managed-company was under any legal obligation to finance the selling agent or to guarantee any loans to the selling agent. Held on the facts, that the sum of Rs. 5,60,199 was not allowable as a bad debt. The guaranteeing of the loan could not be said to have indirectly facilitated the carrying on of the respondent's business. Nor could it be said that it was in the larger interests of the respondent's business that the guarantee was given. [1970] 077 ITR 0751- CIT vs. Birla Bros. Pvt. Ltd. (Supreme Court of India)

EMBEZZLEMENT LOSSES

A debt arises out of a contract between the parties, express or implied, and when an agent misappropriates monies belonging to his employer by fraud or in breach of his obligations to him it cannot be said that he owes these monies under an agreement. He is no doubt liable in law to make good that amount, but that is not an obligation arising out of a contract, express or implied. Nor does it make a difference that in the accounts of the business the amounts embezzled are shown as debits, the amounts realised towards them if any are shown as credits, and the balance is finally written off. They are merely journal entries adjusting the accounts and do not import a contractual liability. The amounts would therefore not be deductible as bad debt - Badridas Daga V/s. CIT [1958] 34 ITR 10 (SC).

ENTITLEMENT TO SUCCESSOR TO BUSINESS

The expression ‘assessee’ in section 36(2)(i)(a) does not require as a statutory condition that the identity of the assessee both at the time when the debt comes into being and at the time when the debt becomes bad and is claimed as bad, should be the same. If the business is continued right through without any break, some change merely occurring in the persons carrying on the business, then the identity of the business as well as the debt to the incorporated in the accounts of the business would not get lost, and the provisions of section 36(2)(1)(a) will have to be regarded as fully complied with - CIT V/s. T.Veerabhadra Rao K. Koteswara Rao & Co. [1985] 155 ITR 152 (SC).

ACCOUNTS OF DEBTORS NEED NOT BE SQUARED

Under section 36 it is clear that before any claim for allowance for a bad debt is held established by the Income-tax Officer it must appear that the concerned bad debt was written off as irrecoverable in the account books of the assessee for the relevant previous years. This requirement has become a condition for the grant of claim for bad debt allowance. The requirement of section 36(2) is that the concerned bad debt must have been written off as irrecoverable in the accounts of the assessee. If the debit entries posted by the assessee indicate the said fact the requisite statutory condition has got to be treated as fully complied with. Once the assessee has posted entries in the profit and loss account and corresponding entries are posted in the bad debt reserve account that would be sufficient compliance with the provisions of the statutory requirement for writing off as irrecoverable the concerned debt in the books of the assessee. No further requirement can be spelt out from the express language used by the Legislature. It is not necessary that the assessee must also post corresponding entries in the ledger account of the concerned parties and should close those accounts. [1981] 130 ITR 0095- Vithaldas H. Dhanjibhai Bardanwala vs. CIT (Gujarat High Court). In other words It is not necessary that the assessee must also post corresponding entries in the ledger account of the concerned parties and should close those accounts

SEC.41(4) RECOVERY OF BAD-DEBTS

Where a deduction has been allowed in respect of a bad debt or part of debt under the provisions of clause (vii) of sub-section (1) of section 36, then, if the amount subsequently recovered on any such debt or part is greater than the difference between the debt or part of debt and the amount so allowed, the excess shall be deemed to be profits and gains of business or profession, and accordingly chargeable to income tax as the income of the previous year in which it is recovered, whether the business or profession in respect of which the deduction has been allowed is in existence in that year or not.

SEC.36(1)(VIA): PROVISION FOR BAD AND DOUBTFUL DEBTS RELATING TO RURAL BRANCHES OF COMMERCIAL BANKS.

The amount of deduction in respect of provision for bad and doubtful debts is given below:

	In the case of a scheduled bank [other than a foreign bank] and non-scheduled bank	In case of a foreign bank or a public financial institution, a State financial corporation, a state
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		industrial investment corporation
Total income (computed before this deduction and amount deductible under section 80CCC to 80U)	7 ½ per cent of such income (A)	5 per cent of such income (A)
Aggregate average advances made by rural branches	10 per cent of such advances (B)	Nil
TOTAL DEDUCTION	A + B	A + NIL
At option total deduction in both the cases can be substituted as deduction in respect of any provision made by it for any assets classified by the Reserve Bank of India as doubtful assets or loss assets in accordance with the guidelines issued by it in this behalf, for an amount not exceeding ten percent of the amount of such assets shown in the books of account of the bank on the last day of the previous year.		

A scheduled bank or a non-scheduled bank referred to in this sub-clause shall, at its option, be allowed a further deduction in excess of the limits specified in the foregoing provisions, for an amount not exceeding the income derived from redemption of securities in accordance with a scheme framed by the Central Government. Provided also that no deduction shall be allowed unless such income has been disclosed in the return of income under the head “Profits and gains of business or profession”

SEC.36(1)(VIII) FINANCIAL CORPORATION WHICH IS ENGAGED IN PROVIDING LONG-TERM FINANCIAL FOR INDUSTRIAL OR AGRICULTURAL DEVELOPMENT OR FOR HOUSING.

In respect of any special reserve created and maintained by a financial corporation which is engaged in providing long-term financial for industrial or agricultural development or development of infrastructure facility in India or by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes, an amount not exceeding forty per cent of the profits derived from such business of providing long-term finance (computed under the head “Profits and gains of business or profession before making any deduction under this clause) carried to such reserve account:

Provided that where the aggregate of the amounts carried to such reserve account from time to time exceeds twice the amount of the paid up share capital and of the general reserves of the corporation or, as the case may be, the company, no allowance under this clause shall be made in respect of such excess. (Must visit kalpeshclasses.com for downloading material for PE2 and Final)

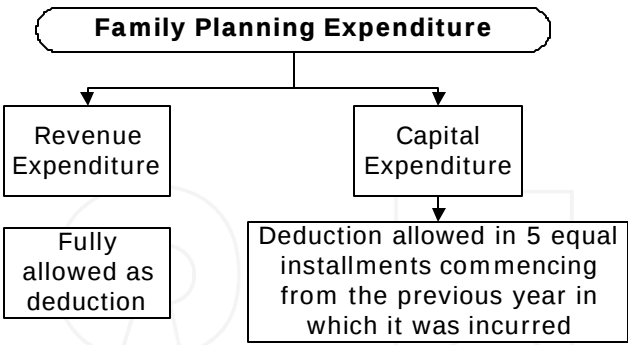
SEC.41(4A) CONSEQUENCE WHEN ANY AMOUNT IS WITHDRAWN FROM THE SPECIAL RESERVE.

Where a deduction has been allowed in respect of any special reserve created and maintained under 36(1)(viii), any amount subsequently withdrawn from such special reserve shall be deemed to be the profits and gains of business or profession and accordingly be chargeable to income-tax as the income of the previous year in which such amount is withdrawn.

SEC.36(1)(IX) EXPENDITURE BY COMPANIES ON PROMOTION OF FAMILY PLANNING AMONG ITS EMPLOYEES.

Any expenditure bonafide incurred by a company for the purpose of promoting family planning amongst its employees. Provided that where such expenditure or any part thereof is of a capital nature, one-fifth of such expenditure shall be deducted for the previous year in which it was incurred; and the balance thereof shall be deducted in equal instalments for each of the four immediately succeeding previous years.

Provisions of section 32(2) and 72 shall apply in relation to deductions allowable under this clause as they apply in relation to deductions allowable in respect of depreciation.



SEC.36(1)(X) CONTRIBUTION TOWARDS ANY FUND SPECIFIED UNDER CLAUSE (23E) OF SECTION 10

Any sum paid by a public financial institution by way of contribution towards any Exchange Risk Administration Fund set up by public financial institutions, either jointly or separately

SEC.36(1)(XII) ANY EXPENDITURE INCURRED BY CORPORATION

Any expenditure (not being in the nature of capital expenditure) incurred by a corporation or a body corporate, by whatever name called, constituted or established by a Central, State or Provincial Act for the objects and purposes authorised by the Act under which such corporation or body corporate was constituted or established.

SEC.36(1)(XIII) ANY BANKING TRANSACTION TAX

It allows deduction in respect of banking cash transaction tax paid by the assessee during the year on the taxable banking transactions entered into by him.

SEC.37(1): BUSINESS EXPENDITURE

Any expenditure (not being expenditure of the nature described in sections 30 to 36 and not been in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head “Profits and gains of business or profession”.

Explanation.--For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure.

DISALLOWANCE OF ILLEGAL EXPENSES: IN ORDER TO CLARIFY THAT NO ALLOWANCE SHALL BE MADE IN RESPECT OF EXPENDITURE INCURRED BY AN ASSESSEE FOR ANY PURPOSE WHICH IS AN OFFENCE OR WHICH IS PROHIBITED BY LAW, AN EXPLANATION TO SECTION 37(1) WAS INSERTED WITH RETROSPECTIVE EFFECT FROM APRIL 1, 1962, BY THE FINANCE (NO. 2) ACT, 1998 (I.E., FOR THE ASSESSMENT YEAR 1962-63 AND SUBSEQUENT YEARS) WHICH RESULTS IN DISALLOWANCE OF THE CLAIM MADE BY CERTAIN TAX PAYERS TO DEDUCTION OF PAYMENTS ON ACCOUNT OF PROTECTION MONEY, EXTORTION MONEY, HAFTA, BRIBES, ETC., AS BUSINESS EXPENDITURE.

NO DEDUCTION FOR EXPENDITURE INCURRED IN RESPECT OF EXEMPT INCOME AGAINST TAXABLE INCOME SEC. 14A

For the purposes of computing the total income, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act. Assessing Officer not be empowered to either to reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year beginning on or before the 1st day of April, 2001.

Certain incomes are not includible while computing the total income as these are exempt under various provisions of the Act. There have been cases where deductions have been claimed in respect of such exempt income. This in effect means that the tax incentive given by way of exemptions to certain categories of income is being used to reduce also the tax payable on the non-exempt income by debiting the expenses incurred to earn the exempt income against taxable income. This is against the basic principles of taxation whereby only the net income, i.e., gross income minus the expenditure, is taxed. On the same analogy, the exemption is also in respect of the net income. Expenses incurred can be allowed only to the extent they are relatable to the earning

of taxable income. Now section 14A clarify the intention of the legislature since the inception of the Income-tax Act, 1961, that no deduction shall be made in respect of any expenditure incurred by the assessee in relation to income which does not form part of the total income (Must visit kalpeshclasses.com for downloading material for PE2 and Final)

GENERAL NOTE ON BUSINESS EXPENSE

Business income is computed according to ordinary principles of commercial accounting. Even so, section 29 would require that the income should be computed "in accordance with the provisions contained in sections 30 to 43D". These Sections list out certain permissible deductions, while prohibiting some others. At the same time, these are not exhaustive as pointed out by the Supreme Court in the case of *Badridas Daga v. CIT* when it allowed the money lost on embezzlement, though not specifically listed as a deduction. Capital expenditure has to be disallowed even where it is not specifically ruled out as under section 37 because both capital receipt and capital expenditure should ordinarily be treated as being outside the scope of computation of income.

In order that specific deductions should be available, the assessee should carry on the business during the year with the result that the expenditure in connection with the closure of a business or even of its transfer may well get hit notwithstanding the fact that such expenditure has been incurred genuinely, and in connection with the business.

PROVISION MUST BE CONSTRUED LIBERALLY

On accepted commercial practice and trading principles an item of business expenditure must be deducted in order to arrive at the true figure of profits and gains for tax purposes. If the contents of this rule be true on general principle, there is no good reason why the scope of section 37(!) should not be construed liberally - *CIT V/s. Kalyanji Mavji & Co.* [1980] 122 ITR 49 (SC).

POWERS OF DEPARTMENTAL AUTHORITIES

It is not open to the department to prescribe what expenditure an assessee should incur and in what circumstances he should incur that expenditure. Every businessman knows his interest best - *CIT V/s. Dhanrajgiri Raja Narasingirji* [1973] 91 ITR 544 (SC). (Must visit kalpeshclasses.com for downloading material for PE2 and Final)

MEANING OF 'EXPENDITURE'

'Expenditure' is what is 'paid out or away' and is something which has gone irretrievably - *Indian Molasses Co. (P) Ltd. V/s. CIT* [1959] 37 ITR 66 (SC). 'Expenditure' is not necessarily confined to the money which has been actually paid out. It covers a liability which has accrued or which has been incurred although it may have to be discharged at a future date. However, a contingent liability which may have to be discharged in future cannot be considered as expenditure. In its normal meaning, the expression 'expenditure' denotes 'spending' or 'paying out or away', i.e., something that goes out of the coffers of the assessee. A mere liability to satisfy an obligation by an assessee is undoubtedly not 'expenditure'

WHOLLY AND EXCLUSIVELY LAID OUT FOR THE PURPOSE OF BUSINESS - MEANING OF

The expression 'wholly and exclusively laid out for the purpose of business' emphasises the nexus between the trade and the expenditure. The first adverb 'wholly' refers to quantum of expenditure and gives jurisdiction to the taxing authorities to examine these matters. The true test is that the expenditure is incurred by the assessee as incidental to his trade for the purpose of keeping the trade going and of making it pay and not in any other capacity than that of the trader.

The expression 'wholly and exclusively' used in section 37(1) does not mean 'necessarily'. Ordinarily it is for the assessee to decide whether any expenditure should be incurred in the course of his or its business. Such expenditure may be incurred voluntarily and without any necessity and if it is incurred for promoting the business and to earn profits, the assessee can claim deduction under section 37(1) even though there was no compelling necessity to incur such expenditure - *Sasson J. David & Co. (P) Ltd. V/s. CIT* [1979] 118 ITR 261 (SC).

ILLEGAL PAYMENTS

The expenditure that can be allowed must be legitimate and not illegal. In a large number of decisions, a consistent view has been taken that though the illegal transaction might have resulted in profit and which may be taxable, no deduction for such unlawful means employed for this purpose can be given. It is true, that under the Act the income is of course taxed, but the illegal ways and means employed by the assessee for procuring such illegal profit cannot be countenanced and it is against the public policy - *CIT V/s. Sauser Liquor Traders* [1996] 222 ITR 33 (MP). (Must visit kalpeshclasses.com for downloading material for PE2 and Final)

CONTINGENT LIABILITIES

Contingent liabilities do not constitute expenditure and cannot be the subject-matter of deduction even under the mercantile system of accounting. Expenditure which is deductible for income-tax purposes is towards a liability actually existing at the time but the setting apart money which might become expenditure on the happening of an event is not expenditure - Shree Sajjan Mills Ltd. V/s. CIT [1985] 156 ITR 585 (SC); Indian Molasses Co. (P) Ltd. V/s. CIT [1959] 37 ITR 66 (SC).

NO TEST IS PARAMOUNT OR CONCLUSIVE.

There is no all embracing formula which can provide a ready solution to the problem, no touchstone has been devised. Every case has to be decided on its own facts, keeping in mind the broad picture of the whole operation in respect of which the expenditure has been incurred. No two cases are alike and quite often emphasis on one aspect or the other may tilt the balance in favour of capital expenditure or revenue expenditure - CIT V/s. Coal Shipments (P) Ltd. [1971] 82 ITR 902 (SC); Bringing into existence an asset or advantage of enduring nature would lead to the inference that the expenditure disbursed is of a capital nature. Ultimately, the question will have to depend on the facts and circumstances of each case, namely, quality and quantum of the amount, the position of the parties, the object of the transaction which has impact on the business, the nature of trade for which the expenditure is incurred and the purpose thereof, etc.

WARRENTY CLAIMS

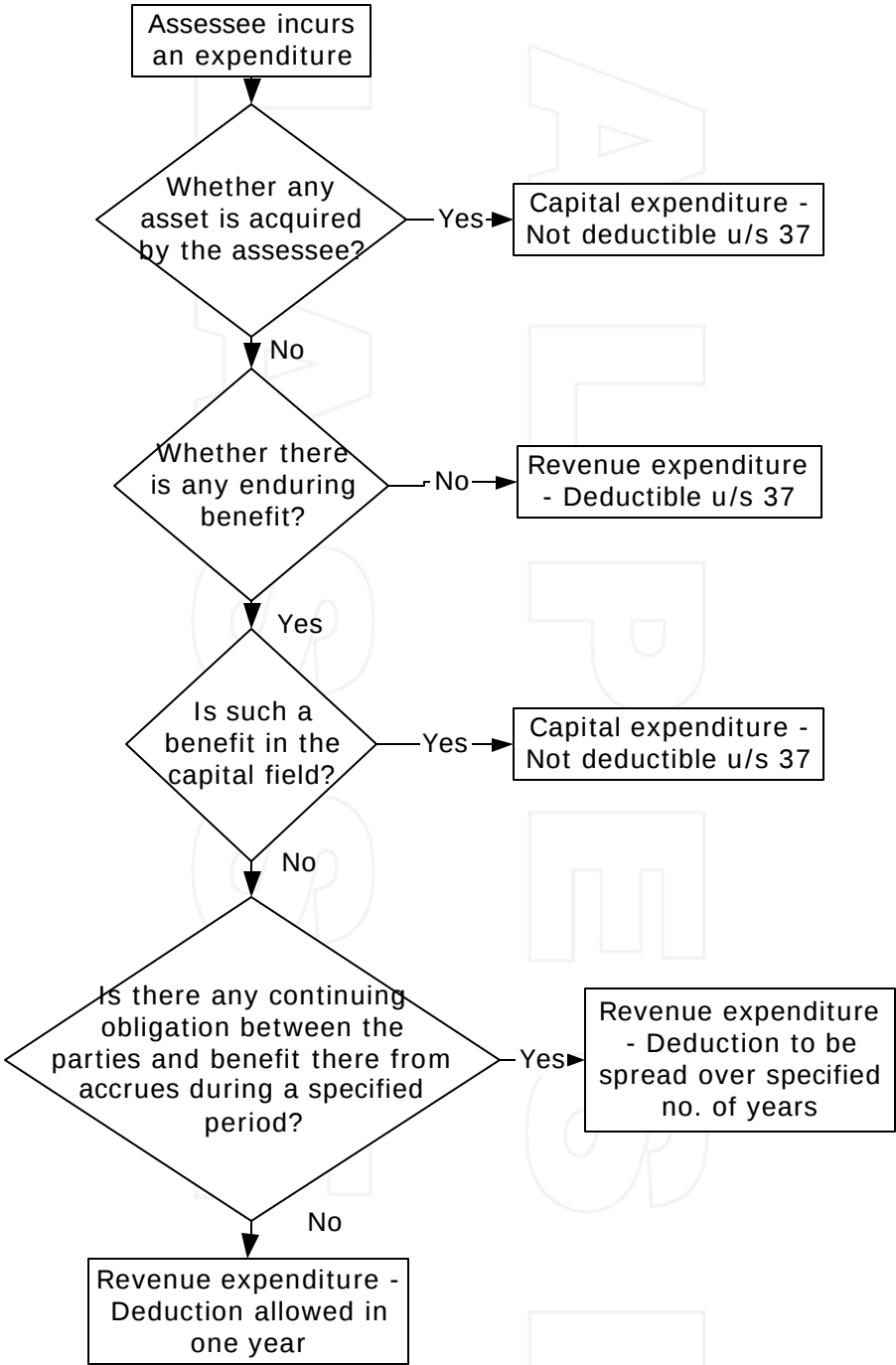
It is well-established that under the accrual or mercantile system of accounting, the taxpayer is entitled to make a provision for all liabilities which are foreseen in relation to transactions of the year, whether it is payable during the year or not. The court has pointed out that taxable income is not on gross receipts but on profits and gains of the business. The profits, as was pointed out by the House of Lords should be understood in its natural and proper sense, in a sense which no commercial man would misunderstand. It has to be real profits. It was for this reason that the assessee was allowed deduction of a provision in respect of what he has undertaken by way of amenities, when it had sold a plot in a layout. This has been followed in a number of cases. It was for this reason that the warranty claim was considered and found allowable in CIT v. Majestic Auto Ltd. [1993] 204 ITR (AT) 14, though it was claimed for the first time by a change in the method of accounting. [1959] 037 ITR 0001- Calcutta Co. Ltd. vs. Commissioner of Income-tax (Supreme Court of India)

CERTAIN FUNDAMENTAL PRINCIPLES TO DISTINGUISH CAPITAL EXPENDITURE FROM REVENUE EXPENDITURE, AS -

1. Capital expenditure cannot be attributed to revenue and vice versa.
2. It is equally clear that a payment in a lump sum does not necessarily make the payment a capital one. It may still possess revenue character in the same way as a series of payments.
3. If there is a lump sum payment but there is no possibility of a recurrence, it is probably of a capital nature, though this is by no means a decisive test.
4. If the payment of a lump sum closes the liability to make repeated and periodic payments in the future, it may generally be regarded as a payment of a revenue character.
5. If the ownership of the money, whether in point of fact or by a resulting trust, be still in the taxpayer, then there is acquisition of a capital asset and not an expenditure of a revenue character - Indian Molasses Co. (P) Ltd. V/s. CIT [1959] 37 ITR 66 (SC).
6. When expenditure is incurred not only once and for all, and with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, ordinarily such expenditure is on capital account;
7. Where the expenditure is incurred in the field of fixed capital, it is on capital account, but if it is a part of the circulating capital, it is on revenue account;
8. If the expenditure is a part of the working expenses in ordinary commercial trading, it is not capital but revenue expenditure;
9. If the expenditure is incurred for the initial outlay or for extension of business or substantial replacement of equipment, it is capital expenditure but if it is incurred for running the business or is laid out as part of the process of profit making, it is revenue in character; and
10. If expenditure is incurred for ensuring the regular supply of raw material, maybe for period extending over several years, it is on revenue account - Gujarat Mineral Development Corp. Ltd. v. CIT [1983] 143 ITR 822 (Guj.).

Where the expenditure laid out for the acquisition or improvement of a fixed capital asset is attributable to capital, it is a capital expenditure, but if it is incurred to protect the trade or business of the assessee, then it is a revenue expenditure. What the Courts have to see is whether the expenditure in question was incurred to create any new asset or was incurred for maintaining the business. If it is the former, it is capital expenditure; if it is the latter, it is revenue expenditure - *Dalmia Jain & Co. Ltd. V/s. CIT* [1971] 81 ITR 754 (SC).

What is material to consider is the nature of the advantage in a commercial sense and it is only when the advantage is in the capital field that the expenditure would be disallowable on an application of this test. If an advantage consists merely in facilitating the assessee's trading operations or enabling the management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account, even though the advantage may endure for an indefinite future.



THE GENERAL PRINCIPLES APPLICABLE IN DETERMINING WHETHER A PARTICULAR EXPENDITURE IS CAPITAL OR REVENUE EXPENDITURE ARE AS FOLLOWS

- (1) Outlay is deemed to be capital when it is made for the initiation of a business, for extension of a business, or for a substantial replacement of equipment;
- (2) Expenditure may be treated as properly attributable to capital when it is made not only once and for all,

but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade. If what is got rid of by a lump sum payment is an annual business expense chargeable against revenue, the lump sum payment should equally be regarded as a business expense, but if the lump sum payment brings in a capital asset, then that puts the business on another footing altogether

- (3) Whether for the purpose of the expenditure, any capital was withdrawn, or, in other words, whether the object of incurring the expenditure was to employ what was taken in as capital of the business. Again, it is to be seen whether the expenditure incurred was part of the fixed capital of the business or part of its circulating capital.
- (4) If the expenditure is for the initial outlay or for acquiring or bringing into existence an asset or advantage of an enduring benefit to the business that is being carried on, or for extension of the business that is going on, or for a substantial replacement of an existing business asset, it would be capital expenditure.
- (5) If, on the other hand, the expenditure, although for the purpose of acquiring an asset or advantage, is for running of the business or for working out that asset with a view to produce profit, it would be revenue expenditure.
- (6) If the outgoing is so related to the carrying on or the conduct of the business that it may be regarded as an integral part of the profit earning process or operations, and not for the acquisition of an asset of a permanent character, the possession of which is a condition precedent for the running of the business, then it would be expenditure of a revenue nature.
- (7) Special knowledge, or technical knowledge, or a patent, or a trade mark, is an asset and if it is acquired by payment for use and exploitation for a limited period, and what is acquired is not an asset or advantage of an enduring nature and at the end of the agreed period that advantage or asset reverts back intact to the giver of that special knowledge or the owner of the patents or trade marks, it would be expenditure of a revenue nature.
- (8) If it is intrinsically a capital asset, it is immaterial whether the price for it is paid once and for all, or periodically, or whether it is paid out of capital or income, or linked up with the net sales. The outgoing, in such a case, would be of the nature of capital expenditure.
- (9) If the amount paid for the acquisition of an asset of an enduring nature is settled, the mere fact that the amount so settled is chalked out into various small amounts or periodic installments, the capital nature of expenditure would not cease to be so or alter into the nature of a revenue expenditure.
- (10) A lump sum amount for liquidating recurring claims would not cease to be revenue expenditure or get converted into capital expenditure merely because its payment is spread over a number of years. It is the intention and object with which the asset is acquired, that determines the nature of the expenditure incurred over it, and not the method or the manner in which the payment is made, or the source of such payment.
- (11) If the expenditure is recurring and is incurred during the course of business or manufacture, it would be revenue expenditure. (Kalpesh Classes Tel. 23820676)
- (12) An asset or advantage of an enduring nature does not mean that it should last for ever. If the capital asset is, in its nature, a short-lived one, the expenditure incurred over it does not, for that reason, cease to be a capital expenditure.
- (13) It is not the law that if an enduring advantage is obtained, the expenditure for securing it must always be treated as capital expenditure. If the advantage acquired is to get the stock-in-trade of the business, then it would be revenue expenditure. But if what is acquired is not the advantage of getting the stock-in-trade directly, but of something which has to be dressed up or processed before it is converted into stock-in-trade, the expenditure incurred over it would be capital expenditure.

REAL INCOME CONCEPT

The objective of taxation of income has undergone metamorphosis from time to time with various deeming provisions treating capital receipts as income and disallowing revenue expenditure. Capital gains and lottery income, for example are instances of receipts deemed as income. Similarly disallowance of expenditure incurred in cash under section 40A(3) and specified unpaid liability under section 43B are instances of revenue

expenditure being disallowed. These constitute divergences as between real and assessable income as a matter of State policy.

However, there are many disputes as to whether a particular receipt is income or a particular payment is really a revenue expenditure, on which one is not able to give a decisive answer. The concept of real income is often used for deciding the issue one way or the other. The courts have used this concept for ensuring that what is taxed, is as nearly real as possible within the constraints of statutory limitations.

The concept of real income came for critical analysis in *State Bank of Travancore v. CIT* [1986] 158 ITR 102 (SC) where the issue related to the deductibility or otherwise of a provision by way of interest suspense account, majority decisions holding that the concept of real income does not extend to a situation, where such provision is made on an ad hoc basis. The Supreme Court in the judgment of Sabyasachi Mukharji J. in the leading judgment had laid down the following propositions as to what constitutes real income in the following words in *State Bank of Travancore v. CIT* [1986] 158 ITR 102 at page 155:

1. It is the income which has really accrued or arisen to the assessee that is taxable. Whether the income has really accrued or arisen to the assessee must be judged in the light of the reality of the situation.
2. The concept of real income would apply where there has been a surrender of income which in theory may have accrued but in the reality of the situation, no income had resulted because the income did not really accrue.
3. Where a debt has become bad, deduction in compliance with the provisions of the Act should be claimed and allowed.
4. Where the Act applies, the concept of real income should not be so read as to defeat the provisions of the Act.
5. If there is any diversion of income at source under any statute or by overriding title, then there is no income to the assessee.
6. The conduct of the parties in treating the income in a particular manner is material evidence of the fact whether income has accrued or not.
7. Mere improbability of recovery, where the conduct of the assessee is unequivocal, cannot be treated as evidence of the fact that income has not resulted or accrued to the assessee. After debiting the debtor's account and not reversing that entry-but taking the interest merely in suspense account cannot be such evidence to show that no real income has accrued to the assessee or been treated as such by the assessee.
8. The concept of real income is certainly applicable in judging whether there has been income or not but, in every case, it must be applied with care and within well-recognised limits.

It was however conceded that application of the above principles in a particular case is not easy. There is no strait-jacket formula applicable for all occasions. In a recent judgment, the Supreme Court in *CIT v. Shiv Prakash Janak Raj & Co. Pvt. Ltd.* [1996] 222 ITR 583 had occasion to review the case law in a case where the assessee-company had claimed that the interest receivable by it, from a firm in which its shareholders and directors were interested, had been waived and that, therefore, it would not be taxable. A number of citations were given and the concept of real income was canvassed in favour of the assessee. The Supreme Court found that the case law had always indicated that under mercantile system of accounting, accrual of income had involved tax liability. The fact, that such income was not realised subsequently, is not a matter which could be taken into consideration in determination of the income for that year. Similarly, where it is found that the assessee retains the right to recover such accrued income as at the end of the year, it cannot retrospectively claim that such income is not taxable. In other words, the fact that the income was given up subsequent to the year cannot help the taxpayer and the concept of real income cannot come to the assistance of such taxpayer as was found in *Morvi Industries Ltd. v. CIT* [1971] 82 ITR 835 (SC).

The principle of real income is not to be so subordinated as to amount virtually to a negation of it when a surrender or concession or rebate in respect of managing agency commission is made, agreed to or given on grounds of commercial expediency, simply because it takes place some time after the close of an accounting year. In examining any transaction and situation of this nature the court would have more regard to the reality and speciality of the situation rather than the purely theoretical or doctrinaire aspect of it. It will lay greater emphasis on the business aspect of the matter viewed as a whole when that can be done without disregarding statutory language.

ALLOWABILITY OF EXPENDITURE WITH A TAIN OF ILLEGALITY

One of the vexing problems for taxpayers has been the approach of the Assessing Officer to disallow legitimate business expenditure on the ground that such payment is tainted by illegality following the decision of the Supreme Court in the case of Haji Aziz and Abdul Shakoor Bros. v. CIT [1961] 41 ITR 350, where the Supreme Court disallowed a fine paid to avoid confiscation of the goods imported in contravention of import regulations. The ruling was that any payment occasioned by infraction of any law could not be allowed. This decision has often been indiscriminately applied with what is sometimes described as puritanical approach. The issue became complicated and somewhat anomalous, because the Supreme Court itself found its way to allow even illegal expenditure, if the income itself was from an illegal business in CIT v. S. C. Kothari [1971] 82 ITR 794 and CIT v. Piara Singh [1980] 124 ITR 40. The reasoning for this apparent inconsistency was that in the cases of illegal business, the tax collector cannot be heard to say that he will bring the gross receipts to tax.

Our law has wrongly understood that allowance of an illegal expenditure would tantamount to endorsement of such illegality on the part of the courts. The English law, on the other hand, in Minister of Finance v. Smith [1927] AC 193 (PC) took the view that by defining an illegal expenditure admissible as a business expenditure, the court "does not condone or take part in the illegal enterprise". When the Revenue finds that it is entitled to tax profits from an illegal business, (Must visit kalpeshclasses.com for downloading material for PE2 and Final) even those businesses in trafficking in drugs, gun running, smuggling, running gambling house, etc., it is odd that there should be hesitancy in allowing penalties or fines in the course of carrying on such business. Some of these contraventions may not be wilful and may have occurred because of the complexities in our laws especially those relating to imports, customs, excise, company law or foreign exchange. Some of these contraventions may not involve any moral turpitude.

But the present tendency is to relax the rigidities as is apparent from some later Supreme Court decisions. Interest paid for non-payment of cess in time was held allowable by the Supreme Court in Mahalakshmi Sugar Mills Co. Ltd. v. CIT [1980] 123 ITR 429 (SC) reiterated in CIT v. Luxmi Devi Sugar Mills P. Ltd. [1991] 188 ITR 41 (SC). A statutory impost though described as penalty under the Sales Tax Act, or where the payment is for breach of contract, may be allowable to the extent it is compensatory and not punitive as held in Prakash Cotton Mills P. Ltd. v. CIT [1993] 201 ITR 684 (SC) and Standard Batteries Ltd. v. CIT [1995] 211 ITR 444 (SC).

Some High Courts also found their way to justify deductions in some cases. A fine for infraction of import restrictions was allowed in CIT v. P. C. Tangal [1990] 184 ITR 88 (Bom); redemption fine for importing without licence in CIT v. N. M. Parthasarathy [1995] 212 ITR 105 (Mad); demurrage paid to port authorities: Mahalaxmi Sugar Mills Co. Ltd. v. CIT [1986] 157 ITR 683 (Delhi); expenses to regularise after unlicensed imports in CIT v. Maddi Venkataratnam & Co. (Pvt.) Ltd. [1983] 144 ITR 373 (AP) and Apeejay (P) Ltd. v. CIT [1978] 114 ITR 544 (Cal) were all found admissible. Penalty for delayed contribution to provident fund/ESI was an issue remitted by the Calcutta High Court to be decided after consideration whether it was confiscatory or punitive in character in CIT v. General Fibre Dealers Ltd. [1994] 205 ITR 441 reversing their stand Hasimara Industries Ltd. v. CIT [1993] 200 ITR 659 (Cal) following the rationale of the Supreme Court decision under the relevant Acts in Organo Chemical Industries v. Union of India, AIR 1979 SC 1803. The same class of payments was found admissible by other High Courts in New Mahalaxmi Silk Mills P. Ltd. v. CIT [1994] 206 ITR 302 (Bom), CIT v. Hyderabad Allwyn Metal Works Ltd. [1988] 172 ITR 113 (AP) and CIT v. Mysore Electrical Industries Ltd. [1992] 196 ITR 884 (Kar). The amount payable on overdue municipal tax was held allowable as interest, Russel Properties P. Ltd. v. CIT [1982] 137 ITR 358 (Cal), while it was described as penalty and not deductible in CIT v. Dhanraj Mills P. Ltd. [1994] 209 ITR 851 (Bom). The amount of compensation paid to the Government for shortfall of export obligation was held allowable in CIT v. Ahmedabad Cotton Mfg. Co. Ltd. [1994] 205 ITR 163 (SC). (Kalpesh Classes Tel. 23820676)

The Supreme Court in Sri Venkata Satyanarayana Rice Mill's case [1997] 223 ITR 101 has leaned in favour of the liberal approach. It has approved the decision of the Full Bench of the Madhya Pradesh High Court in Addl. CIT v. Kuber Singh Bhagwandas [1979] 118 ITR 379, where donations given to the Chief Minister's Drought Relief Fund in the expectation of permit for export of gulabi chana was held deductible on the ground

of commercial expediency. It relied upon the decision in *Patnaik and Co. Ltd. v. CIT* [1986] 161 ITR 365 (SC), where the loss incurred in subscribing to the Government securities merely with a view to sell trucks was held allowable. After advertent to similar other decisions, it reversed the view of the Andhra Pradesh High Court and in the decision in *Sri Venkata Satyanarayana Rice Mill's case* [1997] 223 ITR 101 held that contributions made to a public welfare fund solely for promotion of assessee's business, whether at the instance of the authorities or otherwise cannot be treated as opposed to public policy.

Though the decision in the case of *Prakash Cotton Mills* [1993] 201 ITR 684 (SC) and now the decision in *Sri Venkata Satyanarayana Rice Mills' case* [1997] 223 ITR 101 do make some advance in resolving such disputes, the basic difference as between the approaches in respect of legal and illegal businesses as exemplified in *Haji Aziz and Abdul Shakoor Bros.' case* [1961] 41 ITR 350 on the one hand and *Piara Singh's case* [1980] 124 ITR 40 is yet to be reconciled, because the law which puts a smuggler or those in such illegal activities in a better tax position than the one who gets tripped by the multiplicity of our laws, which a businessman has to encounter in the course of his business, is difficult to understand.

TEST OF 'FIXED V. CIRCULATING CAPITAL'

The test of 'Fixed v. Circulating capital' also sometimes breaks down because there are many forms of expenditure which do not fall easily within either of the categories and not infrequently the line of demarcation is difficult to draw and leads to subtle distinctions between profit that is made out of assets and profits that is made upon assets or with assets. Moreover there may be cases where expenditure though referable to or in connection with fixed capital is nevertheless allowable as revenue expenditure. An illustrative example would be of expenditure incurred in preserving or maintaining capital assets. This test is therefore clearly not one of universal application - *Empire Jute Co. Ltd. V/s. CIT* [1980] 124 ITR 1 (SC); *CIT V/s. Coal shipments (P) Ltd.* [1971] 82 ITR 902 (SC).

PRE-COMMENCEMENT EXPENDITURE

Expenditure incurred in respect of any business is deductible from the date of commencement of business but only where it has been set up. Expenditure incurred prior to the setting up of a business is not allowed as a deduction. Pre-commencement expenditure may well be a dead loss unless it could be treated as cost of the capital asset so as to be entitled for depreciation.

The distinction between setting up and commencement of business is one which will cause tax problems for the first year of one's business especially in manufacturing line and such problem may sometimes extend to more than a year, where there is a long gestation period for a particular line of business. It was pointed out in the case of *CIT v. Bihar Spinning & Weaving Mills Ltd.* That the fact that the business was in the second year of its commencement does not mean that the expenses are deductible unless it is shown to have been set up. The result is that the income earned during this period may well be taxable as income from other sources, while the expenditure would be treated as one not admissible, the assessee suffering both ways.

The view that the income earned is incidental to the activity for setting up the business as in the case of sale of scrap or gunny bags or interest income from deposits of moneys pending use, the share contributions or borrowings could be treated as abatement of capital cost has not found favour with many courts. In *Tuticorin Alkali Chemicals & Fertilisers Ltd. v. CIT* the Supreme Court held that moneys earned prior to commencement of business, viz., interest earned on deposits made out of borrowed funds was taxable and could not be set off against interest payable on borrowed funds.

Tax planning is sometimes thought of by having a trial run for a new industrial undertaking, which would mean that the asset is brought to use, in an existing business so that depreciation can be claimed, but a successful trial is claimed only early next year so that depreciation for the assets can be got in an earlier year, while the period for relief would be reckoned only from the next succeeding year. This happens because the income of a new industrial undertaking would be reckoned after it starts manufacturing goods, while depreciation is available once the machinery is brought to use, another refinement in law giving ample scope for tax planning in one sense and controversy in the other.

DISPUTED LIABILITY

Disputed liabilities cannot be avoided in a running business. Various claims are made for supplies which are not accepted or for additional amount for services rendered or supplies made. It sometimes results in court cases with damages being paid. Mere claim against the assessee may be treated as contingent unless admitted.

Disputed liability is not ordinarily provided in the accounts but may well be eligible for deduction where there is a certain degree of certainty about it, though not contingent. It is only the ascertained liability which needs to be provided and allowed. (Must visit kalpeshclasses.com for downloading material for PE2 and Final) There can be a legal liability; but such liability may be questioned by way of a writ petition before the High Court pending disposal as at the end of the year. Where such writ petition is dismissed, the year in which the deduction should be allowed can be a matter of controversy. But a statutory liability is allowed as a deduction unless it falls under section 43B which permits such deduction on payment only.

TEST OF 'COMMERCIAL EXPEDIENCY'

The test of commercial expediency cannot be reduced to the shape of a ritualistic formula, nor can it be put in a water-tight compartment so as to be confined in a strait-jacket. The test merely means that the Court will place itself in the position of a businessman and find out whether the expenses incurred could be said to have been laid out for the purpose of the business or the transaction was merely a subterfuge for the purpose of sharing or dividing the profits ascertained in a particular manner. In the ultimate analysis the matter would depend on the intention of the parties as spelt out from the terms of the agreement or the surrounding circumstances, the nature or character of the trade or venture, the purpose for which the expenses are incurred and the object which is sought to be achieved - CIT V/s. Panipal Woolen & General Mills Co. Ltd. [1976] 103 ITR 66 (SC).

Commercial expediency must be judged not in the light of the 19th century laissez faire doctrine which regarded man as an economic being concerned only to protect and advance his self-interest, but in the context of current socio-economic thinking which places the general interest of the community above the personal interest of the individual and believes that a business or undertaking is the product of the combined efforts of the employer and the employees - Shahzada Nand & Sons V/s. CIT [1977] 108 ITR 358 (SC).

Gratuity paid in excess of limits prescribed under the Payment of Gratuity Act need not be disallowed merely on that ground. It was so held in CIT v. Associated Cement Companies Ltd. [2001] 249 ITR 3 (Bom) following CIT v. Hindustan Motors Ltd. [1989] 175 ITR 411 (Cal). It is established law that any payment to an employee even if it is gratuitous and therefore non-contractual could not be disallowed as was found in the case of Sassoon J. David and Co. Pvt. Ltd. v. CIT [1979] 118 ITR 261 (SC) in the following words "It is too late in the day now, whatever may have been the position about two decades ago, to treat the expenditure incurred by a management in paying reasonable sums by way of gratuity, bonus, retrenchment compensation or compensation for termination of service as not business expenditure. Such expenditure would ordinarily fall within the scope of section 37(1) of the Act."

CONCEPT OF 'FOR THE PURPOSE OF BUSINESS'

The expression 'for the purpose of business' in section 37(1) is wider in scope than the expression 'for the purpose of earning profits'. Its range is wide; it may take in not only the day-to-day running of the business but also the rationalisation of its administration and modernisation of its machinery; it may include measures for the preservation of the business and for the protection of its assets and property from expropriation or coercive process; it may also comprehend payment of statutory dues and taxes imposed as a precondition to commence or for carrying on of a business; it may comprehend many other acts incidental to the carrying on of a business. The expression for the purpose of business and profession is wide it may take in not only the day to day running of a business but also the rationalisation of its administration and modernisation of its machinery; it may include measure for the preservation of the business and for the protection of its assets and property from expropriation, coercive process of assertion of hostile title; it may also comprehend payment of statutory dues and taxes imposed as a pre-condition to commence or for the carrying on of a business; it may comprehend many other acts incidental to the carrying on of a business. (Must visit kalpeshclasses.com for downloading material for PE2 and Final) The only limitation is that the purpose should be for the purpose of the business, that is to say, the expenditure incurred should be for the carrying on of business and the assessee should incur it in his capacity as a person carrying on the business. It cannot include sums spent for purposes unconnected with the business.

Whether an item of expenditure falls within the description 'for the purpose of business' has of necessity to be determined having regard to the nature of the expenditure and the relation between the business and the expenditure - Travancore Titanium Product Ltd. V/s. CIT [1966] 60 ITR 277 (SC)

If an assessee carries on several distinct and independent businesses and one of such businesses is closed before the previous year, he cannot claim allowance under section 37 of an outgoing attributable to the business which

is closed against the income of his other businesses in that year - L.M.Chhabda & Sons V/s. CIT [1967] 65 ITR 638 (SC).

PERSONAL EXPENSES

Personal expenses include only expenses on the person of the assessee or to satisfy his personal needs such as clothes, food, etc. or for purposes not related to the business. Every expenses to discharge a personal obligation does not become a personal expense - State of Madras V/s. G.J. Coelho [1964] 54 ITR 186 (SC).

It is not correct to take the view that for an expenditure to be deductible under section 37(1) the primary motive in incurring the expenditure must be directly to earn income thereby - Shree Meenakshi Mills Ltd. V/s. CIT [1967] 63 ITR 207 (SC).

CHARACTER IN RECIPIENT'S HANDS

It is not a universally true proposition that what may be a capital receipt in the hands of the payee must necessarily be capital expenditure in relation to the payer. The fact that a certain payment constitutes income or capital receipt in the hands of the recipient is not material in determining whether the payment is revenue or capital disbursement qua the payer - Empire Jute Co. Ltd. V/s. CIT [1980] 124 ITR 1 (SC).

BENEFIT ENURING TO THIRD PARTY

The fact that somebody other than the assessee is also benefited by the expenditure should not come in the way of an expenditure being allowed by way of deduction under section 37(1), if it otherwise satisfies the tests laid down by law - Sassoon J. David & Co. (P) Ltd. V/s. CIT [1979] 118 ITR 261 (SC).

RELEVANCE OF BOOK ENTRIES

If an assessee under some misapprehension or mistake fails to make an entry in the books of account and if under the law a deduction must be allowed by the ITO, the assessee will not lose the right of claiming or will not be debarred from being allowed that deduction. Whether the assessee is entitled to a particular deduction or not will depend on the provision of law relating thereto and not on the view which the assessee might take of his rights nor can the existence or absence of entries in the books of account be decisive or conclusive in the matter - Kedarnath Jute Mfg. Co. Ltd. V/s. CIT [1971] 82 ITR 363 (SC).

To determine whether a particular expenditure falls within the four corners of section 37(1), the question whether the expenditure was within or outside the powers of the company is of little consequence - Kishan Prasad & Co. Ltd. V/s. CIT [1955] 27 ITR 49 (SC).

EXPENDITURE AFTER 'SETTING UP' BUT BEFORE 'COMMENCEMENT'

Expenses incurred in the interregnum between the 'setting up' of a business and the 'commencement of business are deductible. Any expenses incurred prior to the setting up of a business would obviously not be permissible deductions because those expenses would be incurred at a point of time when the previous year of the business would not have commenced - Western India Vegetable Products Ltd. V/s. CIT [1954] 26 ITR 151 (Bom.).

INAUGURATION EXPENSES

Merely because the expenditure was incurred before the commissioning of a new unit would not make it any the less an expenditure coming under section 37(1) if it satisfies all the other conditions. Where the assessee was already having manufacturing units and had only expanded its existing business and inaugurated another new project, expenditure incurred by it in connection with the inaugural function of that unit was allowable as revenue expenditure - CIT V/s. Aluminium Industries Ltd. [1995] 214 ITR 541 (Ker.). See also CIT V/s. Hindustan Aluminium Corporation Ltd. [1989] 176 ITR 206 (Cal.)

WARDING OFF COMPETITION

Payment made to rival dealer to ward off competition in business would constitute capital expenditure if the object of making that payment is to drive an advantage by eliminating the competition over some length of time; the same result would not follow if there is no certainty of the duration of the advantage and the same can be put to an end at any time. How long the period of contemplated advantage should be in order to constitute enduring benefit would depend upon the circumstances and facts of each case - CIT V/s. Coal Shipments (P) Ltd. [1971] 82 ITR 902 (SC).

PRESERVATION OF GOODWILL OR CUSTOMER RELATIONS

Where an assessee makes concessions in the interest of his business instead of taking a stand strictly on his legal obligations, any loss incurred will be expenditure laid out wholly and exclusively for the purpose of business. Thus, where jewellery and cash deposited by customers with the bank were stolen and the bank, instead of taking a strictly legal stand, reimbursed the loss to the customers in order to maintain its business connections and goodwill, the resulting loss was allowable as business expenditure - CIT V/s. Nainital Bank Ltd. [1966] 62 ITR 638 (SC).

SHIFTING OF PLANT AND MACHINERY

Where the assessee shifted his sugar factory from a disadvantageous location to another location, the expenditure incurred on the shifting of plant/machinery to the new site was clearly not incurred for the purpose of carrying on the concern but was incurred in setting up the concern with a greater advantage for the trade than it had in its previous set-up. The expenditure was not incurred in earning any profit but only for putting its factory (capital) in better shape, and it went towards effecting a permanent improvement in the profit-making machinery. It was therefore a capital expenditure and not revenue expenditure - Sitalpur Sugar Works Ltd. V/s. CIT [1963] 49 ITR 160 (SC).

PURCHASE OF RUNNING CONCERN OR ACQUISITION OF BUSINESS

A purchaser may buy a running concern and fix a certain price and the price may be payable in a lump sum or may be payable by instalments. But the mere fact that the capital sum is payable by instalments spread over a certain length of time will not convert the nature of that payment from capital expenditure into a revenue expenditure - Travancore Sugars & Chemicals Ltd. V/s. CIT [1966] 62 ITR 566 (SC).

If the purchaser of a business undertakes to the vendor as one of the terms of the purchase that he will pay a sum annually to a third party, irrespective of whether the business yields any profits or not, it would be difficult to say that the annual payments were made solely for the purpose of earning the profits of the business. It would seem to make no difference that the annual sum was made payable out of a particular receipt of the business, irrespective of the earning of any profit from the business as a whole - Tata Hydro-Electric Agencies Ltd. V/s. CIT [1937] 5 ITR 202 (PC).

ACQUISITION OF RIGHTS

Where the assessee acquired the right of sole selling agency held by another company under an agreement which envisaged payment of 75 per cent of its profits to that company, the expenditure by way of payment of profits was made for in the initial outlay on the acquisition of a capital asset, and was hence capital in nature - CIT V/s. Jalan Trading Co. (P) Ltd. [1985] 155 ITR 536 (SC).

ACQUISITION OF GOODWILL

Acquisition of the goodwill of a business is acquisition of a capital asset. Therefore, its purchase price would be capital expenditure. It would not make any difference whether it is paid in a lump sum at one time or in instalments distributed over a definite period. Where, however, the transaction is not one for the acquisition of goodwill but for the right to use it, the expenditure would be revenue expenditure - Devidas Vithaldas & Co. V/s. CIT [1972] 84 ITR 277 (SC).

CONSTRUCTION OF ROADS

Where a sugar manufacturer made contribution under a statutory obligation towards the construction and development of roads between the sugarcane -producing centres and the sugar mills, and the roads were at all times the property of the Government, the contribution so made was revenue in nature, since it was incurred for reasons of commercial expediency and it did not evoke any benefit of an enduring nature to the manufacturer - Lakshmiji Sugar Mills Co. (P) Ltd. V/c. CIT [1971] 82 ITR 376 (SC). (Kalpesh Classes Tel. 23820676)

Where a sugar manufacturer made a contribution under the Sugarcane Development Scheme promoted by the State Government for the construction of roads in the area around the sugar factories, and though there was no statutory obligation to make the contribution the construction of the roads was considerably advantageous to the business of sugar manufacturer, the contribution was deductible as revenue expenditure - L.H.Sugar Factory & Oil Mills (P) Ltd. V/s. CIT [1980] 125 ITR 293 (SC).

TECHNICAL KNOW-HOW

Where the assessee entered into an agreement with a foreign company for the supply of technical know-how and under the relevant agreement the assessee was a mere licensee for a limited period and was merely allowed the right to draw upon the technical knowledge of the foreign company for the purpose of carrying on its

business, the royalty paid by the assessee to the foreign company was deductible under section 37(1) - CIT V/s. Ciba of India Ltd. [1968] 69 ITR 692 (SC).

‘ONCE AND FOR ALL’ PAYMENT

Where an assessee, engaged in the manufacture of penicillin, made a ‘once and for all’ payment to a foreign firm for the supply of technical know-how relating to increasing the yield of penicillin for a period of two years on the condition that the assessee should keep the technical information confidential, the payment so made was allowable as revenue expenditure - Alembic Chemical Works Co. Ltd. V/s. CIT [1989] 177 ITR 377 (SC).

REPAIRS

Expenditure incurred on repairs to buildings/plant/machinery which does not fall under section 30 or section 31 on the ground that they are not ‘current repairs’ can be considered for deduction under section 37(1) - CIT V/s. Kalyanji Mavji & Co. [1980] 122 ITR 49 (SC).

INTEREST PAID UNDER INCOME-TAX ACT

Interest paid for non-payment or for payment of lesser amount or delayed payment of income-tax is not in respect of the business which is carried on, and therefore cannot stand on the same footing as delayed payment of other taxes like purchase tax and sales tax. Hence, interest paid under section 215/216/217/220(2) is not allowable as revenue expenditure.

REMUNERATION TO EMPLOYEES/DIRECTORS

It is an erroneous proposition to content that as soon as an assessee has established two facts, viz., the existence of an agreement between the employer and the employee and the fact of actual payment, no discretion is left to the ITO except to hold that the payment was made wholly and exclusively for the purpose of the business. It would still be open to the ITO to take into consideration all the relevant factors which will got to show whether the amount was paid as required to section 37(1). It is manifest that the ITO is entitled to examine the circumstances of each case to determine for himself whether the remuneration paid to the employee or any portion thereof was properly deductible under section 37(1) - Swadeshi Cotton Mills Co. Ltd. V/s. CIT [1967] 63 ITR 57 (SC).

RETRENCHMENT COMPENSATION

Where a liability to make a payment arises not in the course of the business nor for the purpose of carrying on the business but springs from the transfer of the business, it is not a properly debitable item in the profit and loss account, and is not deductible. Deduction on account of retrenchment compensation under section 25FF of the Industrial Disputes Act is not admissible, since the right to such compensation arises from determination of employment, or from the transfer of the undertaking - CIT V/s. Gemini Cashew Sales corporation [1967] 65 ITR 643 (SC).

REMUNERATION TO PROMOTERS

Expenditure incurred for remunerating the persons who have promoted a company is not in law a revenue expenditure admissible under section 37(1) - Lakshmiratan Cotton Mills Co. Ltd. V/s. CIT [1969] 73 ITR 634 (SC).

COMPENSATION PAYMENTS

Payment for breach of contract in respect of purchase of machinery is made to avoid a larger capital expenditure that would not have served the interests of the assessee. Such a payment necessitated by the cancellation of the contract for purchase due to changed circumstances is clearly in the nature of capital expenditure - Swadeshi Cotton Mills Co. Ltd. V/s. CIT [1967] 63 ITR 65 (SC).

COMMISSION PAYMENTS

The mere existence of agreement between the assessee and its selling agents or payment of certain amounts as commission does not bind the ITO to hold that the payments were made exclusively and wholly for the purpose of the assessee’s business. Despite the existence of such agreement/payments, it is open to the ITO to consider the relevant facts and determine for himself whether the commission said to have been paid to the selling agents or any part thereof is properly deductible under section 37(1) - Lachminarayan Madan Lal V/s. CIT [1972] 86 ITR 439 (SC).

Where the selling agents had not only canvassed the sales but had also undertaken the responsibility for the fulfilment of contracts by customers and for the payment of dues by customers to the assessee, the commission paid by the assessee on all sales, whether made through the agents or not, was deductible - Aluminium Corporation of India Ltd. V/s. CIT [1972] 86 ITR 11 (SC).

SECRET COMMISSION

A claim for deduction of secret commission alleged to have been paid to promote sales, in respect of which the assessee refused to furnish names and addresses of payees, is not allowable, since the assessee could not be said to have discharged the burden of proving that the amounts were actually expended - Goodlas Nerolac Paints Ltd. V/s. CIT [1982] 137 ITR 58 (Bom.)

LITIGATION/LEGAL EXPENSES

For the purpose of section 37(1), it makes no difference whether the proceedings are civil or criminal. All that has to be seen is whether the legal expenses were incurred by the assessee in his character as a trade, i.e. whether the transaction in respect of which the proceedings are taken arose out of and was incidental to the assessee's business - CIT V/s. Dhanrajgiriji Raja Narasingirji [1973] 91 ITR 544 (SC).

The question whether litigation expenses are of capital or revenue nature depends on whether the expenses were incurred by the assessee for the purpose of creating, rectifying or completing the assessee's title to the capital, or whether it was for the purpose of protecting its business. It is the former, then the expenses incurred must be considered as capital expenditure - Dalmia Jain & Co. Ltd. V/s. CIT [1971] 81 ITR 754 (SC).

In every criminal case where the matter is defended to protect the good name of a businessman or a professional, the fear of possible fine or imprisonment must always be there. It cannot therefore be said that in every such case the expenses incurred by a person exercising a trade or profession in defending a criminal prosecution which arises out of his business or professional activities should be allowed as a deduction. Where the framers of an Ordinance have regarded the offence as one calling for deterrent punishment in view of its anti-social character, it would be idle to suggest that it was for the income-tax authorities to prove in such cases that the conviction might result in sentence of imprisonment and that, in the absence of such proof, there was at the most only a chance of conviction and fine. Expenses incurred in respect of such offences are not deductible - CIT V/s. H. Hirjee [1853] 23 ITR 427 (SC).

PENALTIES

An expenditure is not deductible unless it is a commercial loss in trade, and a penalty imposed for breach of the law cannot be described as such. Such penalties which are incurred by an assessee in proceedings launched against him for an infraction of the law cannot be called commercial losses incurred by an assessee in carrying on his business and are not deductible - Haji Aziz & Abdul Shakoor Bros V/s. CIT [1961] 41 ITR 350 (SC).

Interest payable on arrears of cess under section 3(3) of the U.P. Sugar Cane Cess (Validation) Act is in reality part and parcel of the liability to pay cess, and it is not a penalty for which provision has been separately made in section 3(5). Interest so paid is hence not for the infringement of any law, and is hence deductible - Mahalakshmi Sugar Mills Co. V/s. CIT [1980] 123 ITR 429 (SC).

INTEREST AND DAMAGES UNDER SALES TAX ACT

Where assessee claimed deduction under section 37(1) for interest and damages paid by it for delayed payment of sales tax under Bombay Sales Tax Act and for delayed payment of contribution under ESI Act, appellate authorities were not justified in refusing to allow assessee's claim under section 37(1) without any examination of scheme of provisions of Bombay Sales Tax Act or ESI Act, to find whether impost of interest/damages paid by assessee was compensatory in nature so as to entitle it for deduction under said section - Prakash Cotton Mills (P) Ltd. V/s. CIT [1993] 67 Taxman 546/201 ITR 684 (SC).

EMBEZZLEMENTS

A claim for deduction of loss due to embezzlement cannot be admitted under section 37(1), because moneys which are withdrawn by an employee out of the business without authority and in fraud of the proprietor can in no sense be said to be 'an expenditure laid out or expended wholly and exclusively' for the purpose of the business - Badridas Daga V/s. CIT [1958] 34 ITR 10 (SC); Associated Banking Corporation of India Ltd. V/s. CIT [1965] 56 ITR 1 (SC).

EXPENDITURE ON TAX PROCEEDINGS

The expenditure which the assessee incurs in persuading the tax authorities in making a reasonable and legitimate assessment is an expenditure laid out wholly and exclusively for the purpose of business - Binodiram Balchand V/s. CIT [1963] 48 ITR 548 (MP).

DONATIONS TO POLITICAL PARTIES

Contributions made by assessee to a political party on the ground that with the changing pattern of the economic structure of the society it was in the interest of the assessee to keep that party in power, were not deductible,

when the facts found did not indicate any nexus between the contributions and the business of the assessee - J.K. Cotton Spg. & Wvg. Mills Co. Ltd. V/s. CIT [1966] 62 ITR 813 (All.).

RAISING DEBENTURE LOAN

Expenditure incurred by a company on stamp duty, registration fee, lawyer's fee, etc., in respect of the issue of debentures by the company to secure a loan, is deductible - Premier Automobiles Ltd. V/s. CIT [1971] 80 ITR 415 (Bom.).

ISSUE OF FRESH CAPITAL

Expenditure incurred on issuing shares to increase its share capital by a company is not allowable as revenue expenditure - Brooke Bond India Ltd. V/s. CIT [1997] 91 Taxman 26 (SC).

When an expenditure is made not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, there is very good reason (in the absence of special circumstances leading to an opposite conclusion) (Must visit kalpeshclasses.com for downloading material for PE2 and Final) for treating such an expenditure as properly attributable not to revenue but to capital. But this is not a strait-jacket formula and the question will have to be determined in the backdrop of the facts of each case. The test laid down can at best be a guide for determining whether a particular expenditure forms part of revenue expenditure or capital expenditure. The fees paid to the Registrar of Companies for expansion of the capital base of a company is directly related to the capital expenditure incurred by the company and although incidentally that would certainly help in the business of the company and may also help in profit-making, it still retains the character of capital expenditure since the expenditure is directly related to the expansion of the capital base of the company. [1997] 225 ITR 0792- Punjab State Industrial Development Corporation Ltd. vs. Commissioner of Income-tax (Supreme Court of India)

ISSUE OF RIGHT SHARES

Where share issue expenses are treated as capital expenditure, there cannot be any good ground to hold that expenses for issue of additional shares by way of right shares can be treated in any other way. Such expenses are also capital in nature - CIT V/s. Motor Industries Co. Ltd. [1988] 173 ITR 374 (Kar.).

PRINTING CHARGES

Expenditure incurred on the drafting and printing of the articles of association of a company is deductible - CIT V/s. Wyman Gordon (India) Ltd. [1983] 144 ITR 911 (Bom.).

Where assessee-company paid certain professional charges to solicitors in connection with effecting amalgamation of certain company with it, and Tribunal's finding was that amalgamation of said company with assessee-company was necessary for smooth and efficient conduct of assessee's business, expenditure incurred by assessee towards professional charges of solicitors was deductible as a revenue expenditure - CIT V/s. Bombay Dyeing & Manufacturing Co. Ltd. [1996] 85 Taxman 369 (SC).

PAYMENTS TO OUTGOING PARTNERS

Where the dissolution deed made it clear that the amounts received by outgoing partners was a consideration for relinquishing their share of right in toto, not only in the stock-in-trade, licences, trade marks, shops, branches, etc., but also in the goodwill, the amounts paid would constitute capital expenditure - CIT V/s. Puran Das Ranchoddas & Sons [1988] 169 ITR 480 (AP).

REMUNERATION TO KARTA

It is necessary that before a karta receives remuneration, it should be under a valid agreement which would justify the payment of remuneration to a karta of a HUF for managing the business of the family. To be deductible under section 37(1), the test which should be applied is whether the agreement has been made by or on behalf of all the members of the HUF and whether it was in the interests of the business of the family so that it could be justified on grounds of commercial expediency. If such remuneration is not excessive and is reasonable and is not a device to escape income-tax, then it will be a legitimate deduction in computing the profits of the business. If, on the other hand, the amount paid is unreasonably high and is disproportionate to the services rendered by the karta, then it may be treated as part of the profits of the HUF distributed in a particular manner - Jugal Kishore Baldeo Sahai V/s. CIT [1967] 63 ITR 238 (SC).

Where turnover and income of firm had increased, a corresponding increase in allowance to karta, who was partner in firm, could not be described as an unreasonable decision or a decision actuated by motives other than business - Brij Mohan V/s. CIT [1993] 69 Taxman 523/201 ITR 831 (SC)

ACCRUED LIABILITIES

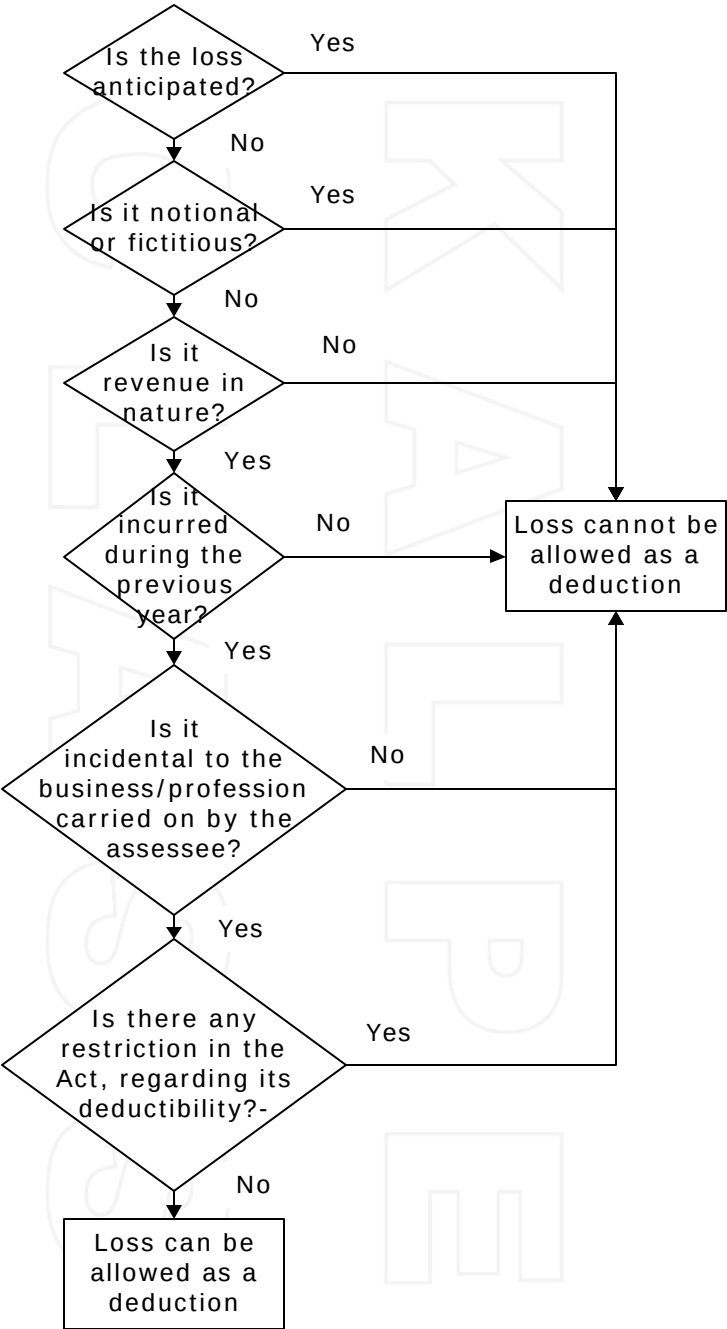
If a liability has accrued during the accounting year but was to be discharged at a future date, the amount to be expended in the discharge of that liability would have to be estimated in order that under the mercantile system of accounting the amount could be debited before it was actually disbursed. The difficulty in the estimation thereof would not convert an accrued liability into a conditional one - Calcutta Co. Ltd. V/s. CIT [1959] 37 ITR 1 (SC).

FOLLOWING RATIO EMERGE BASED ON CLARIFICATION AND INSTRUCTION OF CBDT ISSUED IN PAST.

- 1) The salaries and wages paid to the employees for the period of the training in the courses organised by the Central Board of Workers' Education should be allowed as admissible deductions while computing the income of the employers
- 2) The expenditure by way of membership fee of the Indian Institute of Foreign Trade can be said to be wholly and exclusively incurred for the purpose of business of the members. Therefore, such expenditure may be allowed as admissible deduction under section 37(1) in the hands of the payers in computing their total income from business.
- 3) Expenses incurred by a company on getting its shares listed in a stock exchange should be considered as laid out wholly and exclusively for the purposes of the business and, therefore, admissible as business expenditure under section 37(1).
- 4) Professional tax paid by a person carrying on a business or trade can be allowed to him as a deduction under section 37(1).
- 5) Rebate or bonus (which is in the nature of deferred discount) passed on by the consumer co-operative stores to their members on the value of the purchases made by them during a year should be allowed as a deduction in computing the business income of such a society.
- 6) Reasonable remuneration paid by a company to its Registrar for performing duties in connection with the company's legal obligations to be discharged under the company law should be regarded as revenue expenditure provided the company is not itself maintaining a separate organization for the performance of such duties.
- 7) The expenses incurred in original proceedings for assessment to sales tax as also in appeals arising from such proceedings should be allowed as a deduction in income-tax assessments
- 8) The initial expenditure on the first installation of fluorescent lights, including the expenditure on wiring and fittings, should be treated as capital expenditure as it creates an asset, and all subsequent expenditure for replacement of the tubes should be treated as of a revenue nature, allowable in toto.
- 9) The question of admissibility of expenditure on visits to foreign countries should not be approached from the point of view as to whether such visits result immediately in the earning of profits. All that the law requires is that the expenditure should not be in the nature of capital expenditure or personal expenditure of the assessee, and should be wholly and exclusively laid out for the purposes of the business
- 10) Interest charged by the Government for delay in payment of tax is in the nature of personal liability which cannot be allowed as a deduction in the computation of the taxable income
- 11) Legal expenses incurred in connection with the renewal of lease should be allowed as an admissible deduction for purposes of income-tax provided that the renewal of the lease is for a period of less than fifty years. Expenditure incurred on the compulsory removal of business premises, i.e., in cases where the removal has taken place under the directions of Government should, as in the case of air raid precautions expenditure, be allowed as a deduction for purposes of income-tax.
- 12) Commitment charge payable by a party on the unused portion of the loan which has not been drawn, has to be taken as an expenditure laid out wholly and exclusively for the purposes of the business and, therefore, permissible as a revenue deduction under section 37(1). (Kalpesh Classes Tel. 23820676)
- 13) As the expenses incurred on the occasion of Dewali and mahurat are in the nature of business expenditure, it has been decided not to lay down any monetary limits for the purpose of their allowance.
- 14) It is open to the subscriber either to claim the entire amount paid under the OYT scheme in the year in which the payment is made or proportionately in the years for which advance payment of rent is made. Where the installation of telephone is in the previous year subsequent to the previous year in which the deposit is made, the deduction for the payment should be allowed in the year of payment irrespective of the fact whether the telephone has been installed or not.

- 15) Amount paid by an assessee for obtaining a new telephone connection under the "Tatkal Telephone Deposit Scheme", can be allowed as revenue expenditure in the year of payment. The refund of said amount, if any, will be taxed under section 41(1)-Circular: No. 671,
- 16) Since the deposit of Rs. 10,000 for a telex connection does not earn any interest when the telex machine is installed, at that stage, this amount may be treated as a revenue expenditure allowable as a deduction, if the assessee makes such a claim. However, when the amount is returned by the postal authorities when the telex connection is finally closed, the refund of Rs. 10,000 shall be treated as an income of the assessee of the year in which the amount is refunded.-Circular: No. 420
- 17) With regard to expenses incurred by members of delegation going abroad for exploring new markets for Indian products and similar export promotional activities, all reasonable expenditure incurred by the members of the delegations should be allowed in the assessment of the members concerned.
- 18) Business concerns are required to take the following civil defence measures as part of the civil defence plan in respect of their property:
- Raise, train the following civil defence services at the scale laid down in the Home Ministry's hand books: Messenger service, casualty service, rescue service, etc.
 - Purchase of civil defence equipment, stirrup pump, helmets, sirens, etc., as per prescribed scale.
 - Fire-fighting system is to be brought to the required standard to cope up with likely effect of air raids.
 - A warning system is to be laid to receive air raid warning from the nearest civil defence control centre and disseminate the same to the workers.
 - In addition, some special civil defence measures relating to water supply system, piping system, concealment from glow, etc., are also to be adopted.
- All expenses on civil defence measures may be allowed as revenue expenditure unless any portion thereof is of an enduring nature whose usefulness may be extended beyond the period of emergency in which case depreciation admissible as per rules can be allowed.

Admissibility of trading loss as deduction



SEC.37(2B) DIS-ALLOWANCE OF EXPENDITURE ON ADVERTISEMENT IN MATERIAL PUBLISHED BY A POLITICAL PARTY

Notwithstanding anything contained in sub-section 37(1), no allowance shall be made in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party.

37(2B) provide that, no deduction shall be allowed in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party. It is relevant to note, that the term “political party” has not been defined for the purposes of this provision. As such, the term will bear its ordinary meaning and, therefore, wider connotation for the purposes of this provision.

SEC.38: BUILDING, ETC. PARTLY USED FOR BUSINESS

- (1) Where a part of any premises is used as dwelling house by the assessee -

(a) The deduction under section 30, in the case of rent, shall be such amount as the Assessing Officer may determine having regard to the proportionate annual value of the part used for the purpose of the business or profession, and in the case of any sum paid for repairs, such sum as is proportionate to the part of the premises used for the purpose of the business or profession;

(b) The deduction under section 30 shall be such sum as the Assessing Officer may determine having regard to the part so used.
- (2) Where any building, machinery, plant or furniture is not exclusively used for the purposes of the business or profession, the deductions under section 30, 31 32 shall be restricted to a fair proportionate part thereof which the Assessing Officer may determine, having regard to the user of such building, machinery, plant or furniture for the purposes of the business or profession.

Section 38(2) secures that in a case where the building is only partly used for the purposes of the business or profession, depreciation will be restricted to a proportionate amount.

SEC.40 (a) AMOUNTS NOT DEDUCTIBLE

Notwithstanding anything to the contrary in sections 30 to 38, the following amounts shall not be deducted in computing the income chargeable under the head “Profits and gains of business or profession”, In the case of any assessee

INTEREST, ROYALTY ETC PAYABLE OUT SIDE INDIA	
(i)	Any interest, royalty, fees for technical services or other sum chargeable under this Act, which is payable, (A)outside India; or (B) in India to a non-resident, not being a company or to a foreign company, on which tax has not been deducted or, after deduction, has not been paid before the expiry of the time prescribed Provided that where in respect of any such sum, tax has been deducted or paid in any subsequent year, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.
(ia)	Any interest, commission or brokerage, fees for professional services or fees for technical services payable to a resident, or amounts payable to a contractor or sub-contractor, being resident, for carrying out any work (Must visit kalpeshclasses.com for downloading material for PE2 and Final) (including supply of labour for carrying out any work), on which tax is deductible at source and such tax has not been deducted or, after deduction, has not been paid during the previous year, or in the subsequent year before the expiry of the time prescribed. Provided that where in respect of any such sum, tax has been deducted or paid in any subsequent year, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.
OTHER DIS-ALLOWANCE	
(ii)	Any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains;
(iia)	Any sum paid on account of wealth-tax;
(ib)	Any sum paid on account of securities transaction tax.
(ic)	Any sum paid on account of fringe benefit tax.

(iii)	Any payment which is chargeable under the head “Salaries”, if it is payable (A) outside India; or (B) to a non-resident, and if the tax has not been paid thereon nor deducted there from
(v)	Any tax actually paid by an employer referred to in clause (10CC) of section 10 ; Perquisites Employer Employee Non-Monetary Tax paid by the employer on this is not allowable as deduction

The cess was leviable under the respective statutes on the annual net profits which had to be calculated on the average of the annual net profits for the last three years for which accounts had been made up. The question was whether these cesses paid by the assessee were levied on the basis of profits and gains. Held, that the profits arrived at according to the provisions of the two cess Acts could not be equated to the profits which were determined under the Income tax Act and, therefore, and the cesses paid by the assessee were allowable as deductions in computing its business profits. [1971] 082 ITR 0580- Jaipuria Samla Amalgamated Collieries Ltd. vs. Commissioner of Income-tax (Supreme Court of India)

Surtax is levied on the profits of a company is not deductible. [1996] 219 ITR 0581A Smith Kline and French (India) Ltd. vs. Commissioner of Income-tax (Supreme Court of India)

SEC.40A: EXPENSES OR PAYMENTS NOT DEDUCTIBLE

SEC.40A(2) PAYMENT TO RELATIVES

Where the assessee incurs any **expenditure** in respect of which payment has been or is to be made to any specified person, and the Assessing Officer is of opinion that such **expenditure is excessive or unreasonable** having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him there from, so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction;

SPECIFIED PERSON MEANS:

Where the assessee is an individual	Any relative of the assessee
Where the assessee is a company firm, association of persons or Hindu undivided family	Any director of the company, partner of the firm, or member of the association or family, or any relative of such director, partner or member
Any individual who has a substantial interest in the business or profession of the assessee, or any relative of such individual	
A company, firm, association of persons or Hindu undivided family having a substantial interest in the business or profession of the assessee or any director, partner or member of such company, firm, association or family, or any relative of such director, partner or member;	
A company, firm, association of persons or Hindu undivided family of which a director, partner or member, as the case may be, has a substantial interest in the business or profession of the assessee; or any director, partner or member of such company, firm, association or family or any relative of such director, partner or member	

Any person who carries on a business or profession

Where the assessee being an individual or any relative of such assessee, has a substantial interest in the business or profession of that person; or

Where the assessee being a company, firm, association of persons or hindu undivided family, or any director of such company, partner of such firm or member of the association or family, or any relative of such director, partner or member, has a substantial interest in the business or profession of that person.

Where expenditure incurred in a business or profession for which payment has been or is to be made to the taxpayer’s relatives or associate concerns is liable to be disallowed in computing the profits of the business or profession to the extent the expenditure is considered to be excessive or unreasonable. The reasonableness of any expenditure is to be judged having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession or the benefit derived by, or accruing to, the taxpayer from the expenditure. Such portion of the expenditure which, in the opinion of the Income-tax Officer, is excessive or unreasonable according to these criteria is to be disallowed in computing the profits of the business or profession.

The term “relative”, as defined in section 2(41) means, in relation to an individual, the husband, wife, brother or sister or any lineal ascendant or descendant of that individual. A person will be deemed to have a substantial interest in a business or profession if, in a case where the business or profession is carried on by a company, the person beneficially owns shares in the company (other than preference shares), carrying not less than 20 per cent of the voting power and, in any other case, where the person is beneficially entitled to not less than 20 per cent of the profits of the business or profession.

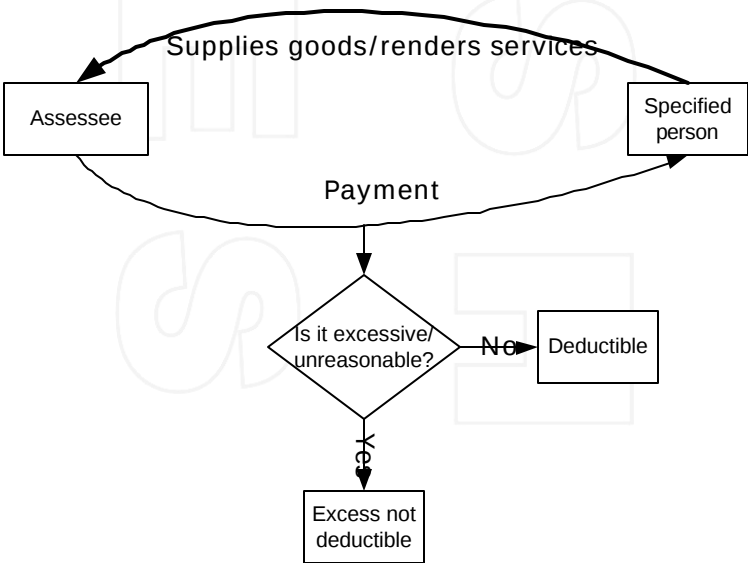
SCOPE OF PROVISION

Section 40A(2)(a) cannot have any application unless it is first held that the expenditure was excessive or unreasonable - Upper India Publishing House (P) Ltd. V/s. CIT [1979] 117 ITR 569 (SC).

The assessee-firm consisted of three partners. The main partner of the firm who was holding one half share in the firm claimed deduction of a certain amount paid as commission at the rate of 9 per cent. to his wife as sole proprietor of a selling agency on the sales effected by the assessee-firm. The Income-tax Officer disallowed the claim under section 40A(2), on the ground that the wife of the partner had hardly invested any capital in her business and was neither educated nor trained to carry on her business and that the expenditure did not satisfy the test of commercial expediency. Held, that the amount in excess of four per cent. claimed as payment of commission was excessive or unreasonable having regard to the circumstances specified in section 40A(2)(a) and the disallowance of the same was justified. [1986] 161 ITR 0876- Ganesh Soap Works vs. CIT (Madhya Pradesh High Court)

MEANING OF ‘SERVICES’

The expression ‘services’ in section 40A(2)(a) is an expression of wide import. The goods, services and facilities referred to in that provision are those which have a market value and which are commercial in character - T.T. (Private) Ltd. V/s. ITO [1980]123 ITR 592 (Mad.)



SEC.40(A)(3) CASH PAYMENT EXCEEDING Rs. 20000

Where the assessee incurs any expenditure in respect of which payment is made, after such date (not being later than the 31st day of March, 1969) as may be specified in this behalf by the Central Government by notification in the Official Gazette, in a sum exceeding twenty thousand rupees otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft, twenty per cent of such expenditure shall not be allowed as a deduction.

Provided further that no disallowance under this sub-section shall be made where any payment in a sum exceeding twenty thousand rupees is made otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft, in such cases and under such circumstances as may be prescribed, having regard to the nature and extent of banking facilities available, considerations of business expediency and other relevant factors.

Cheque transactions carry conviction Entries in the accounts, whether by way of cash borrowings or other credits in the books classed as cash credits, or any payment which is chargeable in trading or P/L Account made in cash are to be proved. (Must visit kalpeshclasses.com for downloading material for PE2 and Final) The same amount if received by cheque or paid by cheque carries greater conviction. The preference for cheque transactions as better proof of transactions has found its way in the statute as well in section 40A(3), section 269SS and 269T. It is very unfortunate that there should be so much faith in bank transactions as proof of genuineness since it is as easy to disguise cheque payments with reference to cheque transactions as in cash. Notwithstanding the fact that there could be tax evasion by adoption of cheque as a mode of payment, statutes as well as practice place greater faith in cheque transactions. Trade practice or the exigencies of business requiring cash payment in certain urgent circumstances, or where it is prompted by other considerations like lack of faith in the other party, a taxpayer may find himself in difficulties when he has to accept cash. The fact that banks take an unduly long time for cashing cheques, especially when they are out-station instruments is also a circumstance which is not taken into consideration when explanation is given for preference of cash to cheque. The payments made in advancing loans and returning the principal amount of borrowed moneys are not covered by these provisions of section 40A(3), as these do not constitute 'expenditure'.

This provision is designed to counter evasion of tax through claims for expenditure shown to have been incurred in cash with a view to frustrating proper investigation by the Department as to the identity of the payee and the reasonableness of the payment. Lot of hardship is faced by assesseees, especially to transport and civil contractors and others, who are engaged in trades where, looking to the exigencies of business, payment has to be made in cash. In order to remove their hardship, fair limit of twenty thousand rupees is kept.

It may be noted that the provision in section 40A(3) is applicable to all categories of expenditure incurred in businesses and professions, including expenditure on purchase of raw materials, stores or goods, salaries to employees and also other expenditure or professional services, or by way of brokerage, commission, interest, etc. By this test, therefore, the provision does not apply to the advancement of loans or repayment of the principal amount of any loan, as these do not constitute expenditure deductible in computing taxable income.

The word 'sum' under section 40A(3) is with reference to the amount of money paid and not to the totality of expenditure as was pointed out in CIT v. Aloo Supply Co. where the Income-tax Department canvassed the view that it applies to the expenditure incurred by the assessee so that different installments covered by such payments would be liable for cheque payment where the transaction exceeds the limit. The cheque must be crossed. Splitting up of the payment would satisfy the requirements of law though potential splitting up where the payment is made on the same day consecutively would certainly be a manner of circumventing the law which can easily be rejected as not a genuine arrangement. But where the payment is made on different occasions even on same day, there is no reason why the claim should be treated as not being a genuine arrangement. It may be possible to show that the payments made on the same day were made on different occasions.

Where there are three parties, A, B and C, where A owes money to B, and B owes money to C, it is possible for B to ask A to take over the responsibility of repayment to C as long as C is agreeable to it. In such an event B would be repaying the money owed to C by a book entry crediting A and debiting C. In the case of A he would debit B and credit C, while C would credit B and debit A. There has been both borrowing and repayment as between the different parties with no cash passing between them. It cannot be said that this should have been done only by account-payee cheque as between the parties.

The object of the provision to have transparency or to have identification of the parties is also an advantage as there are three parties involved with the result that collusion which is possible where two parties are involved in transactions in cash, is practically ruled out. The third party without being a bank, may serve the purpose of a bank where both the parties to the transaction have an account with such third party.

ALL OUTGOINGS, INCLUDING PURCHASE OF STOCK-IN-TRADE ARE COVERED

Section 40A(3) refers to the expenditure incurred by the assessee in respect of which payment is made. It means all outgoings are brought under the word 'expenditure' for the purpose of the sub-section. The expenditure for purchasing the stock-in-trade is one of such outgoings. - Attar Singh Gurmukh Singh v. ITO [1991] 191 ITR 667 (SC). The word "expenditure" in section 40A(3) has not been defined in the Act. It is a word of wide import. Section 40A(3) refers to the expenditure incurred by the assessee in respect of which payment is made. It means that all outgoings are brought under the word "expenditure" for the purpose of the section. The expenditure for purchasing stock-in-trade is one of such outgoings. Section 40A(3) is, therefore, attracted to payments made for acquiring stock-in-trade and other materials. [1991] 191 ITR 0667W Attar Singh Gurmukh Singh vs. ITO (Supreme Court of India)

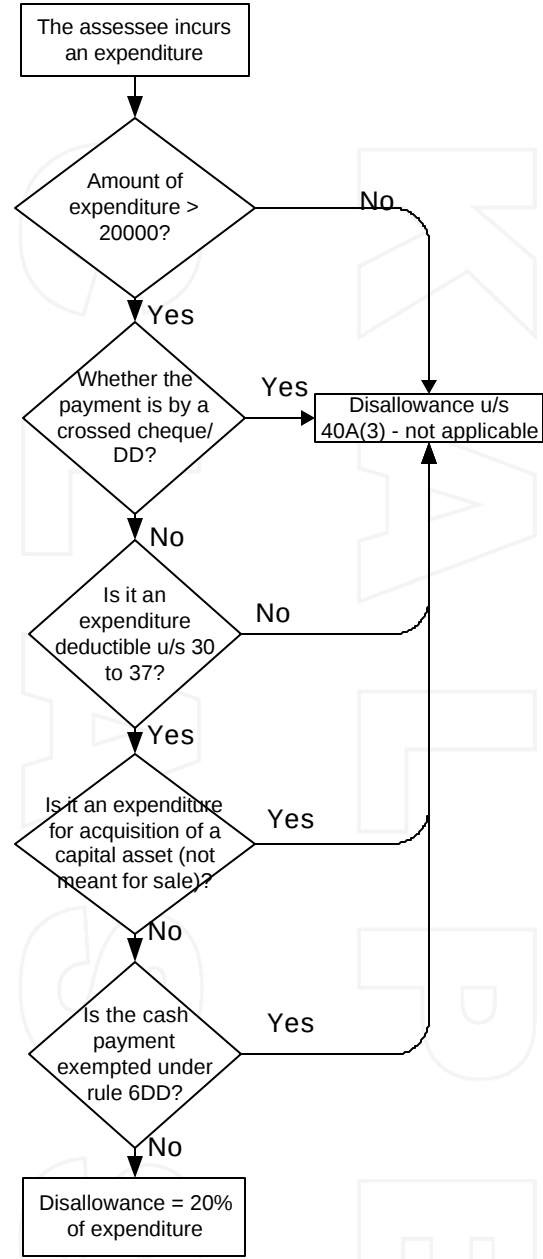
ADVANCE PAYMENTS ARE ALSO COVERED

Even if the payments were made by way of advances and were ultimately treated as discharging the liability to pay the price of the goods purchased, the payments so made must be considered to fall within the expression 'expenditure' incurred for payment of the price of the goods - Kejriwal Iron Stores v. CIT [1988] 169 ITR 12 (Raj.).

LIMIT APPLIES TO PAYMENT TO A PARTY AT ONE TIME

The statutory limit of Rs. 20,000 applies to payment made to a party at one time and not to the aggregate of the payments made to a party in the course of the day as recorded in the cash book. The word 'sum' in section 40A(3) is used only to indicate an amount of money and does not refer to the totality of the expenditure. - CIT v. Aloo Supply Co. [1980] 121 ITR 680 (Ori.).

The word "sum" in section 40A(3), is used only to indicate an amount of money and does not refer to the totality of the expenditure. Therefore, if an assessee makes payments at different times during the day and he has no idea that he has to pay to the same person on more than one occasion, he cannot be subjected to the statutory provision contained in section 40A(3) of the Act, unless any one payment is above Rs. 20,000. (Must visit kalpeshclasses.com for downloading material for PE2 and Final) The statutory limit of Rs. 20,000 under section 40A(3) of the Act applies to payment made to a party at a time and not to the aggregate of the payments made to a party in the course of the day as record in the cash book. [1980] 121 ITR 0680- CIT vs. Aloo Supply Co. (Orissa High Court)



SEC.41(1): PROFITS CHARGEABLE TO TAX

Where an allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee (hereinafter referred to as the first-mentioned person) and subsequently during any previous year -

- (a) The has obtained, whether in cash or in any other manner whatsoever, any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by such person or the value of benefit accruing to him shall be deemed to be profits and gains of business or profession and accordingly chargeable to income-tax as the income of that previous year, whether the business or profession in respect of which the allowance or deduction has been made is in existence in that year or not; or
- (b) The successor in business has obtained, whether in cash or in any other manner whatsoever, any amount in respect of which loss or expenditure was incurred by the first-mentioned person or some benefit in respect of the trading liability referred to in clause (a) by way of remission or cessation thereof, the amount obtained by the successor in business or the value of benefit accruing to the successor in business shall be deemed to be profits and gains of the business or profession, and accordingly chargeable to income-tax as the income of that previous year. (Kalpesh Classes Tel. 23820676)

Explanation 1 - For the purposes of this sub-section, the expression “loss or expenditure or some benefit in respect of any such trading liability by way of remission or cessation, thereof” shall include the

remission or cessation of any liability by a unilateral act by the first mentioned person under clause (a) or the successor in business under clause (b) of that sub-section by way of writing off such liability in his accounts.

Explanation 2. For the purposes of this sub-section, “successor in business” means,-

- (i) Where there has been an amalgamation of a company with another company, the amalgamated company;
- (ii) Where the first-mentioned person is succeeded by any other person in that business or profession, the other person;
- (iii) Where a firm carrying on a business or profession is succeeded by another firm, the other firm
- (iv) Where there has been a demerger, the resulting company.**

IT MUST BE PROVED THAT ALLOWANCE OR DEDUCTION WAS GIVEN IN AN EARLIER YEAR

Unless it is proved that an allowance or deduction has been made in the assessment in any previous year in respect of loss, expenditure or trading liability, it is not open to the revenue to refer to section 41(1) for charging the tax on the receipt by the assessee by refund or otherwise of such expenditure in a subsequent year - Tirunelveli Motor Bus Service Co. (P.) Ltd. v. CIT [1970] 78 ITR 55 (SC).

SALES TAX COLLECTED / SALES TAX REFUND RECEIVED

The assessee in the course of sale of its products collected amounts towards possible liability to sales tax from the purchasers. The amounts collected as sales tax were deposited by the assessee with the Government and the assessee was allowed deduction of the same. The provisions relating to sales tax were under challenge and ultimately the provisions were struck down by the High Court. Consequently, the assessee obtained refund of the amount of sales tax deposited with the Government. The Income-tax Officer held that the refund received by the assessee was taxable trading profit for the relevant year. Held, that the sales tax collected by the assessee had to be treated as its income and any payment of sales tax made by the assessee was equally liable to be deducted from its profits. If any deduction was given from the assessee's income, and later the same was refunded to the assessee, the refund would have the character of a revenue receipt. The amount of sales tax refunded to the assessee by the Government was a revenue receipt liable to tax under the express provisions of section 41(1) of the Act. However, the assessee would be entitled to claim deduction of the amount of refund of sales tax received from the Government as and when the same was refunded to the purchasers. CIT v. Thirumalaiswamy Naidu & Sons [1998] 98 Taxman 57 (SC).

The appellant, a private company dealing in furniture, also acted as an auctioneer. In respect of the sales effected by it as auctioneer, the appellant realised in addition to the commission, Rs. 32,986 as sales tax. This amount was credited separately in its account books under the head "Sales tax collection account". The appellant did not pay the amount of sales tax to the actual owner of the goods. Nor did it deposit the amount realised by it as sales tax in the State Exchequer, because it took the position that the statutory provision creating that liability upon it was not valid, or refund it to the persons from whom it had been collected. Held that, the sum of Rs. 32,986 realised as sales tax by the appellant in its character as an auctioneer formed part of its trading or business receipts. That the fact that the appellant credited the amount received as sales tax under the head "sales tax collection account" did not make any material difference. It is the true nature and quality of the receipt and not the head under which it is entered in the account books as would prove decisive. If a receipt is a trading receipt, the fact that it is not so shown in the account books of the assessee would not prevent the assessing authority from treating it as trading receipt. [1973] 087 ITR 0542A Chowringhee Sales Bureau P. Ltd. vs. CIT (Supreme Court of India)

SEC.43B: CERTAIN DEDUCTIONS TO BE ONLY ON ACTUAL PAYMENT.

Deduction in respect of the following sums is allowed only on “payment” basis (not on due basis) even if books of account are maintained on the basis of mercantile system of accounting:

Expenses	Time for Payment
Any sum payable by way of tax, duty, cess or fee, by whatever name called under any law for the time being in force	Payment should be made either during the relevant previous year or on or before the due date for furnishing return of income under section 139(1).
Any sum payable by an employer by way of contribution to provident fund or superannuation fund or any other fund for the welfare of employees	
Any sum payable as bonus or commission to employees for service rendered	
Any sum payable as interest on any loan or borrowing from a public financial institution (i.e. ICICI, IFCI, IDBI, LIC and UTI) or a state financial corporation or a state industrial investment corporation	
Interest on any loans and advances taken from a scheduled bank. (The act include a co-operative bank within the meaning of the term “scheduled bank”)	
Any sum payable by the assessee as an employer in lieu of any leave at the credit of his employee.	

Section 43B of the Income-tax Act, 1961, opens with a non-obstante clause which means that irrespective of other provisions, section 43B will have overriding effect. The intention of the Legislature is to allow deduction in respect of any tax or duty in computing under section 28 the income of that previous year in which such sum is actually paid by the assessee. The intention is made more specific by providing that it would be so irrespective of the previous year in which the liability to pay such sum was incurred by the assessee according to the method of accounting regularly employed by the assessee. [1986] 162 ITR 0240A Lakhanpal National Ltd. vs. ITO (Gujarat High Court)

44AA. MAINTENANCE OF ACCOUNTS BY CERTAIN PERSONS CARRYING ON PROFESSION OR BUSINESS.

Category of the Person	Whether to Maintain books as per income tax act.
Every person carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or any other profession as is notified by the Board in the Official Gazette.	Shall keep and maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of this Act. For the Boards clarification vide Rule 6F Refer Note No. 1
Every person carrying on business or profession if his income from business or profession exceeds one lakh twenty thousand rupees or his total sales, turnover or gross receipts, as the case may be, in business or profession exceed or exceeds ten lakh rupees in any one of the three years immediately preceding the previous year. Where the business or profession is newly set up in any previous year than during such previous year	Keep and maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of this Act.
Where the profits and gains from the business are deemed to be the profits and gains of the assessee under section 44AD or section 44AE or section 44AF, or section 44BB or section 44BBB and the assessee has claimed his income to be lower than the profits or gains so deemed to be the profits and gains of his business, during such previous year,	Keep and maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of this Act.

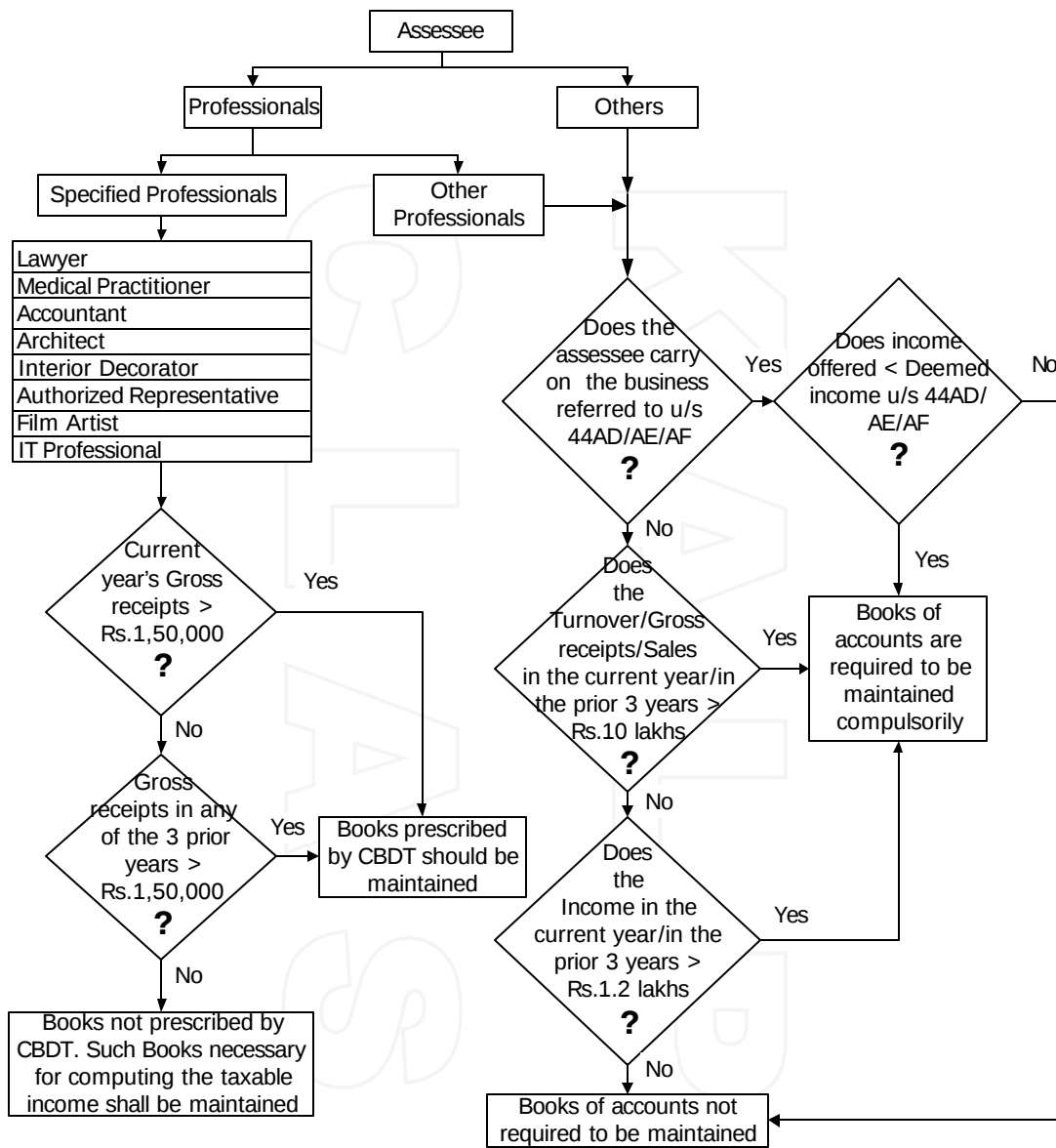
Note No.1

As per rule 6F a cash book; a journal, a ledger; carbon copies of bills, original bills wherever issued to the person and receipts in respect of expenditure incurred by the person is required to be maintained by such person. A person carrying on medical profession shall, in addition to the books of account and other documents specified above shall keep and maintain the following, namelya daily case register in Form No.3C and an inventory under broad heads, as on the first and the last day of the previous year, of the stock of drugs, medicines and other consumable accessories used for the purpose of his profession.

Provided that no books shall be maintained in any previous year in the case of any person if his total gross receipts in the profession do not exceed one lakh fifty thousand rupees in any one of the three years, immediately preceding the previous year, or, where the profession has been newly set up in the previous year, his total gross receipts in the profession for that year are not likely to exceed the said amount.

FAILURE TO KEEP, MAINTAIN OR RETAIN BOOKS OF ACCOUNT, DOCUMENTS, ETC. 271A

If any person, fails to keep and maintain any such books of account and other documents as required by section 44AA or the rules made thereunder, in respect of any previous year or to retain such books of account and other documents for the period specified in the said rules, the Assessing Officer or the Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum of twenty-five thousand rupees.



44AB. AUDIT OF ACCOUNTS OF CERTAIN PERSONS CARRYING ON BUSINESS OR PROFESSION.

Every person carrying on business	If his total sales, turnover or gross receipts, as the case may be, in business exceed or exceeds forty lakh rupees in any previous year get his accounts of such previous year audited by an accountant before the specified date and furnish by that date the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed:
Every person carrying on profession shall	If his gross receipts in profession exceed ten lakh rupees in any previous year get his accounts of such previous year audited by an accountant before the specified date and furnish by that date the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed: (Kalpesh Classes Tel. 23820676)
Every person Carrying on the business shall, if covered by section 44AD or 44AE or 44AF or section 44BB or section 44BBB and he has claimed his income to be lower than the profits or gains so deemed to be the profits and gains of his business, in any previous year.	Get his accounts of such previous year audited by an accountant before the specified date and furnish by that date the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed. There is no turnover criteria for such cases.

MEANING OF "SPECIFIED DATE"

Specified date in relation to the accounts of the assessee means 31st October of the assessment year.

OBJECTIVE OF TAX AUDIT

A proper audit for tax purposes would ensure that the books of account and other records are properly maintained, that they faithfully reflect the income of the taxpayer and claims for deduction are correctly made by him. Such audit would also help in checking fraudulent practices. It can also facilitate the administration of tax laws by a proper presentation of the accounts before the tax authorities and considerably saving the time of assessing officers in carrying out routine verifications, like checking correctness of totals and verifying whether purchases and sales are properly vouched or not. The time of the assessing officers thus saved could be utilised for attending to more important investigational aspects of a case.

APPLICABILITY TO COMMISSION AGENTS

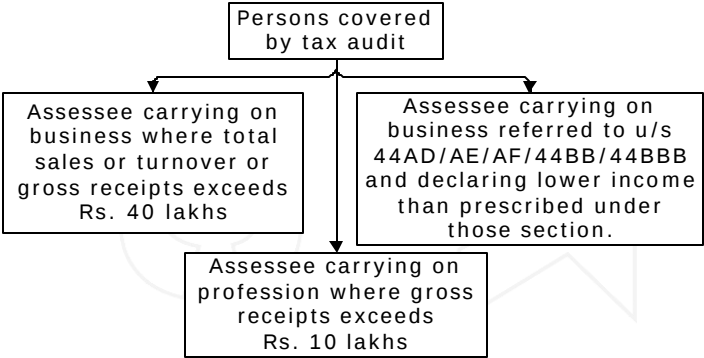
If the commission agent does not sell the goods of his principal as his own and only charges commission for bringing two persons to holy marriage of sale and purchase, then he will not come within the ambit of section 44AB, except when his Professional receipts exceed Rs. 10 lakhs - Abhay Kumar & Co. v. Union of India [1987] 164 ITR 148 (Raj.)

CHARTERED ACCOUNTANT’S DUTIES

The position of chartered accounts representing the assessee is similar to that of advocates representing parties in court and their obligations are similar to those of the advocates. The accountant is under a duty to prepare and present correct statements of the accounts of the assessee, and he should of course neither suggest nor assist in the preparation of false accounts. But he is under no duty to investigate whether the accounts produced by the assessee are correct or not. That is a matter for the decision of the Income-tax Tribunals - CIT v. G.M. Dandekar [1952] 22 ITR 235 (Mad.).

PENALTY FOR FAILURE TO GET THE BOOKS OF ACCOUNTS AUDITED. SECTION 271B.

If any person fails, to get his accounts audited in respect of any previous year or years relevant to an assessment year or furnish a report of such audit as required under section 44AB, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum equal to one-half per cent. of the total sales, turnover or gross receipts, as the case may be, in business, or of the gross receipts in profession, in such previous year or years or a sum of one hundred thousand rupees, whichever is less.



44AD. SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS OF BUSINESS OF CIVIL CONSTRUCTION, ETC.

In the case of an assessee engaged in the business of **civil construction** or supply of labour for civil construction, a sum equal to **eight per cent.** of the gross receipts paid or payable to the assessee in the previous year on account of such business or, as the case may be, a sum higher than the aforesaid sum as declared by the assessee in his return of income, shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession". Provided this scheme shall not apply in case the aforesaid gross receipts paid or payable exceed an amount of **forty lakh rupees**.

WHEN THIS SCHEME APPLIES

Any deduction allowable under the provisions of sections 30 to 38 shall, be deemed to have been already given full effect to and no further deduction under those sections shall be allowed.

Where the assessee is a firm, the salary and interest paid to its partners shall be deducted from the income computed subject to the conditions and limits specified in section 40(b). The written down value of any asset used for the purpose of the business shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment years. The provisions of sections 44AA and 44AB shall not apply in so far as they relate to the business referred and in computing the monetary limits under those sections, the gross receipts or, as the case may be, the income from the said business shall be excluded.

Explanation.--For the purposes of this section, the expression "civil construction" includes--

- (a) The construction or repair of any building, bridge, dam or other structure or of any canal or road;
- (c) The execution of any works contract.

WHEN LESS PROFIT IS CLAIMED

An assessee may claim lower profits and gains than the profits and gains as per the scheme, if he keeps and maintains such books of account and other documents as required under section 44AA and gets his accounts audited and furnishes a report of such audit as required under section 44AB.

FEATURES OF THE SCHEME

The Estimated Income Method of assessment for certain categories of businesses is prevalent in several countries. The Tax Reforms Committee had recommended gradual introduction of the Estimated Income Method in certain areas to facilitate better tax compliance. Accordingly, section 44AD provide for a method of estimating income from the business of civil construction or supply of labour for civil construction work. The section is applicable to all assesseees whose gross receipts from the abovementioned business do not exceed Rs. 40 lakhs. Gross receipts are the amount received from the clients for the contract and will not include the value of material supplied by the client. The income from the above-mentioned business will be estimated at 8 per cent of the gross receipts paid or payable to an assessee. A taxpayer can voluntarily declare a higher income in his return. he rate of 8 per cent is comprehensive. All deductions under sections 30 to 38 including depreciation, will be deemed to have been already allowed and no further deduction will be allowed under these sections.

44AE. SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS OF BUSINESS OF PLYING, HIRING OR LEASING GOODS CARRIAGES.

In the case of an assessee, who owns **not more than ten goods** at any time during the previous year carriages and who is engaged in the business of plying, hiring or leasing such goods carriages, the income of such business chargeable to tax under the head "Profits and gains of business of profession" shall be deemed to be the aggregate of the profits and gains, from all the goods carriages owned by him in the previous year, computed as follows

Heavy goods vehicle	Shall be an amount equal to three thousand Five Hundred rupees for every month or part of a month during which the heavy goods vehicle is owned by the assessee in the previous year or, as the case may be, an amount higher than the aforesaid amount as declared by him in his return of income
Other than a heavy goods vehicle	Shall be an amount equal to Three thousand one hundred & Fifty only rupees for every month or part of a month during which the goods carriage is owned by the assessee in the previous year or, as the case may be, an amount higher than the aforesaid amount as declared by him in his return of income.

WHEN THIS SCHEME APPLIES

Any deduction allowable under the provisions of sections 30 to 38 shall, be deemed to have been already given full effect to and no further deduction under those sections shall be allowed.

Where the assessee is a firm, the salary and interest paid to its partners shall be deducted from the income computed subject to the conditions and limits specified in section 40(b). The written down value of any asset used for the purpose of the business shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment years. The provisions of sections 44AA and 44AB shall not apply in so far as they relate to the business referred and in computing the monetary limits under those sections, the gross receipts or, as the case may be, the income from the said business shall be excluded.

- (a) The expressions "goods carriage" and "heavy goods vehicle" shall have the meanings respectively assigned to them in section 2 of the Motor Vehicles Act, 1988 (59 of 1988);
- (b) An assessee, who is in possession of a goods carriage, whether taken on hire purchase or on instalments and for which the whole or part of the amount payable is still due, shall be deemed to be the owner of such goods carriage.

WHEN LESS PROFIT IS CLAIMED

An assessee may claim lower profits and gains than the profits and gains as per the scheme, if he keeps and maintains such books of account and other documents as required under section 44AA and gets his accounts audited and furnishes a report of such audit as required under section 44AB.

FEATURES OF THE SCHEME

A section 44AE provide for a method of estimating income from the business of plying, hiring or leasing trucks owned by a taxpayer. The scheme applies to persons owning not more than ten trucks. It is not applicable to the persons who do not own any truck but operate trucks taken on hire. The income from each truck, being a heavy goods vehicle, will be estimated at Rs. 3500 for every month or part of a month during which the truck is owned by the assessee. The income from each truck, other than a heavy goods vehicle, will be estimated at Rs. 3150 for every month or part of a month during which the truck is owned by the assessee. In either case, the taxpayer can declare his income from trucks at a higher amount than that specified above. The estimated income is comprehensive. All deductions under sections 30 to 38 including depreciation, will be deemed to have been already allowed and no further deduction will be allowed under these sections.

Illustration (1): An assessee owns a light commercial vehicle for 9 months 15 days, a medium goods vehicle for 9 months and a medium goods vehicle for 12 months during the previous year. His profits and gains from the three trucks shall be deemed to be $(Rs. 3150 \times 10) + (Rs.3150 \times 9) + (Rs. 3150 \times 12)$

Illustration (2): An assessee owns a heavy goods vehicle for 9 months 7 days, a medium goods vehicle for 9 months and a light commercial vehicle for 12 months during the previous year. His profits and gains from the three trucks shall be deemed to be $(Rs. 3500 \times 10) + (Rs. 3150 \times 9) + (Rs. 3150 \times 12)$

SPECIAL PROVISIONS FOR COMPUTING PROFITS AND GAINS OF RETAIL BUSINESS.**SEC.44AF:**

In order to simplify the procedure of computation of income of retail trades, a scheme for computing profits and gains of such businesses presumptively at five per cent of the gross receipts is prescribed. This scheme is similar to the presumptive schemes of computation of income under section 44AD or section 44AE

In the case of an assessee engaged in **retail trade** in any goods or merchandise, a sum equal to **five per cent** of the total turnover in the previous year on account of such business or, as the case may be, a sum higher than the aforesaid sum as declared by the assessee in his return of income shall be deemed to be the profits and gains of such business chargeable to tax under the head “Profits and gains of business or profession” Provided that this scheme shall not apply in respect of an assessee whose total turnover exceeds an amount of **forty lakh rupees** in the previous year.

WHEN THIS SCHEME APPLIES

Any deduction allowable under the provisions of sections 30 to 38 shall, be deemed to have been already given full effect to and no further deduction under those sections shall be allowed.

Where the assessee is a firm, the salary and interest paid to its partners shall be deducted from the income computed subject to the conditions and limits specified in section 40(b). The written down value of any asset used for the purpose of the business shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment years. The provisions of sections 44AA and 44AB shall not apply in so far as they relate to the business referred and in computing the monetary limits under those sections, the gross receipts or, as the case may be, the income from the said business shall be excluded.

WHEN LESS PROFIT IS CLAIMED

An assessee may claim lower profits and gains than the profits and gains as per the scheme, if he keeps and maintains such books of account and other documents as required under section 44AA and gets his accounts audited and furnishes a report of such audit as required under section 44AB.

Provisions of sections 44AD, 44AE and 44AF of the Income-tax Act, presumptive tax schemes are provided for computing the profits and gains of the business of civil construction, the business of plying, hiring or leasing goods carriages, and retail trade in any goods or merchandise, respectively. There is no requirement for the assessee to maintain books of account for such businesses and to get them audited, if the deemed profits and gains are taken as taxable profits of such businesses. The Act now provide for enabling provisions so as to allow an assessee to claim his income to be lower than the deemed profits and gains, subject to the condition that the books of account and other documents are kept and maintained as required under section 44AA(2) and the assessee gets his accounts audited and furnishes a report of such audit as prescribed under section 44AB.

SEC. 44BBB SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS OF FOREIGN COMPANIES ENGAGED IN THE BUSINESS OF CIVIL CONSTRUCTION, ETC., IN CERTAIN TURNKEY POWER PROJECTS.

In the case of an assessee, being a foreign company, engaged in the business of civil construction or the business of erection of plant or machinery or testing or commissioning thereof, in connection with a turnkey power project approved by the Central Government in this behalf a sum equal to ten per cent of the amount paid or payable (whether in or out of India) to the said assessee or to any person on his behalf on account of such civil construction, erection, testing or commissioning shall be deemed to be the profits and gains.

WHEN LESS PROFIT IS CLAIMED

An assessee may claim lower profits and gains if he keeps and maintains such books of account and other documents as required under 44AA and gets his accounts audited and furnishes a report of such audit as required under section 44AB, and thereupon the Assessing Officer shall proceed to make an assessment of the total income or loss of the assessee section 143(3) and determine the sum payable by, or refundable to, the assessee.

SEC. 44C DEDUCTION OF HEAD OFFICE EXPENDITURE IN THE CASE OF NON-RESIDENTS.

In the case of an assessee, being a non-resident, no allowance shall be made, in computing the income chargeable under the head "Profits and gains of business or profession", in respect of so much of the expenditure in the nature of head office expenditure as is in excess of the amount computed as hereunder, namely:

- 1) An amount equal to five per cent of the adjusted total income; or
- 2) The amount of so much of the expenditure in the nature of head office expenditure incurred by the assessee as is attributable to the business or profession of the assessee in India

whichever is the least [Provided that in a case where the adjusted total income of the assessee is a loss, the amount under clause (a) shall be computed at the rate of five per cent of the average adjusted total income (average of three years) of the assessee.]

"ADJUSTED TOTAL INCOME" MEANS

The total income computed in accordance with the provisions of this Act, without giving effect to the allowance referred to in this section or in sub-section (2) of section 32 or the deduction referred to in section 32A or section 33 or section 33A or the first proviso to clause (ix) of sub-section (1) of section 36 or any loss carried forward under sub-section (1) of section 72 or sub-section (2) of section 73 or sub-section (1) 14[or sub-section (3)] of section 74 or sub-section (3) of section 74A or the deductions under Chapter VI-A;

"HEAD OFFICE EXPENDITURE" MEANS

Executive and general administration expenditure incurred by the assessee outside India, including expenditure incurred in respect of

- 1) Rent, rates, taxes, repairs or insurance of any premises outside India used for the purposes of the business or profession;
- 2) Salary, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profits in lieu of or in addition to salary, whether paid or allowed to any employee or other person employed in, or managing the affairs of, any office outside India;
- 3) Travelling by any employee or other person employed in, or managing the affairs of, any office outside India; and
- 4) Such other matters connected with executive and general administration as may be prescribed.

SEC. 44DA SPECIAL PROVISION FOR COMPUTING INCOME BY WAY OF ROYALTIES, ETC., IN CASE OF NON-RESIDENTS

The income by way of royalty or fees for technical services received from Government or an Indian concern in pursuance of an agreement made by a non-resident (not being a company) or a foreign company with Government or the Indian concern after the 31st day of March, 2003, where such non-resident (not being a company) or a foreign company carries on business in India through a permanent establishment situated therein, or performs professional services from a fixed place of profession situated therein, and the right, property or contract in respect of which the royalties or fees for technical services are paid is effectively connected with such permanent establishment or fixed place of profession, as the case may be, shall be computed under the head "Profits and gains of business or profession" in accordance with the provisions of this Act :

NO DEDUCTION SHALL BE ALLOWED,

- 1) In respect of any expenditure or allowance which is not wholly and exclusively incurred for the business of such permanent establishment or fixed place of profession in India; or
- 2) In respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to its head office or to any of its other offices.

COMPULSORY TAX AUDIT

Every non-resident (not being a company) or a foreign company shall keep and maintain books of account and other documents in accordance with the provisions of 44AA and get his accounts audited by chartered accountant and furnish along with the return of income, the report of such audit in the prescribed form duly signed and verified by such chartered accountant.

BUSINESS OF EXTRACTION OR PRODUCTION OF MINERAL OILS**SECTION 42.**

For the purpose of computing the profits or gains of any business consisting of the prospecting for or extraction or production of mineral oils [“mineral oil” includes petroleum and natural gas.] in relation to which the Central Government has entered into an agreement with any person there shall be made in lieu of, or in addition to, the allowances admissible under this Act, such allowances as are specified in the agreement.

- (a) To expenditure by way of infructuous or abortive exploration expenses in respect of any area surrendered prior to the beginning of commercial production by the assessee ;
- (b) After the beginning of commercial production, to expenditure incurred by the assessee, whether before or after such commercial production, in respect of drilling or exploration activities or services or in respect of physical assets used in that connection,
- (c) To the depletion of mineral oil in the mining area in respect of the assessment year relevant to the previous year in which commercial production is begun and for such succeeding year or years as may be specified in the agreement;

SEC. 44BB SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS IN CONNECTION WITH THE BUSINESS OF EXPLORATION, ETC., OF MINERAL OILS.

In the case of an assessee, being a non-resident, engaged in the business of providing services or facilities in connection with, or supplying plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils, a sum equal to ten per cent of the aggregate of the amounts specified shall be deemed to be the profits and gains [Provided that this section shall not apply in a case where the provisions of section 42 or section 44D or section 115A or section 293A apply for the purposes of computing profits or gains or any other income referred to in those sections. (Kalpesh Clases. Raja Ram Mohan Roy Marg, 198 Diamond queen building, Mumbai 400 004. Maharashtra.)

The specified amounts shall be

- 1) The amount paid or payable (whether in or out of India) to the assessee or to any person on his behalf on account of the provision of services and facilities in connection with, or supply of plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils in India; and
- 2) The amount received or deemed to be received in India by or on behalf of the assessee on account of the provision of services and facilities in connection with, or supply of plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils outside India.

WHEN LESS PROFIT IS CLAIMED

An assessee may claim lower profits and gains than the profits and gains as specified, if he keeps and maintains such books of account and other documents as required under 44AA and gets his accounts audited and furnishes a report of such audit as required under 44AB, and thereupon the Assessing Officer shall proceed to make an assessment of the total income or loss of the assessee under section 143(3) and determine the sum payable by, or refundable to, the assessee.

EXPLANATION

“plant” includes ships, aircraft, vehicles, drilling units, scientific apparatus and equipment, used for the purposes of the said business; (ii) “mineral oil” includes petroleum and natural gas.

POWER TO MAKE EXEMPTION, ETC., IN RELATION TO PARTICIPATION IN THE BUSINESS OF PROSPECTING FOR, EXTRACTION, ETC., OF MINERAL OILS. SECTION 293A

If the Central Government is satisfied that it is necessary or expedient so to do in the public interest, it may, by notification in the Official Gazette, make an exemption, reduction in rate or other modification in respect of income-tax in favour of any class of persons specified

SPECIFIED PERSONS ARE

- (a) Persons with whom the Central Government has entered into agreements for the association or participation of that Government or any person authorised by that Government in any business consisting of the prospecting for or extraction or production of mineral oils;
- (b) Persons providing any services or facilities or supplying any ship, aircraft, machinery or plant (whether by way of sale or hire) in connection with any business consisting of the prospecting for or extraction or production of mineral oils carried on by that Government or any person specified by that Government in this behalf by notification in the Official Gazette; and
- (c) Employees of the persons referred to in clause (a) or clause (b).

CHAPTER - 03

DEEMED INCOME

CERTAIN CASES OF DEEMED INCOME**SECTION 68. CASH CREDITS.**

Where any sum is found credited in the books of an assessee maintained for any previous year, and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the sum so credited may be charged to income-tax as the income of the assessee of that previous year.

The Assessing Officer before invoking the power under section 68 must be satisfied that there are books of account maintained by the assessee and the cash credit recorded in the said books of account. The existence of books of account is a condition precedent for invoking of the power.

IF EXPLANATION OF ASSESSEE IS UNSATISFACTORY

In view of section 68, where any sum is found credited in the books of the assessee for any previous year, the same may be charged to income-tax as the income of the assessee of the previous year if the explanation offered by the assessee about the nature and source thereof, is, in the opinion of the Assessing Officer, not satisfactory. In such case there is prima facie evidence against the assessee, viz., the receipt of money, and if he fails to rebut the same, the said evidence being un rebutted can be used against him by holding that it is a receipt of an income nature. While considering the explanation of the assessee, the department cannot, however, act unreasonable - Sumati Dayal v. CIT [1995] 80 Taxman 89/214 ITR 801 (SC).

ASSESSEE MUST ESTABLISH IDENTITY OF CREDITORS, THEIR CREDITWORTHINESS AND GENUINENESS OF TRANSACTIONS

It is necessary for the assessee to prove prima facie the identity of his creditors, the capacity of such creditors to advance the money and genuineness of the transactions. Only when these things are proved by the assessee prima facie and only after the assessee has adduced evidence to establish the aforesaid facts that the onus shifts on to the Department. It is not enough to establish the identity of the creditors. Mere production of confirmatory letters before the ITO would not by itself prove that the loans have been obtained from those loan creditors or that they have creditworthiness - CIT v. United Commercial & Industrial Co. (P.) Ltd. [1991] 187 ITR 596 (Cal.)

SECTION 69. UNEXPLAINED INVESTMENTS

Where in the financial year immediately preceding the assessment year the assessee has made investments which are not recorded in the books of account, if any, maintained by him for any source of income, and the assessee offers no explanation about the nature and source of the investments or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the value of the investments may be deemed to be the income of the assessee of such financial year.

A close reading of sections 68 and 69 makes it clear that in the case of section 68 there should be a credit entry in the books of account whereas in the case of section 69, there may not be an entry in the books of account. This is a fundamental difference between the two provisions. (Kalpesh Clases. Raja Ram Mohan Roy Marg, 198 Diamond queen building, Mumbai 400 004. Maharashtra.)

SECTION 69A. UNEXPLAINED MONEY, ETC

Where in any financial year the assessee is found to be the owner of any money, bullion, jewellery or other valuable article and such money, bullion, jewellery or valuable article is not recorded in the books of account, if any, maintained by him for any source of income, and the assessee offers no explanation about the nature and source of acquisition of the money, bullion, jewellery or other valuable article, or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the money and the value of the bullion, jewellery or other valuable article may be deemed to be the income of the assessee for such financial year.

Section 69A provide, in substance, that where in any financial year, an assessee is found to be the owner of any money, bullion, jewellery or other valuable articles which is unaccounted for in the books of the assessee and the nature and source of acquisition whereof has not been explained by him to the satisfaction of the Income-tax Officer, such money and the value of such bullion or jewellery, etc., may be deemed to be the income of the assessee for such financial year.

THE CONDITIONS PRECEDENT TO THE APPLICATION OF SECTION 69A ARE,

- 1) The money, bullion, jewellery or other valuable articles in question are not recorded in the books of account, if any, maintained by the assessee concerned for any source of income; and
- 2) That the assessee either offers no explanation as to the nature and source of acquisition thereof or the explanation offered by him is, in the opinion of the Income-tax Officer, not satisfactory. In coming to the conclusion that the explanation offered by the assessee in support of his case is not satisfactory, all the facts, circumstances and evidence in the case have to be considered very carefully, and
- 3) For this purpose, the assessee should be given due opportunity to adduce evidence in support of his explanations.

SECTION 69B. AMOUNT OF INVESTMENTS, ETC NOT FULLY DISCLOSED IN BOOKS OF ACCOUNT.

Where in any financial year the assessee has made investments or is found to be the owner of any bullion, jewellery or other valuable article, and the Assessing Officer finds that the amount expended on making such investments or in acquiring such bullion, jewellery or other valuable article exceeds the amount recorded in this behalf in the books of account maintained by the assessee for any source of income, and the assessee offers no explanation about such excess amount or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the excess amount may be deemed to be the income of the assessee for such financial year.

The effect of this section is that where the Income-tax Officer finds that the amount expended by an assessee in making an investment or acquiring any bullion, jewellery or other valuable articles exceeds the amount recorded in this behalf in his books of account, and the assessee offers no explanation about such excess or the explanation offered by him is, in the opinion of the Income-tax Officer, not satisfactory, the excess amount may be deemed to be the income of the assessee for the financial year in which the investment is made or the assessee is found to be the owner of the said bullion, jewellery or other valuable article.

SECTION 69C. UNEXPLAINED EXPENDITURE, ETC

Where in any financial year an assessee has incurred any expenditure and he offers no explanation about the source of such expenditure or part thereof, or the explanation, if any, offered by him is not, in the opinion of the Assessing Officer, satisfactory, the amount covered by such expenditure or part thereof, as the case may be, may be deemed to be the income of the assessee for such financial year.

Provided that, notwithstanding anything contained in any other provision of this Act, such unexplained expenditure which is deemed to be the income of the assessee shall not be allowed as a deduction under any head of income.

It provides that where an assessee incurs in any financial year an expenditure about the source of which he offers no explanation or the explanation offered by him is found to be not satisfactory, the amount covered by such expenditure shall be treated as income of the assessee for the financial year in which such expenditure is incurred.

MARRIAGE EXPENSES MUST BE DETERMINED ON THE BASIS OF ITS NATURE AND MANNER

It is quite possible for a marriage to be performed with very small expenditure even if the assessee is a wealthy man. It depends on the nature of the marriage and the manner in which it is performed. It therefore becomes material to find out what were the functions held in connection with the marriage. Basically the exact expenditure or even a proper estimate of expenditure would only be in the knowledge of the assessee. If the assessee chooses to give evasive answers, then the ITO can draw an adverse inference regarding the suppression of material facts. He can also take into account what might be the reasonable expenditure on a marriage of that type - Madan Lal v. CIT [1984] 149 ITR 533 (Delhi).

SECTION 69D. AMOUNT BORROWED OR REPAID ON HUNDI.

Where any amount is borrowed on a hundi from, or any amount due thereon is repaid to, any person otherwise than through an account payee cheque drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying the amount aforesaid for the previous year in which the amount was borrowed or repaid, as the case may be:

Provided that, if in any case any amount borrowed on a hundi has been deemed under the provisions of this section to be the income of any person, such person shall not be liable to be assessed again in respect of such amount under the provisions of this section on repayment of such amount.

Explanation.--For the purposes of this section, the amount repaid shall include the amount of interest paid on the amount borrowed.

It provides that if any amount is borrowed from any person on a hundi or any amount due on it is repaid to any person, otherwise than through an account payee cheque drawn on a bank, the amount so borrowed or repaid shall be assessed as the income of the person borrowing or repaying the said amount, for the previous year in which the amount is borrowed or repaid. Where any amount borrowed is assessed as the borrower's income under this provision, it will not be assessed again in his hands under this provision, on repayment of that amount. The requirement contained in the provision will apply also to the amount of interest paid on the amount borrowed on hundi.

MEANING OF HUNDI:

The term "hundi" which has not been defined in the Income-tax Act, denotes, in common commercial parlance, an indigenous instrument in vernacular language which can be used by the holder thereof to collect money due thereon without using the medium of currency. It may also be regarded as an indigenous form of a bill of exchange expressed in vernacular language which has been in use in the mercantile community in India for the purpose of collecting dues. There are numerous varieties of hundis, for example, darshani hundi, muddati hundi, shaha jogi hundi, jokhmi hundi, nam jog hundi, dhani jog hundi, jawabi hundi and zickri chit. The characteristics of hundis will differ according to the variety of the same. It may, however, be mentioned here that the characteristics of a hundi resemble almost all the characteristics of a bill of exchange.

THE FOLLOWING CHARACTERISTICS ARE FOUND IN MOST OF THE HUNDIS:

A hundi is payable to a specified person or order or negotiable without endorsement by the payee. A holder is entitled to sue on a hundi without an endorsement in his favour. A hundi accepted by the drawee could be negotiated without endorsement. If a hundi is lost, the owner could claim a duplicate or a triplicate from the drawer and present it to the drawee for payment. Interest can be charged where usage is established.

TAXATION OF GIFTS SECTION 56(V)

Where any sum of money exceeding twenty-five thousand rupees is received without consideration by an individual or a Hindu undivided family from any person on or after the 1st day of September, 2004, the whole of such sum will be regarded as income of the assessee under the head "Other Sources". Such gifts are not chargeable to tax if money is received (a) from any relative or (b) on the occasion of the marriage of the individual or (c) under a will or by way of inheritance or (d) in contemplation of death of the payer.

For the purposes of this, "relative" means (i) spouse of the individual (ii) brother or sister of the individual (iii) brother or sister of the spouse of the individual (iv) brother or sister of either of the parents of the individual (v) any lineal ascendant or descendant of the individual (vi) any lineal ascendant or descendant of the spouse of the individual (vii) spouse of the persons referred to in clauses (ii) to (vi).

CHAPTER - 04

DISCONTINUED BUSINESS

SEC. 176 DISCONTINUED BUSINESS.

Where any business or profession is discontinued in any assessment year, the income of the period from the expiry of the previous year for that assessment year up to the date of such discontinuance may, at the discretion of the Assessing Officer, be charged to tax in that assessment year. The total income of each completed previous year or part of any previous year included in such period shall be chargeable to tax at the rate or rates in force in that assessment year, and separate assessments shall be made in respect of each such completed previous year or part of any previous year.

Any person discontinuing any business or profession shall give to the Assessing Officer notice of such discontinuance within fifteen days thereof.

ABSENCE OF NOTICE DOES NOT MEAN CONTINUES

Where a partnership at will is dissolved with the mutual consent of the partners and a new deed is drawn up between some of the partners of the old firm, two separate assessments would have to be made on the two firms; mere absence of notice under section 176(3) will not lead to the conclusion that the old firm continued to exist for the purposes of the Act - Gurudeo Prasad Jagannath Prasad v. ITO [1981] 131 ITR 486 (All.).

MEANING OF DISCONTINUATION OF BUSINESS

The firm of Motichand and Devidas was carrying on the business of attorneys. The original partners were Motichand and Devidas. In 1936, Tanubhai, son of Devidas, was also taken as a partner. Devidas died, with the result that the firm was dissolved and a fresh partnership deed was entered into between Motichand and Tanubhai. It was found that the new firm had not taken over the outstandings or liabilities of the old firm but started with new books and got fresh retainers from all clients, but the business was carried on in the same firm name and at the same premises. Held, that there was a discontinuance of the business of the old firm. [1946] 014 ITR 0534A Motichand and Devidas, vs. In re (Bombay High Court)

MEANING OF DISCONTINUATION OF PROFESSION

The assessee was a Barrister and an advocate practising on the Original Side of the Calcutta High Court. He was arrested at the instance of the Government and was kept in detention. During his detention the assessee relieved his clerk from his service and also gave up the chambers which were acquired by him for his professional work. The question was whether the assessee had discontinued his profession. The income-tax authorities contended that as the assessee had returned to practice subsequently, he had not discontinued his profession but had only suspended it during the period of detention. Held that whether a man discontinues a practice or suspends it very largely depends upon the state of his mind and that is to a very large extent, if not altogether, a question of fact. There need not be a complete cessation of the profession for the rest of a man's life in order to constitute discontinuance of a profession. [1950] 018 ITR 0669- Commissioner of Income-tax vs. Sarat Chandra Bose (Calcutta High Court)

SEC. 176 (3A)/(4) AMOUNT RECEIVED AFTER DISCONTINUATION

Where any business is discontinued in any year, any sum received after the discontinuance shall be deemed to be the income of the recipient and charged to tax accordingly in the year of receipt, if such sum would have been included in the total income of the person who carried on the business had such sum been received before such discontinuance.

Where any profession is discontinued in any year on account of the cessation of the profession by, or the retirement or death of, the person carrying on the profession, any sum received after the discontinuance shall be deemed to be the income of the recipient and charged to tax accordingly in the year of receipt, if such sum would have been included in the total income of the aforesaid person had it been received before such discontinuance.

TREATMENT OF EXPENDITURE INCURRED AFTER DISCONTINUANCE

Section 176(3A) of the Income-tax Act, 1961, lays down that where any business is discontinued in any year any sum received after the discontinuance shall be deemed to be the income of the recipient and charged to tax accordingly in the year of receipt. The latter half of sub-section (3A) states that the sum received should be charged to tax, if such sum would have been included in the total income of the person who carried on the business had such sum been received before such discontinuance. It means that the said income shall be charged

to tax in the year of receipt if such sum would have been included in the total income of the person had it been received before such discontinuance. "Total income" has been defined to mean the total amount of income referred to and computed in the manner laid down in the Act.

For carrying on the business prior to its discontinuance, the assessee had availed of loan/overdraft facilities from the Federal Bank. The interest on the outstanding amount was payable to the bank. The interest so paid for the assessment year must be taken as expenditure for deriving the income from the business. Hence, the interest paid to the bank during the accounting year in which the interest on delayed payment was received must be taken to have been incurred for getting the said interest. That portion of the interest, which was paid during the accounting year, must be deducted from the amount received. This was more so since the assessee was following the cash system of accounting after the termination of the business. The assessee was not entitled to claim deduction of the interest paid to the bank during the previous assessment years. [1994] 208 ITR 0914C United Construction Contractors vs. Commissioner of Income-tax (Kerala High Court)

As per the fiction incorporated in section 176(3A), the sum received after the discontinuance of business shall be deemed to be the income and charged to tax accordingly as if it would have been included in the total income of the person during the year of receipt. This means that the entire receipt is not to be taken as the income of the receipt exigible to tax. The expenditure incurred after the year of discontinuance to earn that income should be deducted - United Construction Contractors v. CIT [1994] 75 Taxman 621 (Ker.).

The 'income' liable to be taxed under section 176(3A) will have to be computed only after deducting the expenditure incurred in deriving that income - CIT v. Foresole Ltd. [1985] 153 ITR 349 (Raj.).

MEANING OF RECIPIENT

The assessee, an individual. In order to effectively carry out the three construction contracts, three different partnership firms were constituted which undertook the work in three separate sections. In all the three firms, the assessee was a partner. The construction work was completed by. Thereafter, the firms had no contract works. Due to certain disputes that arose between the assessee and the electricity department, the matter was referred to the arbitrator. The arbitrator awarded payment of Rs. 7,46,471 by his award. The award was also confirmed by the civil court. The assessee received the amount after the discontinuation of business. Once there was a discontinuance of the business by the three firms, the amount received after discontinuance would be deemed to be the income of the recipient and charged to tax in the year of receipt, as had he received the same before discontinuance, he would have been liable to pay tax. Prior to discontinuance the three firms were entitled to receive income. It was only on account of the discontinuance of the firms, that the assessee had received the amount. Therefore, the assessee was only a trustee and the actual recipients were the three firms. The provisions of section 176(3A), were applicable and the amount of Rs. 7,46,471 could not be assessed in the hands of the assessee-recipient but in the hands of the three firms which actually executed the contract. [1999] 236 ITR 0932A Subba Rao (Y.V.) vs. Commissioner of Income-tax (Andhra Pradesh High Court)

AMOUNT RECEIVED AFTER DISCONTINUATION TAXABLE UNDER WHICH HEAD

If an income cannot be charged to income-tax under any of the heads mentioned in clauses A to E of section 14 of the 1961 Act, the same shall be chargeable to income-tax under the head "Income from other sources" mentioned in clause F of the said section 14, under the express provisions of section 156(1) of the 1961 Act. Thus, money received by a person on account of profits or gains of a profession which had been discontinued by him even prior to the year previous to that when he received the same, would be chargeable to tax under the provisions mentioned above. Where fees due to a barrister were realised in the accounting year subsequent to his death, the amount thus realised would be chargeable to income-tax in the assessment year relevant to that accounting year under the head "Income from other sources" in view of the specific provisions of section 56. Further, where the profession of the barrister was discontinued on account of his death, any sum received after the discontinuance shall, under the provisions of section 176(4), be deemed to be the income of the recipient and charged to tax accordingly in the year of receipt. [1974] 095 ITR 0299- Roma Bose (Mrs.) vs. Income-tax Officer (Calcutta High Court)

ISSUE OF NOTICE

Where an assessment is to be made under the provisions of this section, the Assessing Officer may serve on the person whose income is to be assessed a notice under section 142(1)

CHAPTER - 05

SUCCESSION OF BUSINESS

SEC. 170 SUCCESSION TO BUSINESS OTHERWISE THAN ON DEATH.

Where a person carrying on any business or profession has been succeeded therein by any other person who continues to carry on that business or profession,

- 1) The predecessor shall be assessed in respect of the income of the previous year in which the succession took place up to the date of succession;
- 2) The successor shall be assessed in respect of the income of the previous year after the date of succession.

‘SUCCESSION’ MEANS CHANGE OF OWNERSHIP

Succession means a change of ownership in the business keeping the business intact. Change of ownership may be brought about by transfer inter vivos or as a result of operation of law.

Firm with several agency business was incurring losses and partners became insolvent. One of the agencies and stock-in-trade pertaining to it taken over by assessee related to one of the partners of firm does not amount to succession. Notice issued under section 170 quashed. [1979] 118 ITR 0216- Premji Khimraj Shah vs. Income-tax Officer (Gujarat High Court)

To substantiate succession, the two elements that should be established are identity and continuity of business. Merely because some of the partners of the predecessor-firm happen to be the partners of the successor-firm will not disentitle the successor-firm to claim an assessment under section 188/170. A firm with three partners sold its business to a new firm consisting of the three partners of the old firm and another individual. Two returns were filed. The Income-tax Officer made a single assessment on the ground that there had been a change in the constitution of the firm. The Tribunal found that the new firm had taken over the business of the earlier firm as a going concern with all the assets and liabilities. Held that the facts found by the Tribunal clearly showed that the new firm had succeeded to the old one. Two assessments had to be made under section 188/170. [1992] 195 ITR 0463- United Coir Works vs. Commissioner of Income-tax (Kerala High Court)

Where firm converted into company it amounts to succession of business of firm by company. Firm assessable for the period till it was succeeded by company. [1998] 230 ITR 0044- Motor Sales vs. Commissioner of Income-tax (Allahabad High Court)

The assessee-firm was converted into a private limited company. The entire business of the firm continued to be carried on by the company, with the partners of the firm as the only share holders and with all the existing assets and liabilities of the firm. The Income-tax Officer held that in computing the income of the dissolved firm, the closing stock of the firm had to be valued at market price. It was observed that the intention of the partners in transferring the business to a private limited company was to change the form of organisation. The the dissolution was consequential to the transfer of business to the company. Held, that considering the facts and circumstances of the case it was clear that this was not a case where dissolution preceded the transfer. The consistent fact-finding of the three authorities ruled out the question of valuation of closing stock at market rate. It held that section 170 was applicable. [1998] 233 ITR 0620- Commissioner of Income-tax vs. Koder (S.) (Kerala High Court)

PREDECESSOR NOT FOUND OR TAX NOT RECOVERED

When the predecessor cannot be found, the assessment of the income of the previous year in which the succession took place up to the date of succession and of the previous year preceding that year shall be made on the successor in like manner and to the same extent as it would have been made on the predecessor.

When any sum payable in respect of the income of such business or profession for the previous year in which the succession took place up to the date of succession or for the previous year preceding that year, assessed on the predecessor, cannot be recovered from him, the Assessing Officer shall record a finding to that effect and the sum payable by the predecessor shall thereafter be payable by and recoverable from the successor, and the successor shall be entitled to recover from the predecessor any sum so paid.

CHAPTER - 06

CAPITAL GAINS

CAPITAL GAINS.**CHARGING SECTION 45(1)**

Any profits or gains arising from the TRANSFER of a CAPITAL ASSET effected in the PREVIOUS YEAR shall, save as otherwise provided in sections 54,54B,54D,54E,54EA,54EB,54F,54G and 54H be chargeable to income-tax under the head "Capital gains", and shall be deemed to be the income of the previous year in which the transfer took place.

TRANSFER, IN RELATION TO A CAPITAL ASSET, INCLUDES, 2(47)

- (i) The sale, exchange or relinquishment of the asset; or
- (ii) The extinguishment of any rights therein; or
- (iii) The compulsory acquisition thereof under any law ; or
- (iv) In a case where the asset is converted by the owner thereof into or is treated by him as, stock-in-trade of a business carried on by him, such conversion or treatment; or
- (iva) the maturity or redemption of a zero coupon bond; or
 zero coupon bond" means a bond
 - (a) issued by any infrastructure capital company or infrastructure capital fund or public sector company on or after the 1st day of June, 2005;
 - (b) in respect of which no payment and benefit is received or receivable before maturity or redemption from infrastructure capital company or infrastructure capital fund or public sector company; and
 - (c) which the Central Government may, by notification in the Official Gazette, specify in this behalf.
- (v) Any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882 (4 of 1882); or
- (vi) Any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, any immovable property.

RELINQUISHMENT

A relinquishment takes place when the owner withdraws himself from the property and abandons his rights thereto. It presumes that the property continue to exist after the relinquishment - CIT v. Rasiklal Maneklal (HUF) 1989 177 ITR 198 (SC).

REDEMPTION OF PREFERENCE SHARES

When a preference share is redeemed by a company, what the shareholder does in effect is to sell the share to the company. The company redeems its preference shares only by paying the preference shareholders the value of the shares and taking back the preference shares. In effect, the company buys back the preference shares from the shareholders. If redemption of preference shares did not amount to sale, it would not have been necessary, in section 77 of the Companies Act, 1956, to specifically provide that the restriction imposed upon a company in respect of buying its own shares will not apply to redemption of shares issued under section 80 of that Act. The redemption of preference shares by a company, therefore, is a sale and squarely comes within the phrase "sale, exchange or relinquishment" of an asset in section 2(47). [1997] 224 ITR 0422- Anarkali Sarabhai vs. Commissioner of Income-tax (Supreme Court of India) Sections 77,80 and 85 of the Companies Act make it clear that when preference shares are redeemed by a company, what a shareholder does in effect is to sell the shares to the company. Such a transaction is nothing but sale of preference shares by the shareholder to the company, and hence redemption of preference shares will squarely come within the phrase 'sale, exchange or relinquishment of the asset 'in section 2 (47) - Anarkali Sarabhai v. CIT 1997 90 Taxman 509 (SC).

“CAPITAL ASSET” MEANS PROPERTY OF ANY KIND HELD BY AN ASSESSEE, WHETHER OR NOT CONNECTED WITH HIS BUSINESS OR PROFESSION, BUT DOES NOT INCLUDE -- 2(14)

- (i) Any stock-in-trade, consumable stores or raw materials held for the purposes of his business or profession;
- (ii) Personal effect, that is to say, movable property (including wearing apparel and furniture, but excluding jewellery) held for personal use by the assessee or any member of his family dependent on him.
Explanation, - For the purposes of this sub-clause, “jewellery” includes -
 - (a) Ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stone, and whether or not worked or sewn into any wearing apparel ;
 - (b) Precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel ;
- (iii) Agricultural land in India, not being land situate -
 - (a) In any area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee, or by any other name) or a cantonment board and which has a population of not less than ten thousand according to the last preceding census of which the relevant figures have been published before the first day of the previous year ; or
 - (b) In any area within such distance, not being more than eight kilometres, from the local limits of any municipality or cantonment board referred to in item (a), as the Central Government may, having regard to the extent of, and scope for, urbanisation of that area and other relevant considerations, specify in this behalf by notification in the Official Gazette ;
- (iv) 6.5 per cent Gold Bonds, 1977, or 7 per cent Gold Bonds, 1980 or National Defence Gold Bonds, 1980, issued by the Central Government ;
- (v) Special Bearer Bonds, 1991, issued by the Central Government
- (vi) Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 notified by the Central Government

PERSONAL EFFECTS

An intimate connection between the effects and the person of the assessee must be shown to exist to render them "personal effects". The legislature intended only those articles to be included within the expression "personal effects" which were intimately and commonly used by the assessee. The assessee was liable to tax on the capital gains derived by the sale of sovereigns, silver bars and rupee coins,. The silver bars or bullion could by no stretch of imagination be deemed to be " effects " meant for personal use. Nor could the sovereigns and silver coins by their use on special occasions of worship of Maha Lakshmi be designated as effects meant for personal use. [1976] 103 ITR 0061- Rana Hemant Singhji (H.H. Majaraja) vs. Commissioner of Income-tax (Supreme Court of India)

It will not be correct to say that only those items are personal effects which have been intimately connected with the person of the assessee. The very fact that furniture is also included in personal effects in section 2(14) shows that the articles need not have an intimate connection with the person of the assessee. All that is required is that the article is meant for the personal use of the assessee in the ordinary course. The assessee realised capital gains on sale of silver utensils which were purchased by him. All personal effects need not be used daily. So long as they were meant for personal use, they would have to be considered as personal effects. Therefore, the gains resulting from the sale of the silver utensils were not assessable to tax on capital gains. [1985] 156 ITR 0448- Jayantilal A. Shah vs. Anantharam Aiyar (K.N.), CIT (Bombay High Court)

MEANING OF AGRICULTURAL LAND

Where land was situated in the most important and the busiest thoroughfare in the city and was surrounded by industrial and commercial buildings on all sides, and no agricultural operations were carried on any land nearby, the mere fact that vegetables were raised on that land at the time of sale or for some years prior thereto, merely as a stop-gap activity, could not change the character of the land from ‘non-agricultural’ to ‘agricultural’. The sale of such land was not sale of ‘agricultural land in India’, and hence the land was not liable to be excluded from the definition of the words ‘capital asset’ - CIT v. Gemini Pictures Circuit (P.)Ltd. 1996 85 Taxman 594/220 ITR 43 (SC). In other words Rural agricultural land is excluded from capital asset. In order to

determine agricultural status of land totality of relevant facts must be taken into consideration. Where land is situated in most important business center of a city and part of land is used for construction of non-residential buildings the mere fact that vegetables were grown in the land as stop-gap activity is not conclusive that land was agricultural. Profits on sale of such land is assessable as capital gains.

SALE OF STOCK IN TRADE

Assessee was dealer in shares. Shares in one company was valued at cost and was held as stock-in-trade. Such shares was exchanged for shares in another company. Difference between book value of original shares and market value of shares for which exchanged is taxable as business profit. [1997] 224 ITR 0371- Orient Trading Co. Ltd. vs. Commissioner of Income-tax (Supreme Court of India)

45(1A) NOTWITHSTANDING ANYTHING CONTAINED IN SUB-SECTION [MONEY OR OTHER ASSETS UNDER AN INSURANCE]

Where any person receives at any time during any previous year any money or other assets under an insurance from an insurer on account of damage to, or destruction of, any capital asset, as a result of, (i)flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature; or (ii) riot or civil disturbance; or (iii) accidental fire or explosion; (iv) or action by an enemy or action taken in combating an enemy (whether with or without a declaration of war), then any profits or gains arising from receipt of such money or other assets shall be chargeable to income-tax under the head "Capital gains" and shall be deemed to be the income of such person of the previous year in which such money or other asset was received and for the purposes of section 48, value of any money or the fair market value of other assets on the date of such receipt shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of such capital asset. (Kalpesh Clases. Raja Ram Mohan Roy Marg, 198 Diamond queen building, Mumbai 400 004. Maharashtra.)

Explanation.-For the purposes of this sub-section, the expression "insurer" shall have the meaning assigned to it in clause (9) of section 2 of the Insurance Act, 1938 (4 of 1938).'

Section 45(1A) has certain significant implications. In the first place, the destruction, etc., of an asset resulting in receipt of insurance claim is deemed as "transfer" of that asset. Secondly, the money or fair market value of assets received from the insurer is deemed to be the full value of the consideration received on transfer of asset. The provisions contained in section 48 (for non-depreciable assets) and 50 (for depreciable assets) proceed to provide the mode of computation of capital gains on the basis of "the full value of the consideration received or accruing as a result of the transfer of the capital asset." Thus, in effect, capital gains would be worked out in respect of assets which get destroyed, etc., as per the provisions of sections 48 and 50, as the case may be, by taking the insurance money or the market value of the asset received from the insurer as the "full value of consideration". Further, adjustment for cost inflation index will be made for non-depreciable assets and for depreciable assets, the written down value of such assets will be reduced from the block of assets as provided for in section 43(6). **Also, the benefits of provisions contained in section 54EC etc., would be available to the consideration, thus, received.**

TRANSFER PRESUMES THE EXISTENCE OF BOTH THE ASSET AND OF THE TRANSFEREE TO WHOM IT IS TRANSFERRED .

The expression 'extinguishment of any rights therein' will have to be confined to the extinguishment of rights on account of transfer, and cannot be extended to mean any extinguishment of right independent of or otherwise than on account of transfer. Thus, where an asset is destroyed by fire and insurance money is received therefore, there is no 'transfer' - Vania Silk Mills (P.)Ltd. v. CIT 1991 59 Taxman 3 (SC). The compensation paid in pursuance of a contract of insurance cannot be considered as consideration. The money which is received by the assessee is not by way of consideration for extinguishment of any rights. Where moneys are paid by an insurance company consequent upon total destruction of the property and no transfer results from such destruction or extinguishment of all rights in the capital asset, the amount paid by the insurance company cannot be described as a consideration as a result of the transfer of the capital asset. The payment received in pursuance of a contract of indemnity cannot be considered to be payment as a result of transfer of property. It is well established that a contract of insurance is a contract of indemnity. Therefore, the amount received by the assessee in pursuance to such contract of indemnity cannot be considered as consideration received for the transfer of a capital asset as contemplated by section 45 read with section 48.

45(2) CONVERSION OF CAPITAL ASSET TO STOCK IN TRADE

The profits or gains arising from the transfer by way of conversion by the owner of a capital asset into, or its treatment by him as stock-in-trade of a business carried on by him shall be chargeable to income-tax as his income of the previous year in which such stock-in-trade is sold or otherwise transferred by him and, for the

purposes of section 48, the fair market value of the asset on the date of such conversion or treatment shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset.

The Supreme Court in CIT v. bai Shirinbai K.Kooka [1962] 46 ITR 86 had held that where the assessee, holding by way of investment shares in companies, commenced a business in shares converting the shares into stock-in-trade of the business and subsequently sold these shares at profit, the assessable profit was the difference between the sale price of the shares and market price of the shares prevailing on the date when shares were converted into stock-in-trade of the business in shares. In other words, the appreciation in the value of capital asset between the date of purchase of shares and date of its conversion into stock is not chargeable to tax.

D-MAT OF SECURITIES SEC. 45 (2A)

Where any person has had at any time during previous year any beneficial interest in any securities, then, any profits or gains arising from transfer made by the depository or participant of such beneficial interest in respect of securities shall be chargeable to income-tax as the income of the beneficial owner of the previous year in which such transfer took place and for the purposes of Section 48; and Proviso to clause (42A) of section 2, The cost of acquisition and the period of holding of any securities shall be determined on the basis of the first-in-first-out method.

CONVERSION OF ASSETS IN TO PARTNERSHIP AND ITS DISSOLUTION SEC. 45 (3) AND (4)

The profits or gains arising from the transfer of a capital asset by a person to a firm or other association of persons or body of individuals (not being a company or a co-operative society) in which he is or becomes a partner or member, by way of capital contribution or otherwise, shall be chargeable to tax as his income of the previous year in which such transfer takes place and, for the purposes of section 48, the amount recorded in the books of account of the firm, association or body as the value of the capital asset shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset.

With a view to blocking this escape route for avoiding capital gains tax, the Finance Act, 1987 has inserted new 45(3). The effect of this amendment is that profits and gains arising from the transfer of a capital asset by a partner to a firm shall be chargeable as the partner's income of the previous year in which the transfer took place. For purposes of computing the capital gains, the value of the asset recorded in the books of the firm on the date of the transfer shall be deemed to be the full value of the consideration received or accrued as a result of the transfer of the capital asset.

The profits or gains arising from the transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm or other association of persons or body of individuals (not being a company or a co-operative society) or otherwise, shall be chargeable to tax as the income of the firm, association or body, of the previous year in which the said transfer takes place and, for the purposes of section 48, the fair market value of the asset on the date of such transfer shall be deemed to be the full value of the consideration received or accruing as a result of the transfer.)

Conversion of partnership assets into individual assets on dissolution or otherwise also forms part of the same scheme of tax avoidance. Accordingly, the Finance Act, 1987 has inserted new sub-section (4) in section 45 of the Income-tax Act, 1961. The effect is that profits and gains arising from the transfer of a capital asset by a firm to a partner on dissolution or otherwise shall be chargeable as the firm's income in the previous year in which the transfer took place and for the purposes of computation of capital gains the fair market value of the asset on the date of transfer shall be deemed to be the full value of the consideration received or accrued as a result of the transfer.

When a firm owns certain properties, a registered document will be necessary to transfer firm's interest in such properties in favour of partners, and mere book entries will not be sufficient to effect such a transfer. Therefore, where such property is sold merely after effecting book entries, and no registered document is executed for transferring such properties to partners, capital gains arising from the sale by partners would be assessable only in the hands of the firm and not in the hands of the partners - CIT v. Dhadha & Co. 1983, 142 ITR 792 (Mad.).

CONTRIBUTION OF STOCK IN TRADE TO FIRM

The assessee acquired a interest in a joint venture for the purchase and sale of machinery. Unsold machinery (stock) remaining after the venture was divided and the assessee received machinery valued at Rs. 2,06,372 as its share. In its account books the assessee wrote up the value of the machinery by Rs. 4 lakhs. Thereafter, a partnership was formed in which the assessee had a half share. To the new firm the assessee transferred its stock of machinery at the book value of Rs. 6,06,372 as its share of the capital. Held that neither when the assessee

wrote up the value of the machinery in its books nor when it handed over its machinery to the partnership was there a sale and the assessee did not derive any income. The sum of Rs. 4 lakhs [606372 - 206372] was not income of the assessee. A sale contemplates a seller and a purchaser. If a person revalues his goods and shows a higher value for them in his books, he cannot be considered as having sold those goods and made profit therefrom. Nor can a person by handing over his goods to a partnership of which he is a partner as his share of the capital be considered as having sold the goods to the partnership. [1972] 083 ITR 0211- Commissioner of Income-tax vs. Hind Construction Ltd. (Supreme Court of India)

SETTLEMENT OF ACCOUNTS UPON DISSOLUTION

When a partner retired from the firm and received his share of an amount calculated on the value of the net partnership assets including goodwill of the firm, there was no transfer of interest of the partner in the goodwill, and no part of the amount received by him would be assessable as capital gains under section 45. In other words in law it is well established that the money received on settlement of accounts on retirement from a firm cannot be treated as transfer of a capital asset after the decision of the Supreme Court in this case. There could be no longer any doubt that there can be no liability for a partner on what he receives from the firm, whether in cash or in kind. But in view of the departmental interpretation of section 45(4) to include "retirement" within the meaning "or otherwise" following dissolution, there is a possible liability for the firm when it parts with a capital asset in settlement of the accounts of a retiring partner as deemed transfer. [1987] 165 ITR 0166- Additional Commissioner of Income-tax vs. Mohanbhai Pamabhai (Supreme Court of India)

The assessee was a partner in a firm. Disputes arose among the partners. Ultimately the dispute was settled. Under the deed of settlement, the assessee was deemed to have retired from the firm and the remaining partners were authorised to continue to carry on the business of the firm. The assessee was paid a sum of Rs. 1,00,000, as his share of profits in addition to this Rs. 1,00,000 he was also paid Rs. 8,00,000 including the sum of Rs. 50,000 representing the share in the goodwill and Rs. 4,77,941.47 representing his share in the assets of the firm. The assessee contended that only the sum of Rs. 1,00,000 should be brought to tax and not the other amounts. In this context, it may be noted that the manner in which the settlement of accounts had occurred may make a difference in liability. The Bombay High Court has consistently held that it is possible for a person to sell his interest in a firm and thereby render himself liable for capital gains tax, though settlement of accounts after retirement would not constitute transfer. [1999] 236 ITR 0515- Tribhuvandas G. Patel vs. Commissioner of Income-tax (Supreme Court of India) (Kalpesh Clases. Raja Ram Mohan Roy Marg, 198 Diamond queen building, Mumbai 400 004. Maharashtra.)

TAX TREATMENT OF COMPULSORY ACQUISITION SEC. 45 (5)

Where the capital gain arises from the transfer of a capital asset, being a transfer by way of compulsory acquisition under any law, or a transfer the consideration for which was determined or approved by the Central Government or the Reserve Bank of India, and the compensation or the consideration for such transfer is enhanced or further enhanced by any court, Tribunal or other authority, the capital gain shall be dealt with in the following manner, namely

- 1) The capital gain computed with reference to the compensation awarded in the first instance or, as the case may be, the consideration determined or approved in the first instance by the Central Government or the Reserve Bank of India shall be chargeable as income under the head "Capital gains" of the previous year in which such compensation or part thereof, or such consideration or part thereof was first received ; and
- 2) The amount by which the compensation or consideration is enhanced or further enhanced by the court, Tribunal or other authority shall be deemed to be income chargeable under the head "Capital gain" of the previous year in which such amount is received by the assessee. [The cost of acquisition and the cost of improvement shall be taken to be nil] Where by reason of the death of the person who made the transfer, or for any other reason, the enhanced compensation or consideration is received by any other person, the shall be deemed to be the income, chargeable to tax under the head "Capital gains", of such other person.
- 3) Where in the assessment for any year, the capital gain arising from the transfer of a capital asset is computed by taking the compensation or consideration or enhanced compensation or consideration and subsequently such compensation or consideration is reduced by any court, Tribunal or other authority, such assessed capital gain of that year shall be recomputed by taking the compensation or consideration as so reduced by such court, Tribunal or other authority to be the full value of the consideration.

It had been brought to the notice of the Government that in cases of compulsory acquisition of assets, at times there is a considerable gap between the dates of acquisition and payment of compensation. The result is that

provisions of capital gains taxation operate harshly inasmuch as the affected persons are unable to avail of the exemption for roll-over of capital gains, within the specified time period, through investment in specified assets.

INTEREST RECEIVED ON DELAYED PAYMENT OF THE COMPENSATION

Interest received on delayed payment of the compensation under the Land Acquisition Act, is a revenue receipt exigible to income-tax. Once it is construed to be a revenue receipt, necessarily, unless there is an exemption under the appropriate provisions of the Act, the revenue receipt is exigible to tax. However, the appellants were entitled to spread over the income for the period for which payment came to be made, so as to compute the income for assessing tax for the relevant accounting year. [1997] 224 ITR 0551- Bikram Singh vs. Land Acquisition Collector (Supreme Court of India)

TAX TREATMENT OF UNITS COVERED BY 80CCB: SEC. 45 (6)

The difference between the repurchase price of the units referred to in section 80CCB and the capital value of such units shall be deemed to be the capital gains arising to the assessee in the previous year in which such repurchase takes place or the plan referred to in that section is terminated and shall be taxed accordingly.

CAPITAL GAINS ON DISTRIBUTION OF ASSETS BY COMPANIES IN LIQUIDATION. SEC 46

Where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as a transfer by the company for the purposes of section 45. Where a shareholder on the liquidation of a company receives any money or other assets from the company, he shall be chargeable to income-tax under the head "Capital gains", in respect of the money so received or the market value of the other assets on the date of distribution, as reduced by the amount assessed as dividend within the meaning of section 2(22)(c) and the sum so arrived at shall be deemed to be the full value of the consideration.

2(22)(C) "DIVIDEND" INCLUDES (MEANING OF DIVIDEND)

Any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not.

Distribution of assets by companies in liquidation - the provisions of section 46 (2) apply only to the distribution of assets by such companies in liquidation as are covered by the definition of the word 'company' in section 2 (17). The Legislature having made no similar provision in respect of companies other than those which fall within the definition contained in section 2 (17), there can be no tax on capital gains when such other companies distribute assets on liquidation to shareholders - CIT v. R.M. Amin 1977, 106 ITR 368 (SC).

MEANING OF ACCUMULATED PROFITS

The expression "accumulated profits", shall not include capital gains arising before the 1st day of April, 1946, or after the 31st day of March, 1948, and before the 1st day of April, 1956. I.e. today it includes the capital gains.

The expression "accumulated profits", in sub-clauses 2 (22) (a), (b), (d) and (e), shall include all profits of the company up to the date of distribution or payment referred to in those sub-clauses, and in sub-clause 2(22)(c) shall include all profits of the company up to the date of liquidation, but shall not, where the liquidation is consequent on the compulsory acquisition of its undertaking by the Government or a corporation owned or controlled by the Government under any law for the time being in force, include any profits of the company prior to three successive previous years immediately preceding the previous year in which such acquisition took place.

46A. CAPITAL GAINS ON PURCHASE BY COMPANY OF ITS OWN SHARES OR OTHER SPECIFIED SECURITIES

Where a shareholder or a holder of other specified securities receives any consideration from any company for purchase of its own shares or other specified securities held by such shareholder or holder of other specified securities, then, subject to the provisions of section 48, the difference between the cost of acquisition and the value of consideration received by the shareholder or the holder of other specified securities, as the case may be, shall be deemed to be the capital gains arising to such shareholder or the holder of other specified securities, as the case may be, in the year in which such shares or other specified securities were purchased by the company. "specified securities" shall have the meaning assigned to it in Explanation to section 77A of the Companies Act.

2(22) (iv) but "dividend" does not include

Any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 77A of the Companies Act.

The Companies Act, 1956, which allows a company to purchase its own shares subject to certain conditions. The shares bought back have to be extinguished and physically destroyed and the company is precluded from making any further issue of securities within a period of 24 months from such buy-back. The above introduced provisions of buy-back of shares threw up certain issues in relation to the existing provisions of the Income-tax Act. The two principal issues are whether it would give rise to deemed dividend under section 2(22) of the Income-tax Act and whether any capital gains would arise in the hands of the shareholder. The legal position on both the issues were far from clear and settled and there was apprehension that there will be unnecessary litigation unless the issues are clarified with finality.

Dividend does not include any payment made by a company on purchase of its own shares in accordance with the provisions contained in section 77A of the Companies Act, 1956. Section 46A, provide that any consideration received by a shareholder or a holder of other specified securities from any company on purchase of its own shares or other specified securities shall be, subject to provisions contained in section 48, deemed to be the capital gains. (Kalpesh Clases. Raja Ram Mohan Roy Marg, 198 Diamond queen building, Mumbai 400 004. Maharashtra.)

TRANSACTION NOT REGARDED AS TRANSFER. SEC 47**TRANSFER IN THE PARTITION OF HUF 47(i)**

Nothing contained in section 45 shall apply to any distribution of capital assets on the total or partition of Hindu undivided family;

TRANSFER IN CASE OF GIFT WILL ETC. 47(iii)

Nothing contained in section 45 shall apply to any transfer of a capital asset under a gift or will or an irrevocable trust

Provided that this clause shall not apply to transfer under a gift or an irrevocable trust of a capital asset being shares, debentures or warrants allotted by a company directly or indirectly to its employees under the Employees Stock Option Plan or Scheme of the company offered to such employees in accordance with guidelines issued by the central government.

By proviso in clause (iii) of section 47 has provided that in a case where the employee transfers by way of gift or irrevocable trust, shares, dividends or warrants received from his employer in such a stock option plan or scheme, the transfer will nevertheless be regarded as a transfer. Although with effect from assessment year 2001-2002, stock options offered by employers to their employees will not be treated as perquisites in the hands of the employees, capital gains on their transfer by the employees will still be charged to tax in the employees' hands. The mode of computation of capital gains for assessment years 2001-2002 and subsequent years will be as in the case of transfer of any other capital asset. The market value of the shares on the date of such transfer by the employee under a gift or irrevocable trust being deemed as the full value of the consideration received or accruing as a result of the transfer. (Provisio 4 to 48). At the same time 49(2B) HAS BEEN OMITTED

TRANSFER BY HOLDING TO SUBSIDIARY AND VICE A VERSA 47 (IV) AND (V)

Nothing contained in section 45 shall apply to Any transfer of a capital asset by a company to its subsidiary company, if the parent company or its nominees hold the whole of the share capital of the subsidiary company, and the subsidiary company is an Indian company OR Any transfer of a capital asset by a subsidiary company to the holding company, if the whole of the share capital of the subsidiary company is held by the holding company, and the holding company is an Indian company;

WITHDRAWAL OF EXEMPTION 47 A (1)

Where at any time before the expiry of a period of eight years from the date of the transfer of a capital asset such capital asset is converted by the transferee company into, or is treated by it as, stock-in-trade of its business or the parent company or its nominees or, as the case may be, the holding company ceases or cease to hold the whole of the share capital of the subsidiary company, the amount of profits or gains arising from the transfer of such capital asset not charged under section 45 by virtue of the provisions contained in clause (iv) or, as the case may be, clause (v) of section 47 shall, notwithstanding anything contained in the said clauses, be deemed to be income chargeable under the head "Capital gains" of the previous year in which such transfer took place.

TRANSFER OF ASSETS IN THE SCHEME OF AMALGAMATION 47(vi)

Nothing contained in section 45 shall apply to Any transfer, in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company,

TRANSFER OF SHARES IN INDIAN COMPANY IN THE SCHEME OF AMALGAMATION OF FOREIGN COMPANY 47(via)

Nothing contained in section 45 shall apply to any transfer, in a scheme of amalgamation, of a capital asset being a share or shares held in an Indian company, by the amalgamating foreign company to the amalgamated foreign company, if at least twenty-five per cent of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company, and such transfer does not attract tax on capital gains in the country, in which the amalgamating company is incorporated;

TRANSFER IN CASE OF AMALGAMATION OF BANKING COMPANY

any transfer, in a scheme of amalgamation of a banking company with a banking institution sanctioned and brought into force by the Central Government under the Banking Regulation Act,

TRANSFER OF SHARES BY SHARE HOLDER THE SCHEME OF AMALGAMATION 47(vii)

Nothing contained in section 45 shall apply to Any transfer by a shareholder, in a scheme of amalgamation, of a capital asset being a share or shares held by him in the amalgamating company, if the transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company, and the amalgamated company is an Indian company;

TRANSFER OF ASSETS IN THE SCHEME OF DEMERGER 47(vib)

Nothing contained in section 45 shall apply to any transfer, in a demerger, of a capital asset by the demerged company to the resulting company, if the resulting company is an Indian company;

TRANSFER OF SHARES IN INDIAN COMPANY IN THE SCHEME OF DEMERGER OF FOREIGN COMPANY 47(vic)

Nothing contained in section 45 shall apply to any transfer in a demerger, of a capital asset, being a share or shares held in an Indian company, by the demerged foreign company to the resulting foreign company, the shareholders holding not less than three-fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated. Provided that the provisions of sections 391 to 394 of the Companies Act, 1956 (1 of 1956) shall not apply in case of demergers referred to in this clause;

TRANSFER / ISSUE OF SHARES BY SHARE HOLDER THE SCHEME OF AMALGAMATION 47(vid)

Nothing contained in section 45 shall apply to any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking.

TRANSFER OF NRI BONDS 47(viia)

Nothing contained in section 45 shall apply to any transfer of a capital asset, being bonds or GDR's referred to in sub-section (1) of section 115AC, made outside India by a non-resident to another non-resident

TRANSFER OF WORK OR ART ETC. TO NOTIFIED INSTITUTION 47(ix)

Nothing contained in section 45 shall apply to any transfer of a capital asset, being any work of art, archaeological, scientific or art collection, book, manuscript, drawing, painting, photograph or print, to the Government or a University or the National Museum, National Art Gallery, National Archives or any such other public museum or institution as may be notified by the Central Government in the Official Gazette to be of national importance or to be of renown throughout any State or States.

CONVERSION OF BONDS IN TO SHARES OR DEBENTURES 47 (X)

Nothing contained in section 45 shall apply to any transfer by way of conversion of bonds or debentures, debenture-stock or deposit certificates in any form, of a company into shares or debentures of that company.

EXEMPTION OF CAPITAL GAINS TAX ON SALE OF LAND BY A SICK INDUSTRIAL COMPANY MANAGED BY A WORKERS CO-OPERATIVE 47(XII)

It provide that the capital gains arising from the transfer of land of a sick industrial company will be exempt from tax provided the following conditions are fulfilled: the transfer is made under a scheme prepared and sanctioned under section 18 of the Sick Industrial Companies (special Provisions) Act 1985 (SICA)., the sick company is being managed by its workers co-operative. The transfer is made during the period commencing from the previous year in which the company became a sick industrial company under section 17 of the SICA

and ending with the previous year during which the entire net worth of the company becomes equal to or exceeds the accumulated losses. For this purpose 'net worth' has the meaning assigned to it in section 3(1) (ga) of SICA.

BUSINESS REORGANISATIONS

Business reorganisations have definite tax implications under the existing provision of the Income-tax Act. Transfer of assets attracts levy of capital gains tax. Similarly, carry forward of losses and that of unabsorbed depreciation are not available to successor business entities. However, in cases of amalgamation, capital gains tax is not levied and losses and unabsorbed depreciation are allowed to be carried forward under certain conditions. The Expert Group, has recognised the need to encourage business reorganisation when they are in consonance with the whole objective of economic development and not merely devices to secure tax advantage.

CONVERSION OF FIRM INTO COMPANY 47(xiii)

Nothing contained in section 45 shall apply for any transfer of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm, or any transfer of a capital asset to a company in the course of demutualisation or corporatisation of a recognised stock exchange in India as a result of which an association of persons or body of individuals is succeeded by such company

Provided that

- (a) All the assets and liabilities of the firm or of the association of persons or body of individuals relating to the business immediately before the succession become the assets and liabilities of the company ;
- (b) All the partners of the firm immediately before the succession become the shareholders of the company in the same proportion in which their capital accounts stood in the books of the firm on the date of succession;
- (c) The partners of the firm do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the company
- (d) The aggregate of the shareholding in the company of the partners of the firm is not less than fifty per cent. of the total voting power in the company and their shareholding continues to be as such for a period of five years from the date of the succession
- (e) The demutualisation or corporatisation of a recognised stock exchange in India is carried out in accordance with a scheme for demutualisation or corporatisation which is approved by the Securities and Exchange Board of India

TRANSFER OF MEMBERSHIP RIGHTS IN CORPORATISATION OF RESOGNISED STOCK EXCHANGE 47(xiiia)

Nothing contained in section 45 shall apply for any transfer of a capital asset being a membership right held by a member of a recognised stock exchange in India for acquisition of shares and trading or clearing rights acquired by such member in that recognised stock exchange in accordance with a scheme for demutualisation or corporatisation which is approved by the SEBI.

CONVERSION OF PROPRIETORY CONCERN INTO COMPANY 47(xiv)

Nothing contained in section 45 shall apply where a sole proprietary concern is succeeded by a company in the business carried on by it as a result of which the sole proprietary concern sells or otherwise transfers any capital asset or intangible asset to the company:

Provided that-

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

WITHDRAWAL OF EXEMPTION IN CASE OF VIOLATION 47 A (3)

Where any of the conditions laid down in the proviso to clause (xiii) or the proviso to clause (xiv) of section 47 are not complied with, the amount of profits or gains arising from the transfer of such capital asset or intangible asset not charged under section 45 by virtue of conditions laid down in the proviso to clause (xiii) or the proviso

to clause (xiv) of section 47 shall be deemed to be the profits and gains chargeable to tax of the successor company for the previous year in which the requirements of the proviso to clause (xiii) or the proviso to clause (xiv), as the case may be, are not complied with."

If the conditions stipulated regarding the succession of a proprietary concern or firm by a company whereby capital gains tax is not levied are not complied with, the amount of profits or gains arising from the transfer of such capital asset or intangible asset not charged under section 45 by virtue of conditions laid down in the proviso to clause (xiii) or the proviso to clause (xiv) of section 47 shall be deemed to be profits and gains of the successor company and chargeable to tax in the year in which infringement takes place. See also notes under section 47.

TAX TREATMENT OF LENDING ANY SECURITIES. 47(XV)

Any transfer in a scheme for lending of any securities under an agreement or arrangement, which the assessee has entered into with the borrower of such securities and which is subject to the guidelines issued by the Securities and Exchange Board of India or Reserve Bank of India.

MODE OF COMPUTATION SEC 48

Full value of the consideration received or accruing as a result of the transfer of the capital asset		X
Less:		
Expenditure incurred wholly and exclusively in connection in connection with such transfer:	X	
The cost of acquisition of the asset and the const of any improvement thereto:	X	X
The income chargeable under the head "Capital gains"		X

SPECIAL MODE OF COMPUTATION FOR NR'S PROVSIO. 1 TO 48

In the case of an assessee, who is a non-resident, capital gains arising from the transfer of a capital asset being shares in, or debentures of, an Indian company shall be computed by converting the cost of acquisition, expenditure incurred wholly and exclusively in connection with such transfer and the full value of the consideration received or accruing as a result of the transfer of the capital asset into the same foreign currency as was initially utilised in the purchase of the shares or debentures, and the capital gains so computed in such foreign currency shall be reconverted into Indian currency, so, however, that the aforesaid manner of computation of capital gains shall be applicable in respect of capital gains accruing or arising from every reinvestment thereafter in, and sale of shares in, or debentures of, an Indian company: (Kalpseh Clasess. Raja Ram Mohan Roy Marg, 198 Diamond queen building, Mumbai 400 004. Maharashtra.)

INDEXATION FOR THE LONG TERM CAPITAL GAIN PROVSIO. 2 TO 48

Where long-term capital gain arises from the transfer of a long-term capital asset, other than capital gain arising to a non-resident from the transfer of shares in, or debentures of, an Indian company referred to in the first proviso, the words "cost of acquisition" and "cost of any improvement", the words "indexed cost of acquisition" and "indexed cost of any improvement" to be substituted.

WITHDRAWAL OF INDEXATION TO LONG TERM GAINS ON BONDS, DEBENTURES PROVSIO. 3 TO 48

Nothing contained in the second proviso shall apply to the long-term capital gain arising from the transfer of a long-term capital asset being bond or debenture other than capital indexed bonds issued by the Government.

In the case of transfer of bonds and debentures, there is normally a capital loss since these are sold at a discount in the stock market. This capital loss is further enhanced because of the benefit of indexation resulting in a loss of revenue to the exchequer. In order to plug this loophole, the Act has inserted a third proviso to section 48 of the Income-tax Act. This proviso excludes bonds and debentures other than capital indexed bonds issued by the Government from the list of capital assets eligible for the benefit of indexation.

It covers gains arising on transfer of convertible debentures but does not include gains arising on transfer of capital indexed bonds issued by the government, preference shares, units of mutual funds, units issued by unit trust of india, indira vikas patra, government securities.

GIFT OF SECURITIES ISSUED UNDER ESOP - PROVSIO. 4 TO 48

Where shares, debentures or warrants issued under the scheme of ESOP are transferred under a gift or an irrevocable trust, the market value on the date of such transfer shall be deemed to be the full value of consideration received or accruing as a result of transfer for the purposes of computation of capital gains.

The market value of the shares on the date of such transfer by the employee under a gift or irrevocable trust being deemed as the full value of the consideration received or accruing as a result of the transfer.

NO DEDUCTION FOR SECURITIES TRANSACTION TAX - PROVSIO. 5 TO 48

No deduction shall be allowed in computing the income chargeable under the head “Capital gains” in respect of any sum paid on account of securities transaction tax. No deduction to be allowed whether it paid at time of purchase or sale of securities.

“INDEXED COST OF ANY IMPROVEMENT” MEANING OF

Is an amount which bears to the cost of improvement the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the year in which the improvement to the asset took place;

“COST INFLATION INDEX” MEANING OF

"Cost Inflation Index", in relation to a previous year, means such Index as the Central Government may, having regard to seventy-five percent. of average rise in the Consumer Price Index for urban non-manual employees for the immediately preceding previous year to such previous year, by notification in the Official Gazette, specify in this behalf.

Cost Inflation Index has been defined to be the Index which the Central Government may notify having regard to seventy-five per cent. of average rise in Consumer Price Index for urban non-manual employees for that year. Since the Index has to be notified in the beginning of the year in relation to transfer of assets to be effected during that year so as to calculate the installment of advance tax payable, it has to be in relation to 1st day of April of that year on the basis of average rise in Index in the preceding previous year. To clarify the issue beyond any doubt, it is proposed to substitute the clause retrospectively to provide that the Cost Inflation Index for any previous year will be such Index as notified by the Central Government having regard to seventy-five per cent. of average rise in the Consumer Price Index for urban non-manual employees for the immediately preceding previous year.

The notified the “cost inflation index” for the purpose of long-term capital gain is as follows:

<u>F.Y.</u>	<u>INDEX</u>	<u>F.Y.</u>	<u>INDEX</u>
1981-82	100	1993-94	244
1982-83	109	1994-95	259
1983-84	116	1995-96	281
1984-85	125	1996-97	305
1985-86	133	1997-98	331
1986-87	140	1998-99	351
1987-88	150	1999-00	389
1988-89	161	2000-01	406
1989-90	172	2001-02	426
1990-91	182	2002-03	447
1991-92	199	2003-04	463
1992-93	223	2004-05	489
		2005-06	

ASSETS HAVING NO COST OF ACQUISITION

What is contemplated under section 48 is an asset in the acquisition of which it is possible to envisage a cost. The intent goes to the nature and character of the asset, that it is an asset which possesses the inherent quality of being available on the expenditure of money to a person seeking to acquire it. It is immaterial that although the asset belongs to such a class, it may on the facts of a certain case be acquired without the payment of money.

None of the provisions pertaining to the head "Capital gains" suggests that they include an asset in the acquisition of which no cost at all can be conceived - CIT v. B.C. Srinivasa Setty 1981 128 ITR 294 (SC).

MEANING OF 'FULL VALUE OF CONSIDERATION'

The expression 'full value of the consideration' cannot be construed as the market value but as the price bargained for by the parties to the sale. The expression 'full value' means the whole price without any deduction whatsoever and it cannot refer to the adequacy or inadequacy of the price bargained for - CIT v. Geroge Henderson & Co. Ltd. 1967 66ITR 622 (SC).

WHEN COMPUTATION IS NOT POSSIBLE

If, on the facts of a particular case, computation under section 48 is not possible, the charge under section 45 fails because it cannot be effectuated - CIT v. B.C. Srinivasa Setty 1981 128 ITR 294 (SC).

CAPITAL GAINS IN CASE OF RIGHTS

Under section 2(14) a capital asset means property of any kind held by an assessee, whether or not connected with his business or profession. The word "property" used in section 2(14) of the Act is a word of the widest amplitude and the definition has re-emphasised this by the use of the words "of any kind". Any right which can be called property will be included in the definition of "capital asset". A contract for sale of land is capable of specific performance. It is also assignable. Therefore, a right to obtain conveyance of immovable property is clearly property as contemplated by section 2(14) of the Act. [1980] 122 ITR 0594 Commissioner of Income-tax vs. Tata Services Ltd. (Bombay High Court)

CAPITAL GAINS IN CASE LEASE PREMIUM

The appellant, a body of individuals, purchased two pieces of land in 1966 at a price of Rs. 27,600. In 1970 it granted a mining lease to a private company to extract clay for a period of 10 years at a premium of Rs. 5 lakhs in addition to payment of royalty. The grant of the mining lease was transfer of a "capital asset" within the meaning of section 45. The cost of acquisition of the land would include the "cost of acquisition" of the mining right under the lease and the date of acquisition of the right to grant lease had to be the same as the date of acquisition of the freehold rights. The amount paid by the appellant to purchase the land was for acquiring a bundle of rights in the land including the right to grant a lease. The cost of acquisition had to be apportioned in each case on the basis of evidence. [1989] 176 ITR 0417- Krishnamurthy (A.R.) vs. Commissioner of Income-tax (Supreme Court of India)

INTEREST ON CAPITAL BORROWED AS COST

The expression "actual cost" should be construed in the sense which no commercial man would misunderstand. The accepted principle of accountancy is that, for the determination of the cost of a fixed asset, all the expenditure incurred for bringing into existence such asset must be included in the cost of acquisition. In the instant case, the assessee incurred interest to a tune of Rs. 11,344 on the amount borrowed by him for acquisition of the capital asset, and, therefore, the capitalised interest must be included in the actual cost of the site. Determination of actual cost of site by any other method would be contrary to principles of accountancy. Challapalli Sugars Ltd. v. CIT [1975] 98 ITR 167 (SC) and CIT v. Mithlesh Kumari [1973] 92 ITR 9 (Delhi) followed. Gupta (K.S.) 119 ITR 372 (AP). However if such interest is allowed as deduction under some other section then again deduction shall not be allowed. 152 ITR 247 Maithreyi Pai (Kar).

"LONG-TERM CAPITAL ASSET" 2(29A)

"long-term capital asset" means a capital asset which is not a short-term capital asset.

"SHORT-TERM CAPITAL ASSET" 2(42A)

"short-term capital asset" means a capital asset held by an assessee for not more than thirty-six months immediately preceding the date of its transfer.

Provided that in the case of a share held in a company or any other security listed in a recognised stock exchange in India or a unit of the Unit Trust of India established under the Unit Trust of India Act, or a unit of a Mutual Fund specified under clause (23D) of section 10 or zero coupon bond, the provisions of this clause shall have effect as if for the words "thirty-six months", the words "twelve months" had been substituted.

Explanation (I) In determining the period for which any capital asset is held by the assessee -

- (a) In the case of a share held in a company in liquidation, there shall be excluded the period subsequent to the date on which the company goes into liquidation
- (b) In the case of a capital asset which becomes the property of the assessee in the circumstances mentioned in sub-section (1) of section 49, there shall be included the period for which the asset was

held by the previous owner referred to in the said section

- (c) In the case of a capital asset being a share or shares in an Indian company, which becomes the property of the assessee in consideration of a transfer referred to in clause (vii) of section 47, there shall be included the period for which the share or shares in the amalgamating company were held by the assessee
- (d) In the case of a capital asset, being a share or any other security (hereafter in this clause referred to as the financial asset) subscribed to by the assessee on the basis of his right to subscribe to such financial asset or subscribed to by the person in whose favour the assessee has renounced his right to subscribe to such financial asset, the period shall be reckoned from the date of allotment of such financial asset
- (e) In the case of a capital asset, being the right to subscribed to any other person, the period shall be reckoned from the date of the offer of such right by the company or institution, as the case may be, making such offer
- (f) In the case of a capital asset, being a financial asset, allotted without any payment and on the basis of holding of any other financial asset, the period shall be reckoned from the date of the allotment of such financial asset (Kalpseh Clasess. Raja Ram Mohan Roy Marg, 198 Diamond queen building, Mumbai 400 004. Maharashtra.)
- (g) In the case of a capital asset, being a share or shares in an Indian company, which becomes the property of the assessee in consideration of a demerger, there shall be included the period for which the share or shares held in the demerged company were held by the assessee

In respect of capital assets other than those mentioned the period for which any capital asset is held by the assessee shall be determined subject to any rules which the Board may make in this behalf.

COST WITH REFERENCE TO CERTAIN MODES OF ACQUISITION SECTION 49.

COST OF ACQUISITION IN CASE OF GIFT, WILL, INHERITANCE ...	
49(1)	Where the capital asset became the property of the assessee On any distribution of assets on the total or partial partition of a Hindu undivided family or Under a gift or will or by succession, inheritance or devolution, or under any such transfer as is referred to in clause (iv) or (v) or (vi) or (via) or (viaa) of section 47 the cost of acquisition of the asset shall be deemed to be the cost for which the previous owner of the property acquired it, as increased by the cost of any improvement of the assets incurred or borne by the previous owner or the assessee, as the case may be.
COST OF ACQUISITION IN CASE OF AMALGAMATION	
49(2)	Where the capital asset being a share or shares in an amalgamated company which is an Indian company became the property of the assessee in consideration of a transfer referred to in clause (vii) of section 47 [amalgamation], the cost of acquisition of the asset shall be deemed to be the cost of acquisition to him of the share or shares in the amalgamating company.
COST OF ACQUISITION IN CASE OF CONVERSION OF DEBENTURES IN TO SHARES	
49(2A)	Where the capital asset, being a share or debenture in a company, became the property of the assessee in consideration of a transfer referred to in clause (x) of section 47, the cost of acquisition of the asset to the assessee shall be deemed to be that part of the cost of debenture, debenture-stock or deposit certificates in relation to which such asset is acquired by the assessee.
COST OF ACQUISITION IN CASE OF ESOP	
49(2AA)	Where the capital gain arises from the transfer of the shares, debentures or warrants, the value of which has been taken into account while computing the value of perquisite, the cost of acquisition of such shares, debentures or warrants shall be the fair market value on the date of the exercise of the option.
COST OF ACQUISITION IN CASE OF EMPLOYEES STOCK OPTION	
49(2B)	OMITTED W.E.F. A.Y. 2001-02 Where the capital gain arises from the transfer of the specified security issued under the scheme of ESOP, the cost of acquisition of such specified security shall be the fair market value on the date of exercise of option.
COST OF ACQUISITION IN CASE OF DEMERGER	
49(2C) & 49(2D)	The cost of acquisition of the shares in the resulting company shall be the amount which bears to the cost of acquisition of shares held by the assessee in the demerged company the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger. The cost of acquisition of the original shares held by the shareholder in the demerged company shall be deemed to have been reduced by the amount as so arrived at under sub-section (2C). “net worth” shall mean the aggregate of the paid up share capital and general reserves as appearing in the books of account of the demerged company immediately before the demerger.
COST OF ACQUISITION IN CASE TRANSFER OF HOLDING TO SUBSIDERY WHERE 47(A) IS VIOLATED	
49(3)	Notwithstanding anything contained in sub-section (1), where the capital gain arising from the transfer of a capital asset referred to in clause (iv) or, as the case may be, clause (v) of section 47 is deemed to be income chargeable under the head “Capital gains” by virtue of the provisions contained in section 47A, the cost of acquisition of such asset to the transferee-company shall be the cost for which such asset was acquired by it.

SECTION 55 MEANING OF COST OF IMPROVEMENT / ACQUISITION

FOR THE PURPOSES OF SECTION 48 AND 49 “COST OF ANY IMPROVEMENT”	
55(1) (b)(1)	In relation to a capital asset being goodwill of a business or a right to manufacture, produce or process any article or thing, or right to carry on any business shall be taken to be nil.
55(1) (b)(2)	In relation to any other capital asset, Where the capital asset became the property of the previous owner or the assessee before the 1st day of April, 1981 means all expenditure of a capital nature incurred in making any additions or alterations to the capital asset on or after the said date by the previous owner or the assessee, and In any other case, means all expenditure of a capital nature incurred in making any additions or alterations to the capital asset by the assessee after it became his property, and, where the capital asset became the property of the assessee by any of the modes specified in sub-section (1) of section 49, by the previous owner.
FOR THE PURPOSES OF SECTIONS 48 AND 49, “COST OF ACQUISITION” OF GOODWILL OF A BUSINESS OR A RIGHT TO MANUFACTURE	
55(2) (a)	In relation to a capital asset, being goodwill of a business or a trade mark or brand name associated with business or a right to manufacture, produce or process any article or thing, right to carry on any business, tenancy rights, stage carriage permits or loom hours, In the case of acquisition of such asset by the assessee by purchase from a previous owner, means the amount of the purchase price; and In any other case not being a case falling under sub-clause (I) to (iv) of sub-section (1) of section 49, shall be taken to be nil;
FOR THE PURPOSES OF SECTIONS 48 AND 49, “COST OF ACQUISITION” OF FINANCIAL ASSETS	
55(2) (aa)	In a case where, by virtue of holding a capital asset, being a share or any other security, the assessee becomes entitled to subscribe to any additional financial asset or Is allotted any additional financial asset without any payment, then In relation to the original financial asset, on the basis of which the assessee becomes entitled to any additional financial asset, means the amount actually paid for acquiring the original financial asset In relation to any right to renounce the said entitlement to subscribe to the financial asset, when such right is renounced by the assessee in favour of any person, shall be taken to be nil in the case of such assessee; In relation to he financial asset, to which the assessee has subscribed on the basis of the said entitlement, means the amount actually paid by him for acquiring such asset; and In relation to the financial asset allotted to the assessee without any payment and on the basis of holding of any other financial asset, shall be taken to be nil in the case of such assessee; In relation to any financial asset purchased by any person in whose favour the right to subscribe to such asset has been renounced, means the aggregate of the amount of the purchase price paid by him to the person renouncing such right and the amount paid by him to the company or institution, as the case may be, for acquiring such financial asset;
COST OF ACQUISITION IN CASE OF MEMBERS OF STOCK EXCHANGE IN THE SCHEME OF CORPORATISATON OF STOCK EXCHANGE	
55(2) (ab)	In relation to a capital asset, being equity share or shares allotted to a shareholder of a recognised stock exchange in India under a scheme for demutualisation or corporatisation approved by the Securities and Exchange Board of India shall be the cost of acquisition of his original membership of the exchange. Provided that the cost of a capital asset, being trading or clearing rights of the recognised stock exchange acquired by a shareholder who has been allotted equity share or shares under such scheme of demutualisation or corporatisation, shall be deemed to be nil;”.

FOR THE PURPOSES OF SECTIONS 48 AND 49, “COST OF ACQUISITION” IN RELATION TO ANY OTHER CAPITAL ASSET	
55(2) (b) (I & II)	Where the capital asset became the property of the assessee before the 1st day of April, 1981 means the cost of acquisition of the asset to the assessee or the fair market value of the asset on the 1st day of April, 1981, at the option of the assessee. Where the capital asset became the property of the assessee by any of the modes specified in sub-section (1) of section 49, and the capital asset became the property of the previous owner before the 1st day of April, 1981, means the cost of the capital asset to the previous owner or the fair market value of the asset on the 1st day of April 1981, at the option of the assessee.
FOR THE PURPOSES OF SECTIONS 48 AND 49, “COST OF ACQUISITION” OF ASSETS RECEIVED ON THE LIQUIDATION OF COMPANY	
55(2)(b)(III)	Where the capital asset became the property of the assessee on the distribution of the capital assets of a company on its liquidation and the assessee has been assessed to income-tax under the head “Capital gains” in respect of that asset under section 46, means the fair market value of the asset on the date of distribution; (Kalpseh Clasess. Raja Ram Mohan Roy Marg, 198 Diamond queen building, Mumbai 400 004. Maharashtra.)
FOR THE PURPOSES OF SECTIONS 48 AND 49, “COST OF ACQUISITION” IN CASE OF CONSOLIDATION, CONVERSION... OF SHARES OR STOCK	
55(2) (b) (V)	Where the capital asset, being a share or a stock of a company, became the property of the assessee on (a) The consolidation and division of all or any of the share capital of the company into shares of larger amount than its existing shares, (b) The conversion of any shares of the company into stock, (c) The re-conversion of any stock of the company into shares, (d) The sub-division of any of the shares of the company into shares of smaller amount, or (e) The conversion of one kind of shares of the company into another kind, Means the cost of acquisition of the asset calculated with reference to the cost of acquisition of the shares or stock from which such asset is derived.
FOR THE PURPOSES OF SECTIONS 48 AND 49, “COST OF ACQUISITION” OF PREVIOUS OWNER COULD NOT BE DETERMINED.	
55(3)	Where the cost for which the previous owner acquired the property cannot be ascertained, the cost of acquisition to the previous owner means the fair market value on the date on which the capital asset became the property of the previous owner.

THE FOLLOWING TABLES HIGHLIGHTS THESE DEEMING PROVISIONS

TABLE 1 - GOODWILL OF A BUSINESS

	Self generate d	Initially acquired under the circumstances mentioned under section 49(1)		Initially purchase d
		Self-generated by the previous owner	Originally purchased by the previous owner	
Gain chargeable	Yes	Yes	Yes	Yes
Cost	Zero	Zero	Cost to the previous owner	Purchase Price
Improvement	Zero	Zero	Zero	Zero

TABLE 2 - TENANCY RIGHTS, ROUTE PERMITS AND LOOM HOURS

Gain chargeable	Yes	Yes	Yes	Yes
Cost	Zero	Zero	Cost to the previous owner	Purchase price
Improvement	Expense incurred	Expenditure incurred by the assessee and the previous owner	Expenditure incurred	

TABLE 3 - GOODWILL OF A PROFESSION

Gain chargeable	No	No	No	No
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TABLE 4 - ANY OTHER ASSET (NOT INCLUDED IN TAXABLE 1,2 &3)

Gain chargeable	No	No	Yes	Yes
Cost	--	--	Cost to the previous owner	Purchase price
Improvement	--	--	Expenditure incurred by the assessee and previous owner	Expense incurred

SPECIAL PROVISION FOR COMPUTATION OF CAPITAL GAINS IN CASE OF DEPRECIABLE ASSETS. SECTION 50

WHERE BLOCK BECOMES NEGATIVE	
	Where the full value of the consideration received or accruing as a result of the transfer of the asset together with the full value of such consideration received or accruing as a result of the transfer of any other capital asset falling within the block of the assets during the previous year, exceeds the aggregate of the following amounts, namely (i) Expenditure incurred wholly and exclusively in connection with such transfer or transfers; (ii) The written down value of the block of assets at the beginning of the previous year, and (iii) The actual cost of any asset falling within the block of assets acquired during the previous year, Such excess shall be deemed to be the capital gains arising from the transfer of short-term capital assets.
WHERE ALL THE ASSETS IN THE BLOCK ARE TRANSFERRED	
	Where any block of assets ceases to exist as such, for the reason that all the assets in that block are transferred during the previous year, the cost of acquisition of the block of assets shall be the written down value of the block of assets at the beginning of the previous year, as increased by the actual cost of any asset falling within that block of assets, acquired by the assessee during the previous year and the income received or accruing as a result of such transfer or transfers shall be deemed to be the capital gains arising from the transfer of short-term capital assets.

50A. SPECIAL PROVISION FOR COST OF ACQUISITION IN CASE OF DEPRECIABLE ASSET

Where the capital asset is an asset in respect of which a deduction on account of depreciation under clause (i) of sub-section (1) of section 32 has been obtained by the assessee in any previous year, the provisions of sections 48 and 49 shall apply subject to the modification that the written down value, as defined in clause (6) of section 43, of the asset, as adjusted, shall be taken as the cost of acquisition of the asset.

The effect of the insertion of new section 50A is to make special provisions for computation of cost of acquisition in the case of depreciable assets referred to in section 32(1)(i). The amendment also provides that the provisions of section 48 and 49 shall apply subject to the modification that the written down value as defined in section 43(6) of the asset as adjusted shall be taken as the cost of acquisition of the asset.

50B SPECIAL PROVISION FOR COMPUTATION OF CAPITAL GAINS IN CASE OF SLUMP SALE

Any profits or gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of long-term capital assets and shall be deemed to be the income of the previous year in which the transfer took place

Any profits or gains arising from the transfer under the slump sale of any capital asset being one or more undertakings owned and held by an assessee for not more than thirty-six months immediately preceding the date of its transfer shall be deemed to be the capital gains arising from the transfer of short-term capital assets.

NET WORTH OF UNDERTAKING SHALL BE THE COST

In relation to capital assets being an undertaking or division transferred by way of such sale, the “net worth” of the undertaking or the division, as the case may be, shall be deemed to be the cost of acquisition and the cost of improvement and no regard shall be given to the provisions contained in the second proviso to section 48. [INDEXATION NOT AVAILABLE]

FURNISHING OF THE REPORT OF C.A.

Every assessee, in the case of slump sale, shall furnish in the prescribed form along with the return of income, a report of an Chartered Accountant indicating the computation of the net worth of the undertaking or division, as the case may be, and certifying that the net worth of the undertaking or division, as the case may be, has been correctly arrived.

MEANING OF NETWORTH

The "net worth" shall be the aggregate value of total assets of the undertaking or division as reduced by the value of liabilities of such undertaking or division as appearing in the books of account. The aggregate value of

total assets of such undertaking or division shall be the written down value of block of assets determined in accordance with the provisions contained in 43(6) (c) in the case of depreciable assets and the book value for all other assets.

50C. SPECIAL PROVISION FOR FULL VALUE OF CONSIDERATION IN CERTAIN CASES

Where the consideration received or accruing as a result of the transfer by an assessee of a capital asset, being land or building or both, is less than the value adopted or assessed by the “stamp valuation authority” for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed shall, for the purposes of section 48, be deemed to be the full value of the consideration received or accruing as a result of such transfer. Where,

1. The assessee claims before any Assessing Officer that the value adopted or assessed by the stamp valuation authority exceeds the fair market value of the property as on the date of transfer
2. The value so adopted or assessed by the stamp valuation authority has not been disputed in any appeal or revision or no reference has been made before any other authority, court or the High Court,

The Assessing Officer may refer the valuation of the capital asset to a Valuation Officer (DVO) and where any such reference is made, the provisions relating to valuation dispute shall apply in relation to such reference

Where the value ascertained by DVO exceeds the value adopted or assessed by the stamp valuation authority the value so adopted or assessed by such authority shall be taken as the full value of the consideration received or accruing as a result of the transfer.

ADVANCE MONEY RECEIVED.(SECTION 51)

Where any capital asset was on any previous occasion the subject of negotiations for its transfer, any advance or other money received and retained by the assessee in respect of such negotiations shall be deducted from the cost for which the asset was acquired or the written down value or the fair market value, as the case may be, in computing the cost of acquisition.

EXEMPTION FROM CAPITAL GAINS

VARIOUS EXEMPTION IS AVAILABLE FROM THE CAPITAL GAINS PROVIDED CERTAIN CONDITIONS ARE SATISFIED. THE SECTIONS GRANTING THE EXEMPTION IS EXPLAINED BELOW IN THE TABULAR MANNER.

	Particulars	SECTION 54	SECTION 54B
1	Who is the assessee qualifying for benrfit ?	Indivdial or HUF	Individual
2	What should be the asset transferred ?	Residential House	Agricultural Land
3	What is the holding period of Transferred asset ?	Transfer of LTCA	2 years usage
4	Any other condition	No	Land should have been Used for agricultural purpose by assessee or his parents
5	Where should assessee invest Monies ?	Residential House	Agricultural Land
6	What is time Limit for Acquisition ?	1 year before or 2 years after	2 years after
7	What is time Limit for Construction ?	3 years after	---
8	What is the amount of Investment ?	Capital Gains	Capital Gains
9	What is holding period of new asset ?	3 years from date of acquisiton	3 years from date of acquisiton
10	What if there is violation in holding period ?	Cost Less	Cost Less
11	Which will be the year of consequence ?	---	---
12	Is 54H applicable ?	Yes	Yes
13	Is CG scheme 1988 applicable ?	Yes	Yes

NOTE 2 – RELATED TO SECTION 54

MEANING OF ‘PURCHASE’

The word ‘purchase’ in section 54 must be interpreted in its ordinary meaning, as buying for a price or equivalent of price by payment in kind or adjustment towards an old debt or for other monetary consideration. There is no stress in the section on ‘cash and carry’. Thus, where the eldest brother in a coparcenery comprising four brothers sold his own house and acquired the common house from his three brothers who executed release deeds for a consideration, there was a ‘purchase’ by the eldest brother of the share of each of the brothers for a price - CIT v. T.N. Arvinda reddy 1979 120 ITR 46 (SC).

PURCHASE FOLLOWED BY CONSTRUCTION

The main purpose of the statute is to give relief for the acquisition of a new residential house. In that context, it does not really matter whether the new residential house is partly constructed or partly purchased. Thus, where the assessee utilised part of the capital gains on the purchase of a house and utilised the remaining part on the construction of an additional floor on that house within the prescribed time-limit, the ITO would not be justified in restricting the exemption to the investment made on the purchase only - B.B. Sarkar v. CIT 1981 132 ITR 150 (Cal.).

HOLDING OF LEGAL TITLE WITHIN PRESCRIBED TIME IS NOT A PRE-CONDITION

Taking into consideration the letter as well as the spirit of section 54 and the word ‘towards’ used before the word ‘purchase’ in section 54(2), it seems that the word ‘purchase is not used in the sense of legal transfer and therefore, the holding of a legal title within a period of one year is not a condition precedent for attracting

section 54. Where the whole consideration was paid, possession of the flat was obtained and it was actually put to use for dwelling within four months, the exemption contemplated under section 54 was clearly attracted - CIT v. Dr. Laxmichand Narpal Nagda 1995 211 ITR 804 (Bom.).

WHEN MORE THAN ONE HOUSE IS PURCHASED

In case the assessee has purchased more than one house/flat within the period prescribed in section 54, it is for the assessee to claim relief against the purchase of any one of the house/flat provided the other conditions mentioned in the section are satisfied - K.C. Kaushik v. P.B. Rane, ITO 1990 84 CTR (Bom.) 62.

MEANING OF HOUSE ASSESSABLE UNDER THE HEAD HOUSE PROPERTY

Section 54 of the Income-tax Act, 1961, provides for exemption in respect of capital gain arising from the transfer of a long-term capital asset, being a residential house, the income of which is chargeable under the head "Income from house property", if the conditions laid down in the said provision are fulfilled. Under section 23(2) the annual value of one house in the occupation of the owner for purposes of his own residence is taken as nil. A question has been raised whether capital gain arising from the transfer of such a house property would be entitled to exemption under section 54 of the Act. Income from a self-occupied residential house is chargeable under the head "Income from house property", even though in certain circumstances such income may be computed at nil or at a negative. [1989] 179 ITR (Stat) 0023- Circular Number: 538

PAYMENT IN KIND

Four brothers, members of a Hindu undivided family, partitioned the joint family properties, leaving undivided a common house. The assessee, the eldest of them, had sold his own house incurring capital gains tax. Each of his three brothers executed a release deed valuing his share in the common house at 30,000 in favour of the assessee towards the extra share (jeshtabhagam) agreed to be given. The question was whether this would amount to a "purchase" of the house by the assessee attracting section 54(1) and the assessee would be entitled to the relief thereunder on the ground that he had "purchased" a house property. The word "purchase" in section 54(1) had to be given its common meaning, viz., buy for a price or equivalent of price by payment in kind or adjustment towards a debt or for other monetary consideration. Each release in this case was a transfer of the releasor's share for consideration to the releasee and the transferee, the assessee, "purchased" the share of each of his brothers and the assessee was, therefore, entitled to the relief under section 54(1). [1979] 120 ITR 0046- Commissioner of Income-tax vs. Arvinda Reddy (T.N.) (Supreme Court of India)

SELF FINANCING SCHEME OF DDA

Under the Self-financing Scheme of the Delhi Development Authority, the allotment letter is issued on payment of the first instalment of the cost of construction. The allotment is final unless it is cancelled or the allottee withdraws from the scheme. The allotment is cancelled only under exceptional circumstances. The allottee gets title to the property on the issuance of the allotment letter and the payment of instalments is only a follow-up action and taking the delivery of possession is only a formality. If there is a failure on the part of the D.D.A. to deliver the possession of the flat after completing the construction, the remedy for the allottee is to file a suit for recovery of possession.

The Board have been advised that under the above circumstances, the inference that can be drawn is that the D.D.A. takes up the construction work on behalf of the allottee and that the transaction involved is not a sale. Under the scheme, the tentative cost of construction is already determined and the D.D.A. facilitates the payment of the cost of construction in instalments subject to the condition that the allottee has to bear the increase, if any, in the cost of construction. Therefore, for the purpose of capital gains tax, the cost of the new asset is the tentative cost of construction and the fact that the amount was allowed to be paid in instalments does not affect the legal position stated above. In view of these facts, it has been decided that cases of allotment of flats under the Self-financing Scheme of the Delhi Development Authority shall be treated as cases of construction for the purpose of capital gains. [1986] 162 ITR (Stat) 0041- Circular Number: 471

[1994] 205 ITR (Stat) 0047A Circular Number: 672 It was clarified in circular 471 that cases of allotment of flats under the self-financing scheme of the Delhi Development Authority (DDA) should be treated as cases of construction for the purposes of sections 54 and 54F of the Income-tax Act, 1961. If the terms of the schemes of allotment and construction of flats/houses by the co-operative societies or other institutions are similar to those mentioned in Board's Circular No. 471, such cases may also be treated as cases of construction for the purposes of sections 54 and 54F of the Income-tax Act. (Kalpesh Clases. Raja Ram Mohan Roy Marg, 198 Diamond queen building, Mumbai 400 004. Maharashtra.)

CONSTRUCTION OF HOUSE

The assessee sold the building in February, 1977. In March, 1975, he had commenced construction of a new house which was completed in March, 1977. The assessee claimed exemption from tax on capital gains under section 54 of the Income-tax Act, 1961. The Income-tax Officer rejected the claim of the assessee on the ground

that the construction of the new building had commenced much earlier to the sale of the old building and the major portion of the building was let out by the assessee.

The building was used mainly for the residential purpose of the assessee and found that the major portion of the building was under the occupation of the assessee. Therefore the first condition prescribed under section 54 was satisfied. It was immaterial that the construction of the new building was started way back. The construction was completed in March, 1977, which was within three years from the date of sale of the old building. Therefore, the assessee was entitled to exemption under section 54 of the Act. [1987] 165 ITR 0571- Commissioner of Income-tax vs. Subramanya Bhat (J.R.) (Karnataka High Court)

REGISTRATION OF HOUSE

Section 54 of the Income-tax Act, 1961, has to be construed in the context of the manner in which residential properties are now being constructed in a city like Bombay where, looking to the cost of the land, co-operative housing societies are being formed for constructing a building in which flats are allotted to members. This must also be viewed as a method of constructing residential tenements. What we have to see is whether the assessee has acquired a right to a specific flat in such a building which is being constructed by the society and whether he has made a substantial investment within the prescribed period which will entitle him to obtain possession of the flat so constructed and in which he intends to reside. [1995] 216 ITR 0376- Commissioner of Income-tax vs. Hilla J.B. Wadia (Mrs.) (Bombay High Court)

AGREEMENT TO SELL ENTERED IN TO ADVANCE

The construction of the flat was finally completed in July, 1988. The assessee paid the consideration on July 29, 1988, and she was put in possession of the flat on July 30, 1988. The assessee claimed the benefit of exemption under section 54F. According to the Department, the agreement for the purchase of the new flat was entered into more than one year prior to the sale and, therefore, the assessee was not entitled to exemption under section 54F. Held that she was entitled to the benefit of exemption under section 54F as the relevant date in this connection was July 29, 1988, when the assessee paid the full consideration on the flat becoming ready for occupation and obtained possession of the flat. [1996] 217 ITR 0363- Commissioner of Income-tax vs. Beena K. Jain (Smt.) (Bombay High Court)

REPURCHASE OF HOUSE

Sale of house used for residence and purchase of another house for residence within two years. There was a clause in deed for repurchase of house and assessee was paying rent for house after its sale. There was subsequent repurchase of house within one year of sale in accordance with clause in original deed the transaction was not bogus. Assessee entitled to exemption under section 54 in relation to the repurchase of the same house. [1994] 205 ITR 0377A Commissioner of Income-tax vs. Phiroze H. Patch (Bombay High Court)

INVESTMENT IN MORE THAN ONE HOUSE

In case the assessee has purchased more than one house/flat within the period prescribed in section 54, it is for the assessee to claim relief against the purchase of any one of the house/flat provided the other conditions mentioned in the section are satisfied [1990] 185 ITR 0499- Kaushik (K.C.) vs. Rane (P.B.), Fifth ITO (Bombay High Court) (Kalpesh Clases. Raja Ram Mohan Roy Marg, 198 Diamond queen building, Mumbai 400 004. Maharashtra.)

The expression used in a statute should ordinarily be understood in the sense in which it is best harmonious with the object of the statute and which effectuates the object of the legislature. It is, therefore, necessary to read section 54 of the Income-tax Act, 1961, in the context of the subject-matter and its setting in the scheme of capital gains and the object of the exemption and to ascertain its true import. The main purpose of section 54 is to give relief in respect of profit on the sale of a residential house. If an assessee is entitled to relief on the fulfilment of either of the two conditions, that is to say, either purchasing a house property within one year or constructing the house within two years, it would be improper to hold that on fulfilment of both the conditions he would be disentitled to that relief. It is the fulfilment of two alternative conditions that is contemplated by section 54. But, where both the conditions are fulfilled within the time stipulated, the assessee will be entitled to the relief under the section. [1981] 132 ITR 0150A Sarkar (B.B.) vs. Commissioner of Income-tax (Calcutta High Court)

NOTE 3 – RELATED TO SECTION 54B

APPLICABILITY TO HUF

The user by the parent, which would also qualify for claiming the benefit of section 54B, would be inapplicable to a case where the assessee is one other than an individual. Hence, section 54B will not apply to a HUF - CIT v. G.K. Devarajulu 1991 191 ITR 211 (Mad.).

	Particulars	SECTION 54D	SECTION 54G
1	Who is the assessee qualifying for benrfit ?	Any Person	Any Person
2	What should be the asset transferred ?	Land and Building forming part of Industrial undertaking	Land, Building, Plant and machinery forming part of Industrial undertaking
3	What is the holding period of Transferred asset ?	2 years usage	No condition
4	Any other condition	It should be subject matter of compulsory acquisition	The undertaking must be loacated in urban area and now being shifted to rural area.
5	Where should assessee invest Monies ?	Land and Building forming part of Industrial undertaking	Land, Building, Plant and machinery forming part of Industrial undertaking
6	What is time Limit for Acquisition ?	3 years after	1 year before or 3 years after
7	What is time Limit for Construction ?	3 years after	1 year before or 3 years after
8	What is the amount of Investment ?	Capital Gains	Capital Gains
9	What is holding period of new asset ?	3 years from date of acquisiton	3 years from date of acquisiton
10	What if there is violation in holding period ?	Cost Less	Cost Less
11	Which will be the year of consequence ?	---	---
12	Is 54H applicable ?	Yes	No
13	Is CG scheme 1988 applicable ?	Yes	Yes

NOTE 4 – RELATED TO SECTION 54D

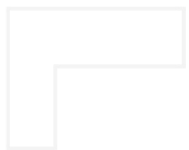
MEANING OF ‘INDUSTRIAL UNDERTAKING’

Since the Act does not define what is an ‘undertaking’ and what is an ‘industrial undertaking’ these words must be given their natural meaning. ‘Undertaking’ in common parlance means an ‘enterprise’, ‘venture’, ‘engagement’. It can as well mean ‘the act of one who undertakes or engages in a project or business’. An ‘undertaking’ mentioned in section 54D must be one maintained by a person for the purpose of carrying on his business. The demonstrative adjective ‘industrial’ qualifying the word ‘undertaking’ unmistakably and with precision shows that the undertaking must be one which partakes the character of a business. The words ‘industrial undertaking’ should therefore be understood to have been used in section 54D in a wide sense, taking in its fold any project or business a person may undertake. Thus, the ‘running of a lodge’ can be said to be an ‘industrial undertaking’ within the meaning of section 54D - P. Alikunju v. CIT 1987 166 ITR 804 (Ker.).

The Government acquired the land and building forming part of an ice factory belonging to the assessee. The assessee claimed exemption from tax under section 54D on the ground that he had invested the capital gain in the construction of a lodging house. The running of a lodge could be said to be an industrial undertaking within the meaning of section 54D. The assessee was entitled to the exemption under section 54D.

A provision for exemption or relief in a fiscal statute should be construed liberally and in favour of the assessee. It, therefore, follows that the words used therein should be given their popular meaning. Section 54D of the Income-tax Act, 1961, which grants an exemption must be construed liberally and the expression "industrial undertaking" occurring in section 54D must be given its popular meaning. An undertaking mentioned in section 54D must be one maintained by a person for take purpose of carrying on his business. "Undertaking" for the

purpose of this section, however, must be "an industrial undertaking". The demonstrative adjective "industrial" qualifying the word "undertaking" unmistakably and with precision shows that the undertaking must be one which partakes of the character of a business. The word "business" connotes some real, substantial and systematic or organised course of activity with a set purpose. [1987] 166 ITR 0804A Alikunju (P.), M.A. Nazeer Cashew Industries vs. Commissioner of Income-tax (Kerala High Court)



	Particulars	SECTION 54EC	SECTION 54ED
1	Who is the assessee qualifying for benrfit ?	Any Person	Any Person
2	What should be the asset transferred ?	Any asset	Listed securities in India
3	What is the holding period of Transferred asset ?	Transfer of LTCA	Transfer of LTCA
4	Any other condition	---	---
5	Where should assessee invest Monies ?	Specified Bonds	Specified Bonds
6	What is time Limit for Acquisition ?	6 months after	6 months after
7	What is time Limit for Construction ?	---	---
8	What is the amount of Investment ?	Capital Gains	Capital Gains
9	What is holding period of new asset ?	3 years from date of acquisiton	1 years from date of acquisiton
10	What if there is violation in holding period ?	Deemed Capital gains	Deemed Capital Gains
11	Which will be the year of consequence ?	Year of Violation.	Year of Violation.
12	Is 54H applicable ?	Yes	No
13	Is CG scheme 1988 applicable ?	No	No

NOTE 6 – RELATED TO SECTION 54EC / 54ED

The assets specified for investment are bonds of the NABARD or the National Housing Authority of India and Rural Electrification corporation limited or other specified investments. Where a part of the gain is so invested exemption will be granted. The bonds / shares will be "locked in" for a period as specified. If before the expiry of this lock-in period, the assessee transfers the bonds or takes a loan against them the assessee will lose the exemption granted earlier and to the extent he has converted the bonds, he will be taxed in the year in which he converts them. The investment in the specified bonds / shares made for the purpose of section 54EC / 54ED will not again be eligible for consideration for purpose of rebate under section 88 / **80C**. (Kalpseh Clasess. Raja Ram Mohan Roy Marg, 198 Diamond queen building, Mumbai 400 004. Maharashtra.)

NOTE 8 – RELATED TO SECTION 54ED

In order to improve the sentiment in the capital markets, and to promote development of the primary market, 54ED provide that the capital gains arising from transfer of a long-term capital asset, being listed securities or unit of a mutual fund or of the Unit Trust of India shall be exempt from tax to the extent such capital gain is invested in equity shares forming part of an eligible issue of capital, made by a public company, and offered for subscription to public. Capital gain scheme 1988 is not provided for. Such newly acquired shares may be given as security for obtaining loans or advances without any consequences in this section. 54H benefit for extended time limit in case of compulsory acquisition is not provided for.

	Particulars	SECTION 54F	SECTION 115F
1	Who is the assessee qualifying for benefit ?	Individual or HUF	Non Resident Indian
2	What should be the asset transferred ?	Any asset (Other than Residential House)	Foreign exchange asset
3	What is the holding period of Transferred asset ?	Transfer of LTCA	Transfer of LTCA
4	Any other condition	Prov. 1 to 54F(1) 54F(2)	---
5	Where should assessee invest Monies ?	Residential House	Specified Asset
6	What is time Limit for Acquisition ?	1 year before or 2 years after	6 months after
7	What is time Limit for Construction ?	3 years after	---
8	What is the amount of Investment ?	Net Consideration	Net Consideration
9	What is holding period of new asset ?	3 years from date of acquisition	3 years from date of acquisition
10	What if there is violation in holding period ?	Deemed Capital gains	Deemed Capital Gains
11	Which will be the year of consequence ?	Year of Violation.	Year of Violation.
12	Is 54H applicable ?	Yes	No
13	Is CG scheme 1988 applicable ?	Yes	No

NOTE 7 – RELATED TO SECTION 54F

Section 54F of the Income-tax Act exempts levy of tax on long-term capital gains arising from transfer of any long-term capital asset (not being a residential house), if invested in a residential house. There is, however, a stipulation that the above exemption cannot be availed of, if there is a house in existence on the date of transfer or if the person goes for a second house within the stipulated period. The above condition stands in the way of a large number of taxpayers from availing of the deduction under section 54F. The existing house may be a small house or a tenanted house which is difficult to sell in view of the stringent tenancy laws or a house which cannot be sold because of non-availability of buyers or slump in market prices. Therefore, section 54F of the Income-tax Act to provide that the deduction under this section may be available to an individual or Hindu undivided family as long as he has one and not more than one house existing on the date of transfer. Other conditions would remain the same.

PROVISIO 1 TO 54F PROVIDES THAT BENEFIT IS NOT AVAILABLE IF THE ASSESSEE

- Owns more than one residential house, other than the new asset, on the date of transfer of the original asset; or
- Purchases any residential house, other than the new asset, within a period of one year after the date of transfer of the original asset; or
- Constructs any residential house, other than the new asset, within a period of three years after the date of transfer of the original asset; and

54F(2) PROVIDES THAT IN SOME CASES THERE WILL BE DEEMED CAPITAL GAINS

Where the assessee purchases, within the period of two years after the date of the transfer of the original asset, or constructs, within the period of three years after such date, any residential house, amount of the benefit shall

be deemed to be income chargeable under the head “Capital gains” relating to long-term capital assets of the previous year in which such residential house is purchased or constructed.

NOTE 5 – RELATED TO SECTION 54H

EXTENSION OF TIME FOR ACQUIRING NEW ASSET OR DEPOSITING OR INVESTING AMOUNT OF CAPITAL GAIN. SEC 54 H

It had been brought to the notice of the Government that in cases of compulsory acquisition of assets, at times there is a considerable gap between the dates of acquisition and payment of compensation. The result is that provisions of capital gains taxation operate harshly inasmuch as the affected persons are unable to avail of the exemption for roll-over of capital gains, within the specified time period, through investment in specified assets. Section 54H provide that in cases where compensation in respect of any asset acquired compulsorily is received after the date of such transfer, the period for investment in specified assets shall be reckoned from the date of receipt of such compensation. (the extension of time limit is applicable to sections 54, 54B, 54D 54EC and 54F)

NOTE 1 – SCHEME OF CAPITAL GAINS 1988

If the new asset is not acquired up the due date of submission of return of income, then the tax payer will have to deposit the money in “capital gain deposit account scheme” with a nationalized bank. The proof of deposit should be submitted along with return of income. On the basis of actual investment and the amount deposited in the deposit account, exemption will be given to the tax payer.

The tax payer can acquire a new asset by with drawing from the deposit account. But the new asset should be acquired within time-limit mentioned above. If the deposit account is not fully utilised for acquiring the new asset, the unutilised amount [but in case of section 54f it is unutilised amount/net sale consideration * capital gain] will become chargeable to tax in the previous year in which the specified time-limit as mentioned above expires. It will be taxable as short-term/long-term capital gain depending upon the original capital gain. The tax payer can withdraw the unutilised amount after the expiry of the aforesaid time limit.

REFERENCE TO VALUATION OFFICER: SEC. 55A

With a view to ascertaining the fair market value of a capital asset to the purposes of this Chapter, the Officer may refer the valuation of capital asset to a Valuation Officer -

- (a) In a case where the value of the asset as claimed by the assessee is in accordance with the estimate made by a registered valuer, if the Officer is of opinion that the value so claimed is less than its fair market value:
- (b) In any other case, if the Officer is of opinion -
 - (i) That the fair market value of the asset exceeds the value of the asset as claimed by the assessee by more than such percentage of the value of the asset as so claimed or by more than such amount as may be prescribed in this behalf ; or
 - (ii) That having regard to the nature of the asset and other relevant circumstances, it is necessary so to do.

Section 55A enables the Income-tax Officer to refer the valuation of any capital asset to the Valuation Officer with a view to ascertaining the market value of such asset. Under the provision, an Income-tax Officer may refer the valuation of any capital asset to a Valuation Officer in a case where the assessee has got the assets valued by a registered valuer and the Income-tax Officer is of opinion that the value as estimated by the registered valuer (i.e., a person registered as a valuer under section 34AB of the Wealth-tax Act) is less than the fair market value of the asset. Other cases in which a reference may be made to the Valuation Officer would be where the Income-tax Officer is of opinion that the fair market value of the asset exceeds the value of the asset as claimed by more than 15 per cent of the value claimed or by more than Rs. 25,000, whichever is less or where, having regard to the nature of the asset and other relevant circumstances, the Income-tax Officer considers it necessary to do so.

SEC 10(37) CAPITAL GAINS ON AGRICULTURAL LAND

In the case of an assessee, being an individual or a Hindu undivided family, any income chargeable under the head “Capital gains” arising from the transfer of agricultural land will be exempt, where

- (i) such land is situate in any rural area
- (ii) such land, during the period of two years immediately preceding the date of transfer, was being used for agricultural purposes by such Hindu undivided family or individual or a parent of his
- (iii) such transfer is by way of compulsory acquisition or a transfer the consideration for which is determined or approved by the Central Government or the Reserve Bank of India

SEC 10(38) LONG TERM CAPITAL GAINS IN CASE OF EQUITY SHARES

Any income arising from the transfer of a long-term capital asset, being an equity share in a company or a unit of an equity oriented fund will be exempt where

- (a) the transaction of sale of such equity share or unit is entered into on or after the date on which securiries transaction tax comes into force; and
- (b) such transaction is chargeable to securities transaction tax under that Chapter.

CHAPTER - 07

SET OFF AND C/F

SET OFF AND CARRY FORWARD
SET OFF OF LOSS FROM ONE SOURCE AGAINST INCOME FROM ANOTHER SOURCE UNDER THE SAME HEAD OF INCOME. SECTION 70

Where the net result for any assessment year in respect of any source falling under any head of income, other than “Capital gains”, is a loss, the assessee shall be entitled to have the amount of such loss set off against his income from any other source under the same head.

EXCEPTION TO INTRA HEAD ADJUSTMENT

1	Any loss, computed in respect of a speculation business carried on by the assessee, shall not be set off except against profits and gains, if any, of another speculation business . 73(1)
2	Where the result of the computation made for any assessment year under sections 48 to 55 in respect of any capital asset (other than a short-term capital asset) is a loss, the assessee shall be entitled to have the amount of such loss set off against the income, if any, as arrived at under a similar computation made for the assessment year in respect of any other capital asset not being a short-term capital asset. 70(2)/(3). I.e. long term capital loss will be allowed to be set off only against long term capital gains. However there is no such restriction in relation to short term capital loss.
3	In the case of an assessee, being the owner of horses maintained by him for running in horse races the amount of loss incurred by the assessee in the activity of owning and maintaining race horses in any assessment year shall not be set off against income, if any, from any source other than the activity of owning and maintaining race horses in that year. 74A(1)
4	No deduction in respect of any expenditure or allowance in connection with such income shall be allowed in computing the income by way of any winnings from lotteries, crossword puzzles, races including horse races (excluding business of maintaining horse races.), card games and other games of any sort or from gambling or betting of any form or nature, whatsoever. 58(4). Any loss can not be set off against winning from lotteries, cross word puzzle etc. by virtue of 115BB since such income is subject to flat rate of tax. However rebates under section 88,88B or 88C will be available.

SET OFF OF LOSS FROM ONE HEAD AGAINST INCOME FROM ANOTHER. SECTION 71

Where in respect of any assessment year the net result of the computation under any head of income, he shall, be entitled to have the amount of such loss set off against his income, if any, assessable for that assessment year under any other head.

EXCEPTION TO INTER HEAD ADJUSTMENT

1	Same exceptions referred to in section 70.
2	Where the net result of the computation under the head "Capital gains" is a loss and the assessee has income assessable under any other head of income, the assessee shall not be entitled to have such loss set off against income under the other head. 71(3)
3	Where in respect of any assessment year, the net result of the computation under the head “Profits and gains of business or profession” is a loss and the assessee has income assessable under the head “Salaries”, the assessee shall not be entitled to have such loss set off against such income. 71(2A)

CARRY FORWARD OF LOSS

Sec.	Type of Loss	In subsequent year	carried forward for	Also Refer.
71B	House property: a) Let out property b) Self-occupied property (On account of interest on borrowed capital)	Income from House property	8 years	Note: 3
72	Business or profession (Non-Speculation other than Depreciation)	Business Income head	8 years	Note: 1,3,4,6,7
32(2)	Depreciation	ANY	ANY	Note: 2 Note: 3
73	Business (Speculation)	Speculation profit.	4 years	Note: 1,3,5
74	Short term Capital Loss	Any Capital Gain	8 years	Note: 3
74	Long term Capital Loss	Long term Capital Gain	8 years	Note: 3
74A	Running and Maintaining Race Horses	Such income only	4 years	Note: 3

NOTE: 1

Unabsorbed business losses / speculative business loss can be carried forward & set off against profits from any business / speculative business. There is no need to continue the same business / speculative business in which the loss was incurred.

NOTE: 2

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

Where, in the assessment of the assessee, full effect cannot be given to any depreciation in any previous year, then, subject to the provisions of 72(2) and 72(3) the allowance or the part of the allowance to which effect has not been given, as the case may be, shall be added to the amount of the allowance for depreciation for the following previous year and deemed to be part of that allowance, or if there is no such allowance for that previous year, be deemed to be the allowance for that previous year, and so on for the succeeding previous years.

NOTE: 3

A return of loss is required to be furnished for determining the carry forward of such losses, by the due date prescribed for different assessee's u/s. 139(1) of the Act. (S.80). However this condition do not apply for carry forward of depreciation and loss under the head house property.

NOTE: 4

Where the business or profession is no longer in existence and there is income chargeable to tax under section 41(1), 41(3), 41(4) or 41(4A) in respect of that business or profession, any loss, not being a loss sustained in speculation business which arose in that business or profession during the previous year in which it ceased to exist and which could not be set off against any other income of that previous year shall, so far as may be, be set off against the income chargeable to tax under the sections aforesaid. This is an exception to the time limit of 8 years.

NOTE: 5

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

LOSS FROM ILLEGAL BUSINESS CANNOT BE SET OFF AGAINST SPECULATIVE BUSINESS INCOME

The loss of an illegal speculative transaction cannot be set off against the profit of another lawful speculative transaction. If however the business was the same, then the loss would be liable to be taken into account while computing the profits under section 28(i) - CIT v. S.C. Kothari [1971] 82 ITR 794 (SC).

NOTE: 6**AMALGAMATION**

Where there has been an amalgamation of a company owning an industrial undertaking or a ship or a hotel with another company or an amalgamation of a banking company with a specified bank, then, the accumulated loss and the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or, as the case may be, allowance for depreciation of the amalgamated company for the previous year in which the amalgamation was effected and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.

CONDITIONS FOR AMALGAMATING COMPANY

- 1) Has been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for three or more years;
- 2) Has held continuously as on the date of the amalgamation at least three-fourths of the book value of fixed assets held by it two years prior to the date of amalgamation;

CONDITIONS FOR THE AMALGAMATED COMPANY

- 1) Holds continuously for a minimum period of five years from the date of amalgamation at least three-fourths of the book value of fixed assets of the amalgamating company acquired in a scheme of amalgamation;
- 2) Continues the business of the amalgamating company for a minimum period of five years from the date of amalgamation;
- 3) Fulfills such other conditions as may be prescribed to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose.”;

DEMERGER

Demerger means the transfer of one or more undertakings to any resulting company pursuant to a scheme of arrangement under Sections 391 to 394 of the Companies Act, 1956 in such a manner that:

All the property/liability of the undertaking becomes the property/liability of the resulting company.

All the property/liabilities are transferred at book value (excluding increase in value due to revaluation).

The resulting company issues shares to the shareholders of demerged company on a proportionate basis.

Shareholders holding minimum 75% of the value of shares become shareholders of the resulting company.

The transfer of an undertaking is on a going concern basis.

The demerger is in accordance with the conditions notified under Section 72A(5).

Undertaking: includes any part of an undertaking or a unit or division of an undertaking or a business activity taken as a whole, but excludes individual assets or liabilities not constituting a business activity.

In the case of a demerger, the accumulated loss and the allowance for unabsorbed depreciation of the demerged company shall all allowed to be set off in the hands of resulting company. where such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting company, be allowed to be carried forward and set off in the hands of the resulting company. Where such loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting company, be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company, and be allowed to be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be.

BUSINESS RE-ORGANISATION

Where there has been reorganisation of business, whereby, a firm is succeeded by a company fulfilling the conditions of section 47(xiii) or a proprietary concern is succeeded by a company fulfilling the conditions of section 47(xiv), then, the accumulated loss and the unabsorbed depreciation of the predecessor firm or the proprietary concern, as the case may be, shall be deemed to be the loss or allowance for depreciation of the successor company for the purpose of previous year in which business reorganisation was effected. If any of the conditions laid down in section 47 (xiii) or (xiv) are not complied with, the set-off of loss or allowance of depreciation made in any previous year in the hands of the successor company, shall be deemed to be the income of the company chargeable to tax in the year in which such conditions are not complied with.

NOTE NO. 7**AMALGAMATION OF BANKS**

Where there has been an amalgamation of a banking company with any other banking institution under a scheme sanctioned and brought into force by the Central Government the accumulated loss and the unabsorbed depreciation of such banking company shall be deemed to be the loss or, as the case may be, allowance for depreciation of such banking institution for the previous year in which the scheme of amalgamation was brought into force and other provisions of this Act relating to set-off and carry forward of loss and allowance for depreciation shall apply accordingly.

Explanation.—For the purposes of this section,—

“accumulated loss” means so much of the loss of the amalgamating banking company under the head “Profits and gains of business or profession” (not being a loss sustained in a speculation business) which such amalgamating banking company, would have been entitled to carry forward and set-off under the provisions of section 72 if the amalgamation had not taken place;

“unabsorbed depreciation” means so much of the allowance for depreciation of the amalgamating banking company which remains to be allowed and which would have been allowed to such banking company if amalgamation had not taken place.

CASE LAWS**ASSESSEE DOES NOT HAVE ANY OPTION**

In the computation of the total income of the assessee under the head "Profits and gains of business", the total income has to be arrived at after considering the profit and loss from different heads of income. "Total income" cannot be computed without adjusting the profit and loss from different heads. Irrespective of adjustments under sections 70, 71 and 72(1) income from all sources accruing to the assessee in the year has necessarily to go into the calculation of the total income. Section 72 provides for carried forward loss only when such loss cannot be set off against income under any other head. For calculating the total income of the assessee, profits and losses from different sources of income are required to be taken into consideration. Under the Act, there is no provision which gives an option to the assessee to show the profit as income from one source and carry forward the loss from another source of income to the next year. CIT v. Milling Trading Co. (P.) Ltd. [1994] 76 Taxman 389 (Guj.) In other words Section 72 provides for carry forward of loss only when such loss cannot be set off against income under any other head. Under the Act, there is no provision which give option to the assessee to show the profit as income from one source and carry forward the loss from another source of income to the next year. **LOSS FROM EXEMPT SOURCE CANNOT BE CARRIED FORWARD**

If the loss arising in the previous year was under a head not chargeable to tax, it could not be allowed to be carried forward and absorbed against income in a subsequent year from a taxable source. In such cases, neither the assessee is required to show the same in the return nor is the ITO under any obligation to compute or assess it, much less for the purpose of ‘carry forward’ - CIT v. Harprasad & Co. (P.) Ltd. [1975] 99 ITR 118 (SC).

LOSS CAN BE SET OFF AGAINST INCOME CLUBBED

Where section 64 operates, the profit or loss from a business of spouse included in the total income of the assessee should be treated as profit or loss of a business ‘carried on’ by him for the purpose of carry forward and set off of such loss under section 72 - CIT v. J.H. Gotla [1985] 156 ITR 323 (SC).

NATURE OF LOSS IS RELEVANT FOR SET OFF : It is a cardinal principle of the law relating to income-tax that income-tax is a single charge on the total income of an assessee. For the purpose of computation, the statute recognises different classes of income which it classifies under different heads of income. For each head of income, the statute has provided the mode of computing the quantum of such income. The mode of computation varies with the nature or the class of such income, for the deductions permissible under the law in computing the income under each head bear a particular relevance to the nature of the income. The statute operates on the principle that it is the net income under each head which should be considered as a component of the total income. The statute permits specified deductions from gross receipts in order to compute the net income. The net income under the different heads is then pooled together to constitute the total income. The process of computation at this stage takes in the provisions relating to the carry forward and setting off of losses and of unabsorbed depreciation. On the conclusion of the entire process of assessment, what emerges is the figure of taxable income, i.e., the quantum of income which is assessed to tax. [1986] 162 ITR 0373D Brooke Bond and Co. Ltd. vs. Commissioner of Income-tax (Supreme Court of India)

EFFECTIVE DATE OF AMALGAMATION : This decision should come as a breather for companies under amalgamation, since the Supreme Court has now clearly laid down that in cases of amalgamation the computation of income as between the amalgamating and amalgamated companies should be with reference to the periods before and after the appointed day and not on the date on which the scheme itself is sanctioned by the court. The law is now settled that it can be taxed only with reference to the appointed day. There is, however, an interesting side-light in this decision in that the Supreme Court had expressed itself as not expressing any opinion on the question whether amalgamation could be treated as a device to evade tax legitimately payable by the subsidiary company. It would mean that such an argument is now possible for Revenue. It would, however, appear that the question of treating it as a device could hardly ever arise because amalgamation is not treated as taxable event in law itself. Section 47(vi) exempts tax on capital gains on amalgamation. There are similar provisions for transactions between holding companies and their wholly owned subsidiaries. [1997] 223 ITR 0809- Marshall Sons and Co. (India) Ltd. vs. Income-tax Officer (Supreme Court of India)

CARRY FORWARD AND SET OFF OF LOSSES IN CASE OF CHANGE IN CONSTITUTION OF FIRM OR ON SUCCESSION. SEC. 78

Where a change has occurred in the constitution of a firm, nothing shall entitle the firm to have carried forward and set off so much of the loss proportionate to the share of a retired or deceased partner as exceeds his share of profits, if any, in the firm in respect of the previous year.

CARRY FORWARD AND SET OFF OF LOSSES IN THE CASE OF CERTAIN COMPANIES SEC. 79.

Where a change in shareholding has taken place in a previous year in the case of a company, not being a company in which the public are substantially interested, no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year unless on the last day of the previous year the shares of the company carrying not less than fifty-one per cent of the voting power were beneficially held by persons who beneficially held shares of the company carrying not less than fifty-one per cent of the voting power on the last day of the year or years in which the loss was incurred

Provided that nothing contained in this section shall apply to a case where a change in the said voting power takes place in a previous year consequent upon the death of a shareholder or on account of transfer of shares by way of gift to any relative of the shareholder making such gift

Provided further that nothing contained in this section shall apply to any change in the shareholding of an Indian company which is a subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company subject to the condition that fifty-one per cent shareholders of the amalgamating or demerged foreign company continue to be the shareholders of the amalgamated or the resulting foreign company.

MEANING OF LOSS

The word 'loss' mentioned in section 79 does not include 'unabsorbed depreciation' or 'unabsorbed development rebate'. Accordingly, the bar imposed under the main part of section 79 is not attracted as far as 'carry forward and set off of unabsorbed depreciation' or 'unabsorbed development rebate' is concerned.

SEC 94(7) DIVIDEND STRIPPING

Where (a) Any person buys or acquires any securities or unit within a period of three months prior to the record date

(b) Such person sells or transfers (i) such securities within a period of three months after such date, or (ii) such unit within a period of nine months after such date

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

SEC 94(8) BONUS STRIPPING

Where (a) Any person buys or acquires any units within a period of three months prior to the record date

(b) Such person is allotted additional units without any payment on the basis of holding of such units on such date

(c) Such person sells or transfers all or any of the units referred to in clause (a) within a period of nine months after such date, while continuing to hold all or any of the additional units referred to in clause (b)

then, the loss, if any, arising to him on account of such purchase and sale of all or any of such units shall be ignored for the purposes of computing his income chargeable to tax and notwithstanding anything contained in any other provision of this Act, the amount of loss so ignored shall be deemed to be the cost of purchase or acquisition of such additional units referred to in clause (b) as are held by him on the date of such sale or transfer. (Kalpesh Clases. Raja Ram Mohan Roy Marg, 198 Diamond queen building, Mumbai 400 004. Maharashtra.)

TAX DEDUCTION AT SOURCE

SEC. 196 SUMS PAYABLE TO GOVERNMENT, RESERVE BANK OR CERTAIN CORPORATIONS.

No deduction of tax shall be made by any person from any sums payable to

1. The Government, or
2. The Reserve Bank of India, or
3. A corporation established by or under a Central Act which is, under any law for the time being in force, exempt from income-tax on its income, or
4. A Mutual Fund specified under clause (23D) of section 10,

SEC. 197 CERTIFICATE FOR DEDUCTION AT LOWER RATE.

Where, in the case of any income of any person or sum payable to any person, income-tax is required to be deducted at the time of credit or, as the case may be, at the time of payment at the rates in force under the provisions of sections 192, 193, 194, 194A, 194C, 194D, 194G, 194H, 194-I, 194J, 194K 194L, 194LA and 195, the Assessing Officer is satisfied that the total income of the recipient justifies the deduction of income-tax at any lower rates or no deduction of income-tax as the case may be, the Assessing Officer shall, on an application made by the assessee in this behalf, give to him such certificate as may be appropriate.

Where any such certificate is given, the person responsible for paying the income shall, until such certificate is cancelled by the Assessing Officer, deduct income-tax at the rates specified in such certificate or deduct no tax, as the case may be.

SEC. 197A(1C) NO DEDUCTION FOR INTEREST / DIVIDEND FOR SENIOR CITIZEN

Notwithstanding anything contained in section 193 or section 194 or section 194A or section 194EE or section 194K, no deduction of tax shall be made in the case of an individual resident in India, who is of the age of sixty-five years or more at any time during the previous year and is entitled to a deduction from the amount of income-tax on his total income referred to in section 88B, if such individual furnishes to the person responsible for paying any income of the nature referred to in section 193 or section 194 or section 194A or section 194EE or section 194K, as the case may be, a declaration in writing in duplicate in the prescribed form and verified in the prescribed manner to the effect that the tax on his estimated total income of the previous year in which such income is to be included in computing his total income will be nil.

SEC. 198. TAX DEDUCTED IS INCOME RECEIVED.

All sums deducted shall, for the purpose of computing the income of an assessee, be deemed to be income received. Provided that the sum being the tax paid, under 192(1A) (TDS on non-monetary perquisite) for the purpose of computing the income of an assessee, shall not be deemed to be income received.

SEC 199. CREDIT FOR TAX DEDUCTED.

Any deduction made and paid to the Central Government shall be treated as a payment of tax on behalf of the person from whose income the deduction was made, credit shall be given to him for the amount so deducted on the production of the certificate furnished under section 203 in the assessment made under this Act for the assessment year for which such income is assessable.

Credit in case of clubbing provisions: In a case where such person or owner or depositor or unitholder or shareholder is a person, whose income is included under the provisions of section 60, section 61, section 64, section 93 or section 94 in the total income of another person, the payment shall be deemed to have been made on behalf of, and the credit shall be given to, such other person.

Credit in case of joint interest: Where any property, deposit, security, unit or share is owned jointly by two or more persons not constituting a partnership, the payment shall be deemed to have been made on behalf of, and

credit shall be given to, each such person in the same proportion in which rent, interest on deposit or on security or income in respect of unit or dividend on share is assessable as his income.

Any sum referred to in 192(1A) (TDS on non monetary perquisite) and paid to the Central Government shall be treated as the tax paid on behalf of the person in respect of whose income, such payment of tax has been made and credit shall be given to him for the amount so paid on production of the certificate furnished under section 203 in the assessment under this Act for the assessment year for which such income is assessable.

Credit without TDS certificate : Where any deduction is made and paid to the Central Government, the amount of tax deducted and specified in the statement referred to in section 203AA shall be treated as tax paid on behalf of the persons and credit shall be given to him for the amount so deducted in the assessment made under this Act for the assessment year for which such income is assessable without the production of certificate.

200. DUTY OF PERSON DEDUCTING TAX.

Any person deducting any sum shall pay within the prescribed time, the sum so deducted to the credit of the Central Government. Any person deducting any sum shall, after paying the tax deducted to the credit of the Central Government within the prescribed time, prepare quarterly statements for the period ending on the 30th June, the 30th September, the 31st December and the 31st March in each financial year and deliver to the prescribed income-tax authority or the person authorised by such authority such statement in such form and verified in such manner and setting forth such particulars and within such time as may be prescribed.

SEC 201. CONSEQUENCES OF FAILURE TO DEDUCT OR PAY.

If any person does not deduct the whole or any part of the tax or after deducting fails to pay the tax as required by he shall be deemed to be an assessee in default in respect of the tax:

If any such person, does not deduct the whole or any part of the tax or after deducting fails to pay the tax as required under this Act, he or it shall be liable to pay simple interest at twelve per cent. per annum on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually paid.

Charge on asset if fails to pay: Where the tax has not been paid after it is deducted, the amount of the tax together with the amount of simple interest thereon shall be a charge upon all the assets of the person.

SEC. 202. DEDUCTION ONLY ONE MODE OF RECOVERY.

The power to recover tax by deduction shall be without prejudice to any other mode of recovery.

SEC. 203 CERTIFICATE FOR TAX DEDUCTED.

Every person deducting tax shall, within such period as may be prescribed from the time of credit or payment of the sum, furnish to the person to whose account such credit is given or to whom such payment is made or the cheque or warrant is issued, a certificate to the effect that tax has been deducted, and specifying the amount so deducted, the rate at which the tax has been deducted and such other particulars as may be prescribed.

Where the tax has been deducted or paid there shall be no requirement to furnish a certificate.

SEC 203A. TAX DEDUCTION AND COLLECTION ACCOUNT NUMBER.

Every person, deducting tax or collecting tax who has not been allotted a tax deduction account number or, as the case may be, a tax collection account number, shall, within such time as may be prescribed, apply to the Assessing Officer for the allotment of a "tax deduction and collection account number".

Where a "tax deduction account number" or, as the case may be, a "tax collection account number" or a "tax deduction and collection account number" has been allotted to a person, such person shall quote such number

- (a) In all challans for the payment of any sum.
- (b) In all certificates furnished.
- (c) In all the returns, and
- (d) In all other documents pertaining to such transactions as may be prescribed in the interests of revenue.

SEC 203AA. FURNISHING OF STATEMENT OF TAX DEDUCTED.

The prescribed income tax authority or the person authorised by such authority shall, within the prescribed time after the end of each financial year prepare and deliver to every person from whose income the tax has been deducted or in respect of whose income the tax has been paid a statement in the prescribed form specifying the amount of tax deducted or paid and such other particulars as may be prescribed.

SEC 206 PERSONS DEDUCTING TAX TO FURNISH PRESCRIBED RETURNS.

The prescribed person and every other person responsible for deducting tax shall, within the prescribed time after the end of each financial year to the prescribed income-tax authority, such returns in such form and verified in such manner and setting forth such particulars as may be prescribed.

The person responsible for deducting tax (other than the principal officer in the case of every company) may, at his option, deliver or cause to be delivered such return to the prescribed income-tax authority in accordance with such scheme as may be specified by the Board on or before the prescribed time after the end of each financial year, on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media (hereinafter referred to as the computer media) and in the manner as may be specified in that scheme

A return filed on computer media shall be deemed to be a return for the purposes of this section and the rules made there under and shall be admissible in any proceedings there under, without further proof of production of the original, as evidence of any contents of the original or of any fact stated therein.

Where the Assessing Officer considers that the return delivered or caused to be delivered is defective, he may intimate the defect to the person responsible for deducting tax or the principal officer in the case of a company, as the case may be, and give him an opportunity of rectifying the defect within a period of fifteen days from the date of such intimation or within such further period which, on an application made in this behalf, the Assessing Officer may, in his discretion, allow; and if the defect is not rectified within the said period of fifteen days or, as the case may be, the further period so allowed, then, notwithstanding anything contained in any other provision of this Act, such return shall be treated as an invalid return and the provisions of this Act shall apply as if such person had failed to deliver the return.

SEC. 206A, FURNISHING OF QUARTERLY RETURN IN RESPECT OF PAYMENT OF INTEREST TO RESIDENTS WITHOUT DEDUCTION OF TAX.

(1) Any banking company or co-operative society or public company responsible for paying to a resident any income not exceeding five thousand rupees by way of interest (other than interest on securities), shall prepare quarterly returns for the period ending on the 30th June, the 30th September, the 31st December and the 31st March in each financial year and deliver or cause to be delivered to the prescribed income-tax authority or the person authorised by such authority the quarterly returns as aforesaid, in the prescribed form, verified in such manner and within such time as may be prescribed, on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media.

(2) The Central Government may, by notification in the Official Gazette, require any person other than 206A(1) responsible for paying to a resident any income liable for deduction of tax at source under Chapter XVII, to prepare and deliver or cause to be delivered quarterly returns in the prescribed form and verified in such manner and within such time as may be prescribed, to the prescribed income-tax authority or the person authorised by such authority on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media.

FOLLOWING ARE THE TRANSACTION ON WHICH TAX IS TO BE DEDUCTED

Sec.	Payer	Nature of payment	Exemption & Limit	Rate of Deduction
192	Any person	Salary to any person	Rs.50000 after considering deduction u/ss.16, 80D, 80DD, 80RRA, & rebate u/s. 88, 89(1) & loss under head 'Income from House property'.	As applicable to individual sch-1, part III of the finance Act, as increased by surcharge.

193	Any person	Interest on securities to resident	a) Rs.2500 for interest on debentures paid by a widely head company (to a resident individual).	Co. 20% Other than co. 10%
194	Indian Company	Dividend (Other than 115-O)	a) Rs.2,500 for Dividend paid by a company (to a resident Shareholder).	10 %
194A	Any person other than individual or HUF. (However Individual or HUF covered by 44AB are subject to TDS)	Interest (other than interest on securities) to resident	a) Rs.5,000 per branch in case of bank interest & deposit with housing finance companies. Rs.5000 in all other cases.	Co. 20% Other than co. 10%
194B	Any person	Winnings from lottery & crossword puzzles or card game and other games of any sort to any person (Including winning in kind) foreign cos.	Rs.5000	30 %
194BB	Book maker or person holding a license for horse racing wagering betting in any race course	Winning from horse races to any person	Rs.2500	30 %
194C(1)	Central or state Govt. Local Authority, Central/State or Provincial Corp. Co. Co-operative Society, Housing Board, Trust or University, Firm	Payment to Resident contractors by	Rs.20000 per contract OR Aggregate of sum during financial year is exceeding Rs. 50,000	a) Advertising - 1 % b) contracts - 2 %
194C(2)	Any contractor other than individual & HUF. (However Individual or HUF covered by 44AB are subject to TDS)	Payment to resident sub-contractors (by above contractors) not being individual/HUF	Rs.20000 per contract	1 %
194D	Any person	Insurance commission to resident	Rs.5000	Co. 20 % Any other Person 10 %

194E	Any person	Payments to non-resident sportsmen/sports association	Not applicable	10%
194EE	Any person	Payments of deposits under NSS to any person	Payment to heirs exempt. In any other case Rs.2500	20 %
194F	Any person	Payment to any person on account of repurchase of units by mutual fund/UTI	Not applicable	20 %
194G	Any person	Commission / Remuneration on sale of lottery tickets to any person	Rs.1000	10 %
194H	Any person not being an individual or a Hindu undivided family (However Individual or HUF covered by 44AB are subject to TDS)	Commission (not being insurance commission referred to in section 194D) or brokerage for services rendered (not being professional services) or for any services in the course of buying or selling of goods or in relation to any transaction relating to any asset, valuable article or thing (not being securities),	Rs. 2500	5 %
194I	Any person (However Individual or HUF covered by 44AB are subject to TDS)	Rent paid to any resident person for land, building or building along with furniture and fittings	Rs.120000 p.a.	Individual / HUF 15 % Any other Person 20 %

194J	Other than individual & HUF. (However Individual or HUF covered by 44AB are subject to TDS)	Fees for professional services or for technical services (Kalpseh Clasess. Raja Ram Mohan Roy Marg, 198 Diamond queen building, Mumbai 400 004. Maharashtra.)	Rs.20000 p.a. No individual or a Hindu undivided shall be liable to deduct income-tax on the sum by way of fees for professional services in case such sum is credited or paid exclusively for personal purposes of such individual or any member of Hindu undivided family.”;	5 %
194K	Mutual Fund / UTI	Where any income (other than 115-R) is payable to a resident in respect of units of a Mutual Fund or of the Unit Trust of India,	Rs.2,500 for Income distribution by a MF / UTI (to a resident Unit holder).	10 %
194LA	Any person	compensation / enhanced compensation on account of compulsory acquisition, of any immovable property (other than rural agricultural land)	Aggregate amount of such payments to a resident during the financial year is one hundred thousand rupees or more.	10 %
195	Any person	Interest or other sums paid to non-resident (Salaries excluded).	ANY AMOUNT (no deduction shall be made in respect of any dividends referred to in section 115-O.)	As per double taxation avoidance treaty or as per sch.1, part II to the finance act, 2000 whichever is beneficial to the assesses

NOTE ON SECTION 192

The respondent, whose employment with the appellant company was terminated, filed a suit against the company in the Court of the District Judge for compensation for wrongful termination of employment, arrears of salary and interest. The court passed a decree and the respondent applied for execution of the decree against the company. That under the scheme of the Civil Procedure Code, the decree had to be executed as it stood, subject to such deductions or adjustments as were permissible under the Code. There was no tax liability which the respondent was assessed to pay in respect of the amount of the decree. As between the company and the respondent the amount did not represent salary: it represented a judgment debt, and for payment of income-tax thereon no provision was made in the decree. Before paying that debt, the appellant company could not claim to deduct at source the tax payable by the respondent. [1961] 041 ITR 0446- All India Reporter Ltd. vs. Ramchandra D. Datar (Supreme Court of India)

Bank filed return showing amount of salary paid to each employee and amount of rebate claimed by each employee. In the case of two employees the bank on the basis of information furnished by them deducting tax at source after giving rebate to investment in NSC certificates and deposit in PPF account. Bank explained to ITO source of investment made in NSC and PPF account. In the case of one employee money withdrawn from bank a few days before investment and handed over to agent for investment and in the case of another employee

withdrawal made from her overdraft account in bank in which her salary was credited. Investments proved and source of money explained. Bank has no authority to enquire into source of investment or to disbelieve its genuineness. Summary assessments in the cases of two employees completed and no demand was created, instead employees received refunds. ITO passing order holding employer responsible for short collection of tax such order of ITO is liable to be quashed. [1999] 236 ITR 0281- State Bank of Patiala vs. Commissioner of Income-tax (Punjab and Haryana High Court)

CERTAIN CASES WHERE TAX IS NOT REQUIRED TO BE DEDUCTED 194A

- 1) Where such income credited or paid to any banking company to which the Banking Regulation Act, applies, or any co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank), or
- 2) Where such income credited or paid to any financial corporation established by or under a Central, State or Provincial Act, or
- 3) Where such income credited or paid to the Life Insurance Corporation of India
- 4) Where such income credited or paid to the Unit Trust of India
- 5) Where such income credited or paid to any company or co-operative society carrying on the business of insurance, or
- 6) Where such income credited or paid to such other notified institution,
- 7) Where such income credited or paid by a firm to a partner of the firm
- 8) Where such income credited or paid by a co-operative society to a member thereof or to any other co-operative society;
- 9) Where such income credited or paid in respect of notified deposits
- 10) Where such income credited or paid in respect of deposits other than time deposits made
- 11) Where such income credited or paid in respect of, deposits with a primary agricultural credit society or a primary credit society or a co-operative land mortgage bank or a co-operative land development bank
- 12) Where such income credited or paid by the Central Government under any provision of this Act or the Indian Income-tax Act, 1922
- 13) Where such income credited or paid by way of interest on the compensation amount awarded by the Motor Accidents Claims Tribunal where the amount of such income or, as the case may be, the aggregate of the amounts of such income credited or paid during the financial year does not exceed fifty thousand rupees.
- 14) Where such income which is paid or payable by an infrastructure capital company or infrastructure capital fund or a public sector company in relation to a zero coupon bond issued on or after the 1st day of June, 2005 by such company or fund or public sector company

“time deposits” means deposits (excluding recurring deposits) repayable on the expiry of fixed periods.

NOTE ON SECTION 194A

When the Land Acquisition Collector deposits the money in court in order to satisfy the decree, he must have made a credit entry to the account of the payee and that moment being earlier in point of time than the actual payment made by the court, the tax at source had to be deducted by him. The liability to deduct the tax from the interest and to pay the same to the Revenue would arise when the amount is credited to the creditor's account and not when the actual payment is made because an entry regarding credit is made earlier in point of time than the actual payment. The court is not the person responsible for paying income or interest. [1993] 199 ITR 0628A Baldeep Singh vs. Union of India (Punjab and Haryana High Court)

NOTE ON SECTION 194B

Company entered into agreement with the state government to organize lotteries on behalf of the state government. As per the agreement the company undertakes to print lottery tickets at its own cost and deposit the prize monies and cost of the draw with the state government. The company given credit for prizes on unsold tickets however there is no sale of lottery tickets by the state government to the company. Such prizes on unsold tickets not winnings from lottery and thus provisions of 194B does not apply. [1993] 201 ITR 0348A Commercial Corporation of India Ltd. vs. Income-tax Officer (Bombay High Court)

NOTE ON SECTION 194C

Deduction of tax at source shall not be made on the amount of any sum credited or paid or likely to be credited or paid, during the course of business of plying, hiring or leasing goods carriages, to a sub-contractor being an individual and not owning more than two goods carriages at any time during the previous year. Such sub-contractor is required, however, to furnish a declaration as may be prescribed to the person paying or crediting such sum. The person responsible for making payment to the sub-contractor shall also furnish to the prescribed income-tax authority or to the persons authorised by such authority, the prescribed particulars in the prescribed form and within the prescribed time.

CHAPTER - 09

TCS

SEC. 206-C TAX COLLECTION AT SOURCE

Every person, being a seller shall, at the time of debiting of the amount payable by the buyer to the account of the buyer or at the time of receipt of such amount from the said buyer in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, collect from the buyer.

Every person, who grants a lease or a licence or enters into a contract or otherwise transfers any right or interest in any parking lot or toll plaza or mine or quarry, to another person, other than a public sector company for the use of such parking lot or toll plaza or mine or quarry for the purpose of business shall, at the time of debiting of the amount payable by the licensee or lessee to the account of the licensee or lessee or at the time of receipt of such amount from the licensee or lessee in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, collect from the licensee a sum equal to the percentage, specified in the Table.

	Nature of goods	Percentage
(i)	Alcoholic liquor for human consumption	One per cent.
(ii)	Tendu leaves	Five per cent.
(iii)	Timber obtained under a forest lease	Two and one-half per cent.
(iv)	Timber obtained by any mode other than under a forest lease	Two and one-half per cent.
(v)	Any other forest produce not being timber or tendu leaves	Two and one half per cent.
(vi)	Scrap	One per cent.
(vii)	Parking lot	Two per cent.
(viii)	Toll plaza	Two per cent.
(ix)	Mining and quarrying	Two per cent.

DEFINITIONS

“BUYER” means a person who obtains in any sale, by way of auction, tender or any other mode, goods of the nature specified or the right to receive any such goods but does not include,

- (i) A public sector company, the Central Government, a State Government, and an embassy, a high commission, legation, commission, consulate and the trade representation, of a foreign State and a club, or
- (ii) A buyer in the retail sale of such goods purchased by him for personal consumption.

“SCRAP” means waste and scrap from the manufacture or mechanical working of materials which is definitely not usable as such because of breakage, cutting up, wear and other reasons;

“SELLER” means the Central Government, a State Government or any local authority or corporation or authority established by or under a Central, State or Provincial Act, or any company or firm or co-operative society and also includes an individual or a Hindu undivided family whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits specified under section 44AB during the financial year immediately preceding the financial year in which the goods of the nature specified are sold.

206C IS NOT A TAX ON PURCHASE

The object in enacting sections 44AC and 206C was to enable the Revenue to collect the legitimate dues of the State from the persons carrying on particular trades in view of the peculiar difficulties experienced in the past. Trade or business produces or results in income which can be brought to tax. In order to prevent evasion of tax legitimately due on such "income", sections 44AC and 206 were enacted, so as to facilitate the collection of tax on that income which is bound to arise or accrue, at the very inception itself or at an anterior stage. These provisions are akin to advance tax. The standard by which the amount of tax is measured, being the purchase price, will not in any way alter the nature and basis of levy, viz., that the tax imposed is a tax on income. It cannot be labelled as a tax on purchase of goods. [1996] 219 ITR 0330A Union of India vs. Sanyasi Rao (A.) (Supreme Court of India)

CHAPTER - 10**PARTNERSHIP FIRMS****ASSESSMENT OF FIRMS****SEC. 184 BASIC CONDITIONS**

A firm shall be assessed as a firm for the purposes of this Act, if the partnership is evidenced by an instrument ; and the individual shares of the partners are specified in that instrument. A certified copy of the instrument of partnership shall accompany the return of income of the firm of the previous year in respect of which assessment as a firm is first sought. Where a firm is assessed as such for any assessment year, it shall be assessed in the same capacity for every subsequent year if there is no change in the constitution of the firm or the shares of the partners as evidenced by the instrument of partnership on the basis of which the assessment as a firm was first sought. Where any such change had taken place in the previous year, the firm shall furnish a certified copy of the revised instrument of partnership along with the return of income for the assessment year relevant to such previous year.

SEC. 184(5) CONSEQUENCE WHEN FIRM IS WITHIN SCOPE OF 144

Where, in respect of any assessment year, there is on the part of a firm any such failure as is mentioned in section 144, the firm shall be so assessed that no deduction by way of any payment of interest, salary, bonus, commission or remuneration, by whatever name called, made by such firm to any partner of such firm shall be allowed in computing the income chargeable under the head “Profits and gains of business or profession” and such interest, salary, bonus, commission or remuneration shall not be chargeable to income-tax under clause (v) of section 28.’.

SEC. 185 ASSESSMENT WHEN SECTION 184 NOT COMPLIED WITH.

Where a firm does not comply with the provisions of section 184 for any assessment year, the firm shall be so assessed that no deduction by way of any payment of interest, salary, bonus, commission or remuneration, by whatever name called, made by such firm to any partner of such firm shall be allowed in computing the income chargeable under the head “Profits and gains of business or profession” and such interest, salary, bonus, commission or remuneration shall not be chargeable to income-tax under clause (v) of section 28.’.

CHANGES IN CONSTITUTION, SUCCESSION AND DISSOLUTION**SEC. 187 CHANGE IN THE CONSTITUTION OF THE FIRM**

Where at the time of making an assessment under section 143 or section 144 it is found that a change has occurred in the constitution of a firm, the assessment shall be made on the firm as constituted at the time of making the assessment.

There is a change in the constitution of the firm

- (a) If one or more of the partners cease to be partners or one or more new partners are admitted, in such circumstances that one or more of the persons who were partners of the firm before the change continue as partner or partners after the change [shall NOT apply to a case where the firm is dissolved on the death of any of its partners.] or
- (b) Where all the partners continue with a change in their respective shares or in the shares of some of them:

MEANING OF “CHANGE IN CONSTITUTION”

Four partners of a firm of five partners retired from the partnership after executing a release deed under which the remaining partner, J, took over the right and liabilities of the firm. On the same day, J formed a new firm with the same name as the old firm by taking in three new partners. The new firm filed two separate returns of income in respect of the newly constituted firm and claimed that two separate assessment should be made. Even if the extinction of the old firm and the constitution of the new firm took place simultaneously, in law it must be presumed that the retirement of the partners of the old firm preceded the constitution of the new firm, for, unless the old firm ceases to exist, a new firm cannot come into being. Merely because there is a common partner in the two firms, it cannot be said that the old firm continued with a mere change in the constitution and, however small or minute the interregnum may be, there is an extinction of the old firm preceding the constitution of the new firm. The two firms are separate entities and the new firm cannot be said to be a continuation of the old firm. [1978] 112 ITR 0715- Mavukkarai (N.) Estate Tea Factory vs. Additional Commissioner of Income-tax

(Madras High Court)

The scheme of sections. 187, 188 and 189 is that if a firm discontinues business or is dissolved without being succeeded by another firm, the case would be covered by section 189. If a firm is dissolved and succeeded by another firm which has as its partners one or more partners of the old firm, the case will be one covered by section 187, as it would be merely a change in the constitution of the firm as defined in sub-section (2) thereof. If a firm is dissolved and is succeeded by another firm and none of the partners of the old firm is a partner in the new firm, the case would be covered by section 188. As the scheme of sections 187, 188 and 189 is clear and there is no ambiguity in them, recourse to the provisions of the Partnership Act, 1932, cannot be taken for construing them. [1982] 138 ITR 0660- Vimal and Amar Talkies vs. Commissioner of Income-tax (Madhya Pradesh High Court)

During the accounting period there were changes in the constitution of the firm. The original partnership was evidenced by a deed of partnership dated consisting of five partners. At the time of retirement of three male partners a deed of dissolution was executed by the partners. The remaining two partners admitted two more lady partners being the wives of the two retired partners. This new partnership was evidenced by a deed of partnership. The said firm continued, when one lady partner retired from the partnership and the remaining partners executed a dissolution deed. On the same day a fresh partnership was executed by the remaining partners and this partnership continued thereafter during the course of the accounting year. The Income-tax Officer clubbed the income of the three periods and assessed the total income in the hands of the assessee-firm and spread it over among the partners in the three periods as according to the Income-tax Officer there was only a change in the constitution of the firm within the meaning of section 187 of the Income-tax Act, 1961. Held that since dissolution within the meaning of the Indian Partnership Act, 1932, took place on two occasions in view of the execution of dissolution deeds it was not possible to hold that there was a mere change in the constitution of the firm. Since the relationship between the parties came to an end by the execution of the dissolution deed the old firm ceased to exist. It could no longer be said that it continued and that there was only a change in the constitution of the firm. Hence, a single assessment on the three firms was not justified. [2000] 244 ITR 0870- Y. Baliah Chetty Sons and Co. vs. Commissioner of Income-tax (Madras High Court)

WHEN MINOR ATTAINS MAJORITY

There are two stages in the case of a minor admitted to the benefits of partnership. The first is the stage before the minor attains majority and the other is after he attains majority. He was already a partner, and he continues as a partner. The share of the minor in the original partnership deed is well defined. Under the original partnership deed, the major partners agreed to share the entire losses. The law is that every partner is not required to share the loss and some of the partners alone can agree to share the loss. Thus the share ratio in profit and loss is well defined under the original partnership deed. The only question for consideration was whether the minor upon attaining majority agreed to share the losses. If the minor agrees to share the losses after attaining majority, then the ratio to share the losses as evidenced in the original partnership deed, will certainly undergo a change and that requires to be evidenced by a fresh partnership deed. When minor elects to become partner, there is no change in constitution 'Change in shares of partners' means change in shares of profit. Change in shares of loss on the minor attaining majority and electing to remain as partner does not constitute change in the constitution of the firm - Jagjivandas Govindji & Co. v. CBDT [1981] 132 ITR 769 (Bom.). However as per CBDT's instruction it amounts to the change in constitution since there is change in loss sharing.

SEC. 188 SUCCESSION OF ONE FIRM BY ANOTHER FIRM.

Where a firm carrying on a business or profession is succeeded by another firm, and the case is not one covered by section 187, separate assessments shall be made on the predecessor firm and the successor firm in accordance with the provisions of section 170.

MEANING OF SUCCESSION

It is not essential in every case that the successor-firm should have mathematically the same extent of business as the predecessor-firm or that it should have taken over the same extent of trade or the same line or set of customers as belonging to the predecessor-firm, nor does it mean that the successor-firm should have taken over all the different businesses which the predecessor-firm had carried on. It is sufficient if there is substantial identity or similarity in the nature and extent of activities carried on by the two firms.

Succession connotes a change of ownership from one entity to another, the former coming to an end and the latter taking over the business in continuity as a going concern. In other words, the successor-business must be a

continuation of the original business. For succession to take place, it is essential that the substantial identity and substantial continuity of the business is preserved.

SEC. 188A JOINT AND SEVERAL LIABILITY OF PARTNERS FOR TAX PAYABLE BY FIRM.

Every person who was, during the previous year, a partner of a firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable along with the firm for the amount of tax, penalty or other sum payable by the firm for the assessment year to which such previous year is relevant, and all the provisions of this Act, so far as may be, shall apply to the assessment of such tax or imposition or levy of such penalty or other sum.

SEC 189 FIRM DISSOLVED OR BUSINESS DISCONTINUED.

Where any business or profession carried on by a firm has been discontinued or where a firm is dissolved, the Assessing Officer shall make an assessment of the total income of the firm as if no such discontinuance or dissolution had taken place, and all the provisions of this Act, including the provisions relating to the levy of a penalty or any other sum chargeable under any provision of this Act, shall apply, so far as may be, to such assessment.

Every person who was at the time of such discontinuance or dissolution a partner of the firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable for the amount of tax, penalty or other sum payable, and all the provisions of this Act, so far as may be, shall apply to any such assessment or imposition of penalty or other sum.

ASSESSMENT AFTER INSOLVANCY

The assessee-firm was carrying on the business of film distribution. The firm and all its partners were declared insolvent by the Additional District Judge and a receiver was appointed. The receiver continued the business of the firm. He filed a return in the status of an association of persons. Held that on the adjudication of the firm as insolvent, it stood dissolved under the Partnership Act, 1932. Thereafter, the business was carried on by the receiver. It could not, therefore, be said that the disputed income arose to the firm. The income was assessable in the hands of the erstwhile partners as an association of persons. [1988] 171 ITR 0386- George Talkies Circuit vs. Commissioner of Income-tax (Rajasthan High Court)

READ 176(3A) AND 189 TOGETHER

Unlike section 176(3A), provision of 189 applies only to firm's business. Section 176(3A) deals with all assessee's whereas section 189 deals only with business carried on by firms. The two provisions deal with two different aspects - section 176(3A) with chargeability of receipt, and section 189 with assessment of a firm despite its dissolution. Conditions are alternative and not cumulative - Section 189 is attracted if either of the two conditions is satisfied, viz., (i) that the business/profession carried on by the firm had been discontinued or (ii) that the firm had been dissolved. Both the conditions need not be satisfied

A careful reading of section 189 and sections 176(3A) and 176(4) makes it abundantly clear that the Income-tax Act contemplates that where a firm is dissolved, the assessment of the total income of such firm shall be made by the Income-tax Officer as if no such dissolution had taken place. The same is the position in the case of discontinuance of the business of the firm. Section 189 keeps the firm alive for the purposes of assessment under the Act despite its dissolution. Sub-section (3A) of section 176 specifically provides that where any business is discontinued in a particular year, any sum received after the discontinuance shall be deemed to be the income of the recipient and shall be charged to tax accordingly in the year of receipt, if such sum would have been included in the total income of the person who carried on the business had such sum been received before such discontinuance. This sub-section thus creates a legal fiction. It is intended to resolve all doubts in regard to taxability of such income on account of discontinuance of business in the year of receipt. It may also be pertinent to mention that section 176(3A) deals with all assessee's whereas section 189 deals only with business carried on by firms. The assessee-firm was dissolved on the last day of the previous year. The amount of Rs. 12,90,000 was due to the assessee-firm in respect of a transaction entered into before its dissolution. A sum of Rs. 3,10,000 had been received by the said firm prior to its dissolution and the balance amount of Rs. 9,80,000 was received after dissolution. The main contention of the assessee was that the assessee-firm having been dissolved on March 31, 1975, the amount of Rs. 12,90,000 received by it after its dissolution could not be assessed to tax. The amount of Rs. 9,80,000 was assessable in the hands of the assessee-firm in the year of receipt despite dissolution. [1994] 208 ITR 0573- Commissioner of Income-tax vs. Star Andheri Estate (Bombay High Court)

The assessee was a registered firm doing the business of production and release of movie films. The Kerala Government had a scheme for paying an amount of Rs. 25,000 to full length feature films entirely produced, processed, recorded and re-recorded in the State of Kerala and duly certified by the Central Board of Film Censors. Subsequently the firm dissolved. The subsidy amount received later by the assessee was treated by the Department as income arising out of the business of the assessee. Held that the right to receive subsidy accrued only when the order was passed by the Government of Kerala which was after the dissolution of the firm. That there was no provision in the rules which made it mandatory for the claimants to be continuing in the business for receiving the subsidy in respect of full length feature films produced during earlier years. Therefore, the receipt of the subsidy in this case would enure to the former firm. It might be that the subsidy was received through the newly formed firm but the receipt of the newly formed firm could be only for and on behalf of the former firm. Section 176(3A) was not applicable. [1996] 217 ITR 0528- Commissioner of Income-tax vs. Excel Productions (Kerala High Court) (Kalpesh Clases. Raja Ram Mohan Roy Marg, 198 Diamond queen building, Mumbai 400 004. Maharashtra.)

Section 189(1) of the Income-tax Act, 1961, provides that in respect of any business carried on by a firm which stood dissolved, the Assessing Officer shall make an assessment of the total income of the firm as if no such dissolution had taken place and all the provisions of the Act including the provisions relating to the levy of penalty under any provision of this Act shall apply, so far as may be to such assessment. What follows from section 189(1) is that for the purpose of making the assessment, the firm notwithstanding its dissolution will be deemed to have continued and that would be subjected to assessment of the year in which the same was dissolved. If a firm is deemed to have continued for the purpose of the assessment for a particular assessment year notwithstanding its dissolution during that assessment year, there is no good reason why the firm, which is deemed to have continued under section 189(1), is not entitled to deduction of the liability, discharged during that year. In the instant case, sales tax liability relating to the calendar year 1986, relevant to the assessment year 1987-88 and 12 days of the calendar year 1987, relevant to the assessment year 1988-89 was discharged during the previous year relevant to the assessment year 1988-89. The liability to pay sales tax did not exist against the erstwhile partner, but under an agreement this liability was discharged by the erstwhile partner, inasmuch as that partner had taken over the assets and liabilities of the assessee-firm. In this situation, discharge of liability by the erstwhile partner would be deemed to have been made for and on behalf of the assessee-firm and, therefore, it was the assessee-firm alone who could claim deduction. [1999] 238 ITR 0924A Commissioner of Income-tax vs. Diza Electricals (Kerala High Court)

TAXATION OF FIRMS

Rate of tax	Flat rate of 35 % on the total income after deduction of interest and remuneration to partners at the specified rates.																															
Interest to partners	Not exceeding 12 % p.a. (simple interest)																															
Remuneration to partners	1. Payment to a non-working partner will not be allowed as a deduction. 2. A 'working partner' is an individual who is actively engaged in conducting the affairs of the business or profession of the firm. 3. Quantum of allowance is to be determined with reference to 'book profit' which is defined to mean a amount computed in accordance with the provisions of Ss. 28 to 44D of the Income-tax Act, as increased by the amount of remuneration to partners if deducted in determining book profit. 4. Maximum permissible deduction for payment of remuneration to working partners. <table><tr><th colspan="2">Professional firms</th><th colspan="2">Business firms</th></tr><tr><th>Book Profit/Loss</th><th>% Or amount of deduction</th><th>Book Profit/Loss</th><th>% Or amount of deduction</th></tr><tr><td>I. Loss</td><td>Rs.50000</td><td>Loss</td><td>Rs.50000</td></tr><tr><td>II. Profit</td><td></td><td>Profit</td><td></td></tr><tr><td>Up to Rs.100000</td><td>90%</td><td>b) Up to Rs.75000</td><td>90%</td></tr><tr><td>Next Rs.100000</td><td>60%</td><td>c) Next Rs.75000</td><td>60%</td></tr><tr><td>Balance profit</td><td>40%</td><td>d) Balance profit</td><td>40%</td></tr></table>				Professional firms		Business firms		Book Profit/Loss	% Or amount of deduction	Book Profit/Loss	% Or amount of deduction	I. Loss	Rs.50000	Loss	Rs.50000	II. Profit		Profit		Up to Rs.100000	90%	b) Up to Rs.75000	90%	Next Rs.100000	60%	c) Next Rs.75000	60%	Balance profit	40%	d) Balance profit	40%
Professional firms		Business firms																														
Book Profit/Loss	% Or amount of deduction	Book Profit/Loss	% Or amount of deduction																													
I. Loss	Rs.50000	Loss	Rs.50000																													
II. Profit		Profit																														
Up to Rs.100000	90%	b) Up to Rs.75000	90%																													
Next Rs.100000	60%	c) Next Rs.75000	60%																													
Balance profit	40%	d) Balance profit	40%																													

Conditions for allowance of remuneration & interest to partners	1. Remuneration should be to a working partner. 2. Payment of remuneration and interest should be authorized by and should be in accordance with the terms of the partnership deed and should relate to any period falling after the date of such partnership deed. 3. No deduction u/s. 40(b) will be admissible unless the partnership deed either specifies the amount of remuneration payable to each individual working partner or lays down the manner of quantifying such remuneration — circular No. 739
Conditions for assessment as a firm	1. The partnership should be evidenced by an instrument in writing specifying individual shares of the partners (Now Kalpesh Classes is totally digital, and now coaching is 200 % better in performance with on screen presentations and professors explanation) 2. A certified copy of the instrument signed by all the partners (not being minors) shall accompany the return of the firm for the first assessment as a 'firm'. 3. In case of any change in the constitution of the firm or shares of the partners in any previous year, the firm shall furnish a certified copy of the revised instrument of partnership signed by all the partners (not minors) along with the return of income for that A.Y. 4. If any default is made in compliance with the above provisions, the firm will be assessed as an AOP on the entire income without deducting interest and salary to partners. 5. If any failure is made as mentioned in S. 144 (ex prate assessment) the firm shall be assessed as an AOP without deducting interest and salary to partners.
Partners assessments	Once tax is paid by firm, no tax will be payable by the partners on share of income from the firm. Interest and/or remuneration etc. received by a partner will be taxed in his hands as 'Business or Professional Income', excluding the amount disallowed in the hands of the firm in excess of limits laid down in S. 40(b).
Losses of the firm	Unabsorbed loss including depreciation of the firm will not be apportioned amongst the partners and will be carried forward by the firm only.
Allowability of remuneration and interest visa-visa presumptive taxation	Remuneration and interest will be allowed from the presumptive income computed at prescribed rate u/ss.44AD, 44AE & 44AF.

PAYMENTS BETWEEN FIRMS HAVING COMMON PARTNERS ARE NOT COVERED

Interest paid by one firm to another firm could not be treated as interest paid to the partners of that other firm within the meaning of section 40(b), even though the two firms have common partners - CIT v. Nagpur Golden Transport Co. [1998] 233 ITR 389 (Delhi).

CHAPTER - 11

A O P

ASSESSMENT OF AOP

‘Association of persons’ means an association in which two or more persons joint in a common purpose or common action, and as the words occur in a section which impose a tax on income, the association must be one, the object of which is to produce income, profits or gains.

For forming an ‘association of persons’ the members of the association must join together for the purpose of producing an income. An ‘association of persons’ can be formed only when two or more individuals voluntarily combine together for a certain purpose. Hence, volition on the part of the members of the association is an essential ingredient. In the case of receiving dividends from shares, where there is no question of any management, it is difficult to draw an inference that two or more shareholders function as an ‘association of persons’ from the mere fact that they jointly own one or more shares, and jointly receive the dividends declared. Those circumstances do not by themselves go to show that they acted as an ‘association of persons’ - G. Murugesan & Bros. v. CIT [1973] 88 ITR 432 (SC). (Now Kalpesh Classes is totally digital, and now coaching is 200 % better in performance with on screen presentations and professors explanation)

An association of persons does not mean any and every combination of persons. It is only when they associate themselves in an income-producing activity that they become an association of persons. They must combine to engage in such an activity; the engagement must be pursuant to the combined will of the persons constituting the association; there must be a meeting of the minds, so to speak. In a nutshell, there must be a common design to produce income. If there is no common design, there is no association. Common interest is not enough. Production of income is not enough. Merely because certain persons are constituted joint owners, such as by inheriting the property of a person on his death, they do not become an association of persons, for, in that event, the jointness is the result of operation of law and not of volition of parties.

BODY OF INDIVIDUALS

The expression ‘body of individuals’ should receive a wide interpretation, perhaps not wide enough to include a combination of individuals who merely receive income jointly without anything further as in the case of co-heirs inheriting shares or securities, but certainly wide enough to include a combination of individuals who have a unity of interest but who are not actuated by a common design, and one or more of whose members producer or help to produce income for the benefit of all

SCHEME OF TAXATION OF AOP

	RATE OF TAX	Whether share included in Individual income of the member
Where none of the members are company and other income of all the members is less than basic exemption limit. (When share is determined)	As applicable to individuals	YES. And Rebate available u/s 110. See also Note. 1
The total income of any member thereof (excluding his share from such association or body) exceeds the maximum amount which is not chargeable to tax. (When share is determined)	Maximum marginal rate	NO as per sec. 86
Any member or members thereof is or are chargeable to tax at a rate or rates which is or are higher than the maximum marginal rate. (When share is determined)	Tax shall be charged on that portion or portions of the total income of the association or body which is or are relatable to the share or shares of such member or members at such higher rate or rates, as the case may be, and the balance of the total income of	NO as per sec. 86

	the association or body shall be taxed at the maximum marginal rate.	
When share is NOT determined	Maximum marginal rate	NO as per sec. 86

NOTE 1: METHOD OF COMPUTING A MEMBER’S SHARE IN INCOME OF ASSOCIATION OF PERSONS OR BODY OF INDIVIDUALS. Sec. 67A

In computing the total income of an assessee who is a member of an association of persons or a body of individuals wherein the shares of the members are determinate and known whether the net result of the computation of the total income of such association or body is a profit or a loss, his share (whether a net profit or net loss) shall be computed as follows, namely

- (a) Any interest, salary, bonus, commission or remuneration by whatever name called, paid to any member in respect of the previous year shall be deducted from the total income of the association or body and the balance ascertained and apportioned among the members in the proportions in which they are entitled to share in the income of the association or body ;
- (b) Where the amount apportioned to a member under clause (a) is a profit, any interest, salary, bonus, commission or remuneration aforesaid paid to the member by the association or body in respect of the previous year shall be added to that amount,

and the result shall be treated as the member’s share in the income of the association or body ;

APPORTIONMENT OF SHARE

The share of a member in the income or loss of the association or body shall, for the purposes of assessment, be apportioned under the various heads of income in the same manner in which the income or loss of the association or body has been determined under each head of income.

DEDUCTION OF CAPITAL BORROWED

Any interest paid by a member on capital borrowed by him for the purposes of investment in the association or body shall, in computing his share chargeable under the head “Profits and gains of business or profession” in respect of his share in the income of the association or body, be deducted from his share.

MEANING OF “ASSOCIATION OF PERSONS”

The word "associate" means "to join in common purpose, or to join in an action". Therefore, "association of persons", as used in section 3 means an association in which two or more persons join in a common purpose or common action, and as the words occur in a section which imposes a tax on income, the association must be one the object of which is to produce income, profits or gains. The co-widows of a Hindu governed by the Mitakshara law inherited his estate which consisted of immovable properties, shares, money lying in deposit and a share in a registered firm. That, as there was no finding that the three widows had combined in a joint enterprise to produce income, and as they had done no act which had helped to produce the income, it could not be held that they had the status of an association of persons. [1960] 039 ITR 0546- Commissioner of Income-tax vs. Indira Balkrishna (Supreme Court of India)

An individual who was carrying on business under the name of M and Co died intestate, and was survived by his mother, widow and three minor children. The mother of the deceased relinquished her interest in the assets of the deceased against a lump sum payment. The business, M and Co., was continued as a single unit in the same name by the widow, on her behalf and on behalf of the three minor children. When the minors along with their mother formed a body to generate income, the levy of tax under section 4 was on that body. The mother could not insist that the income of the joint venture must be assessed separately on the minors and her, even when a joint business was carried on. [1997] 224 ITR 0635B Meera and Company vs. Commissioner of Income-tax (Supreme Court of India)

There is another decision in Bhupindra Food and Malt Industries v. CIT [1998] 229 ITR 496 (HP), where the Assessing Officer presumed an association of persons between an adult guardian and a minor. The assessee had claimed a partnership of four persons of which two were found to be not real partners, with the remaining two being an adult and a minor. The High Court found that there was no evidence of the guardian having given consent to the association on behalf of the minor for business with the result that there was no association of persons, which implied an agreement between two persons competent to contract. But the argument that in such a case a collective assessment is still possible as a body of individuals was not raised on behalf of the Revenue, though such an assessment was upheld by the Supreme Court in Meera & Co. v. CIT [1997] 224 ITR 635 in a

respect of a business carried on by a mother along with her minor children.

JOINT INVESTMENT V/S CHARGE ON INVESTMENT

Assessee who worked in a cycle shop on daily wages of Rs. 2, purchased a lottery ticket for Rs. 2. He agreed to share 25 per cent. of the prize money with the second respondent as he was in need of 50 paise for the next meal. The agreement was reduced into writing. The ticket earned a prize of Rs. 17,85,000. That there was no agreement between the two respondents prior to the purchase of the lottery ticket to form an entity for the purpose of producing income by purchasing the lottery ticket. There was no consensus ad idem between these two persons to purchase the ticket for the purpose of producing the income. Hence, the ingredients for considering both of them as forming an association of persons were lacking. There was no association of persons between the two respondents and hence they could not be assessed in the status of association of persons. [1997] 224 ITR 0391- Commissioner of Income-tax vs. Arumugham Chettiar (O.K.) (Madras High Court) (Now Kalpesh Classes is totally digital, and now coaching is 200 % better in performance with on screen presentations and professors explanation)

NO OPTION TO OFFICER TO MAKE THE ASSESSMENT IN STATUS OF INDIVIDUAL

Section 4 of the Act of 1961 says that income-tax shall be charged on the total income "of every person" and the expression "person" is defined in clause (31) of section 2. The definition merely says that the expression "person" includes, inter alia, a firm and an association of persons or a body of individuals whether incorporated or not. There are no words in the present Act which empower the Income-tax Officer or give him an option to tax either the association of persons or its members individually or for that matter to tax the firm or its partners individually. If it is the income of the association of persons in law, the association of persons alone has to be taxed; the members of the association of persons cannot be taxed individually in respect of the income of the association of persons. Consideration of the interests of the Revenue has no place in this scheme. Under the present Act, the Income-tax Officer has no option He can, and he must, tax the right person and the right person alone. [1996] 218 ITR 0239- Income-tax Officer vs. Atchiaiah (Ch.) (Supreme Court of India)

CHAPTER - 12

CHARITABLE TRUST

ASSESSMENT OF CHARITABLE AND RELIGIOUS TRUST

Income [INCLUDES VOLUNTARY CONTRIBUTION] however excludes Income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution.] derived from property held under trust wholly for charitable or religious purposes, to the extent to which such income is applied to such purposes in India ; and, where any such income is accumulated or set apart for application to such purposes in India, to the extent to which the income so accumulated or set apart is not in excess of fifteen per cent. of the income from such property shall be exempt from tax..

Income derived from property held under trust created for a charitable purpose which tends to promote international welfare in which India is interested, to the extent to which such income is applied to such purposes outside India shall be exempt from tax..

MEANING OF INCOME

“Income” must be understood in commercial sense, and not as ‘total income’ as assessed. It is not the ‘total income’ as would be assessed by the ITO that is relevant for the purpose of investing the funds of the trust or assessing the income of the trust. The mode of determination by the ITO as per the provisions of the Income-tax Act is specially restricted to the income over and above the income shown in the accounts of the business undertaking held by a trust. It follows that with regard to the income of the trust as much, it is the accounts of the trust alone that have to be taken into consideration for the purpose of section 11(1)(a) of the Act. Taking into account the purpose for which the conditions of section 11(1)(a) are imposed, it would be clear that ‘income’ to be considered will be that which is arrived at in the context of what is available in the hands of the assessee subject to an adjustment of any expenses extraneous to the trust - CIT v. P.S.G. & Sons Charities 1996 Tax LR 477 (Mad.). See also - CIT v. Programme for Community Organisation [1997] 228 ITR 620 (Ker.). Taxes like income-tax and wealth-tax must be excluded.

MEANING OF APPLIED

Applied’ need not be equated with ‘spent’. It is not correct to equate the word ‘applied’ with the word ‘spent’. If the Legislature intended that the amounts should actually be spent, there was nothing preventing it from using that word. The word ‘applied’ does not necessarily mean ‘spent’. Even if the amount has been earmarked for the purposes of the institution and allocated, it may be deemed to have been applied.

The word " applied " as defined in Chambers' Dictionary means " to put to use " or " to turn to use ". According to the Oxford Dictionary, the word " applied " means " to make use " or " to put to practical use ". When the income of a trust is used or put to use to meet the expenses incurred for religious or charitable purposes, it is applied for charitable or religious purposes. The said application of the income for charitable or religious purposes takes place in the year in which the income is adjusted to meet the expenses incurred for charitable or religious purposes. In other words, even if the expenses for charitable and religious purposes have been incurred in the earlier year and the said expenses are adjusted against the income of a subsequent year, the income of that year can be said to be applied for charitable and religious purposes in the year in which the expenses incurred for charitable and religious purposes had been adjusted. [1987] 164 ITR 0439A Commissioner of Income-tax vs. Maharana of Mewar Charitable Foundation (Rajasthan High Court)

According to the circular issued by the Central Board of Direct Taxes dated January 24, 1973, if a trust wants to spend more money on charitable and religious purposes, in a particular year, it can take a loan and the said loan can be repaid out of the income of the subsequent year and the payment of the said loan out of the income of the subsequent year would amount to application of income for charitable and religious purposes under section 11(1)(a) of the Act. [1987] 164 ITR 0439A Commissioner of Income-tax vs. Maharana of Mewar Charitable Foundation (Rajasthan High Court) (Now Kalpesh Classes is totally digital, and now coaching is 200 % better in performance with on screen presentations and professors explanation)

The word "applied" is wider in import than the word "expenditure". According to Webster's Third New International Dictionary, the word applied means "to put to practical use; engaged in for a utilitarian or contributory purpose; employed in the decoration, design or execution of useful objects". The word "expenditure" means "disbursement". "Expend" means "to pay out or distribute; to spend". The Supreme Court in the decision in _Indian Molasses Co. (P.) Ltd._ v. _CIT_ [1959] 37 ITR 66 held that the word " expenditure " means " put out or away; spending something which is gone out irretrievably ". Considering these two words,

the word applied " is of a wider import. The money or amount will not go irretrievably when it is " applied " to a purpose. Held that the construction of the building although a capital expenditure can amount to application of the income for the purpose of section 11 of the Act. [1988] 170 ITR 0062- Commissioner of Income-tax vs. St. George Forana Church (Kerala High Court)

MEANING OF GENERAL PUBLIC UTILITY

The expression "object of general public utility" is not restricted to objects beneficial to the whole of mankind. An object beneficial to a section of the public is an object of general public utility. To serve a charitable purpose, it is not necessary that the object should be to benefit the whole of mankind or even all persons living in a particular country or province. It is sufficient if the intention was to benefit a section of the public as distinguished from specified individuals. There cannot be any analogy between public employment and private employment. In the case of private employment, the nexus between the employer and employee is of a personal nature. But, in so far as public employment and in particular employment by the Government is concerned, in the ultimate analysis, it is the public that is the employer. Hence, there is no personal nexus between employer and employee. Therefore, where a charitable trust is established for the benefit of members of the police and their families, the beneficiaries of such trust would constitute a section of the public and the income of the trust would be entitled to exemption under section 11. [1984] 148 ITR 0287- Commissioner of Income-tax vs. Andhra Pradesh Police Welfare Society (Andhra Pradesh High Court)

Contributories to the fund allegedly collected for their personal benefits, could not be held to be forming an association for charitable purpose and thus being entitled to the benefit of exemption under section 11 of the Act. The definition of the term "charitable purpose" under section 2(15) of the Act is inclusive and not exhaustive or exclusive. A perusal of the various provisions of the Act would show that the Legislature had intended to give a restricted meaning to the expression "charitable purpose" with the object to see that no commercial activities are treated as charitable objects and that any activity for profit or for personal enjoyment or for avoiding tax, is not regarded as a charitable purpose. A trust is not charitable, unless it benefits the community or a section of the community. A trust would not be charitable, if it only conferred private benefits. [1997] 225 ITR 0270- Commissioner of Income-tax vs. Bel Employees Death Relief Fund and Service Benefit Fund Assn (Karnataka High Court)

To get the exemption under section 11 what requires is that there must be an obligation created to spend the money exclusively and essentially on charity. In the instant case, there was no obligation that the income from the properties derived by the assessee was to be exclusively used for charitable purposes. It was permissible for the assessee to distribute the whole or part of such income by way of dividends amongst its shareholders. The letters of the Central Government to the assessee could not be construed as imposing any legal obligation on the assessee not to distribute any part of its profits by way of dividends to the shareholders. Therefore, the High Court was right in holding that the assessee was not entitled to exemption under section 11. [1997] 225 ITR 0235- Delhi Stock Exchange Association Ltd. vs. Commissioner of Income-tax (Supreme Court of India)

An object beneficial to a section of the public is an object of general public utility. To serve a charitable purpose it is not necessary that the object should be to benefit the whole of mankind or all persons in a country or State. It is sufficient if the intention to benefit a section of the public as distinguished from a specified individual is present. The section of the community sought to be benefited must be sufficiently definite and identifiable by some common quality of a public or impersonal nature. Ahmedabad Rana Caste Association v. CIT [1971] 82 ITR 704. [1983] 140 ITR 0001- Commissioner of Income-tax vs. Ahmedabad Rana Caste Association (Supreme Court of India)

MEANING OF PROPERTY

'Property' signifies every possible interest and includes business. 'Property' is a term of the widest import, and subject to any limitation or qualification which the context might require, it signifies every possible interest which a person can acquire, hold and enjoy. 'Business' would undoubtedly be 'property', unless there is something to the contrary in the enactment. There is nothing in the language of section 11 which restricts in any manner the normal and accepted meaning of the word 'property' and which excludes business from its connotation - J.K. Trust v. CIT/CEPT [1957] 32 ITR 535 (SC).

TRUST WHETHER CHARITABLE

All the objects must be considered. Whether a trust is for charitable purpose is to be determined by reference to all the objects for which the trust has been brought into existence. The proposition that what should be taken into consideration is the activity actually conducted by the assessee and, not what is open to it under the provisions of its memorandum of association cannot be agreed to. It would be a different case where one or

more of the stated objects were never intended to be undertaken - Dharmaposhanam Co. v. CIT [1978] 114 ITR 463 (SC).

TREATMENT FOR SHORT APPLICATION

If, in the previous year, the income applied to charitable or religious purposes in India falls short of the eighty-five per cent. of the income derived during that year from property held under trust, or, as the case may be, held under trust in part, by any amount for the reason that the whole or any part of the income has not been received during that year, or for any other reason, then so much of the income applied to such purposes in India during the previous year in which the income is received or during the previous year immediately following as does not exceed the said amount may, at the option of the person in receipt of the income [such option to be exercised in writing before the expiry of the time allowed under section 139(1), for furnishing the return of income], be deemed to be income applied to such purposes, during the previous year, in which the income was derived and the income so deemed to have been applied shall not be taken into account in calculating the amount of income applied to such purposes.

Where any income is not applied to charitable or religious purposes in India during the period then, such income shall be deemed to be the income of the person in receipt thereof of the previous year immediately following the previous year in which the income was received. (Now Kalpesh Classes is totally digital, and now coaching is 200 % better in performance with on screen presentations and professors explanation)

CAPITAL GAINS FOR TRUST

Where a capital asset, being property held under trust wholly for charitable or religious purposes, is transferred and the whole or any part of the net consideration is utilised for acquiring another capital asset to be so held, then, the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes to the extent specified hereunder, namely

Where the whole of the net consideration is utilised in acquiring the new capital asset,	The whole of such capital gain ;
Where only a part of the net consideration is utilised for acquiring the new capital asset,	So much of such capital gain as is equal to the amount, if any, by which the amount so utilised exceeds the cost of the transferred asset.

SEC. 11(2) MORE ACCUMULATION THAN 15 %

Where eighty-five per cent. of the income is not applied, or is not deemed to have been applied to charitable or religious purposes in India during the previous year but is accumulated or set apart, either in whole or in part, for application to such purposes in India, such income so accumulated or set apart shall not be included in the total income of the previous year of the person in receipt of the income, provided the following conditions are complied with, namely

1. Such person specifies, by notice in writing given to the Assessing Officer in the prescribed manner, the purpose for which the income is being accumulated or set apart and the period for which the income is to be accumulated or set apart, which shall in no case exceed FIVE years ;
2. The money so accumulated or set apart is invested or deposited in the forms or modes specified in section 11(5).

Any amount credited or paid, out of income which is not applied, but is accumulated or set apart, to any trust or institution registered under section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in section 10(23C), shall not be treated as application of income for charitable or religious purposes, either during the period of accumulation or thereafter.

SEC. 11(3), VIOLATION OF 11(2)

Where any income accumulated as per 11(2)

- (a) Is applied to purposes other than charitable or religious purposes as aforesaid or ceases to be accumulated or set apart for application thereto, or
- (b) Ceases to remain invested or deposited in any of the forms or modes specified in 11(5), or
- (c) Is not utilised for the purposes for which it is so accumulated or set apart during the period or in the year immediately following the expiry thereof,

- (d) Is credited or paid to any trust or institution registered under section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in section 10(23C),

Shall be deemed to be the income of such person of the previous year in which it is so applied or ceases to be so accumulated or set apart or ceases to remain so invested or deposited or credited or paid or, as the case may be, of the previous year immediately following the expiry of the period aforesaid.

SEC. 11(4A) BUSINESS INCOME OF TRUST

For the purposes of this section "property held under trust" includes a business undertaking so held, and where a claim is made that the income of any such undertaking shall not be included in the total income of the persons in receipt thereof, the Assessing Officer shall have power to determine the income of such undertaking in accordance with the provisions of this Act relating to assessment ; and where any income so determined is in excess of the income as shown in the accounts of the undertaking, such excess shall be deemed to be applied to purposes other than charitable or religious purposes.

Business income shall not be chargeable to tax unless the business is incidental to the attainment of the objectives of the trust or, as the case may be, institution, and separate books of account are maintained by such trust or institution in respect of such business.

Where profit-making is the predominant object of the activity, the purpose, though an object of general public utility, would cease to be a charitable purpose. But where the predominant object of the activity is to carry out the charitable purpose and not to earn profit, it would not lose its character of a charitable purpose, merely because some profit arises from the activity. The exclusionary clause does not require that the activity must be carried on in such a manner that it does not result in any profit. It would indeed be difficult for persons in charge of a trust or institution to so carry on the activity, that the expenditure balances the income and there is no resulting profit. That would not only be difficult of practical realisation, but would also reflect unsound principles of management. If the profits must necessarily feed a charitable purpose under the terms of the trust, the mere fact that the activities of the trust yield profit, will not alter the charitable character of the trust. The test now is, more clearly than in the past, the genuineness of the purpose, tested by the obligation created to spend the money exclusively or essentially on charity. The restrictive condition that the purpose should not involve the carrying on of any activity for profit would be satisfied, if profit-making is not the real object. [1997] 225 ITR 1010A Thiagarajar Charities vs. Additional CIT (Supreme Court of India)

SEC. 11(5) MODES OF INVESTMENT OF TRUST MONEY

- (i) Investment in savings certificates as defined in clause (c) of section 2 of the Government Savings Certificates Act, 1959 (46 of 1959), and any other securities or certificates issued by the Central Government under the Small Savings Schemes of that Government ;
- (ii) Deposit in any account with the Post Office Savings Bank ;
- (iii) Deposit in any account with a scheduled bank or a co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank).
- (iv) Investment in units of the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963) ;
- (v) Investment in any security for money created and issued by the Central government or a State Government ;
- (vi) Investment in debentures issued by, or on behalf of, any company or corporation both the principal whereof and the interest whereon are fully and unconditionally guaranteed by the Central Government or by a State Government ;
- (vii) Investment or deposit in any public sector company ;

Provided that where an investment or deposit in any public sector company has been made and such public sector company ceases to be a public sector company,

(A) such investment made in the shares of such company shall be deemed to be an investment made under this clause for a period of three years from the date on which such public sector company ceases to be a public sector company ;

(B) such other investment or deposit shall be deemed to be an investment or deposit made under this clause for the period up to the date on which such investment or deposit becomes repayable by such company;

- (viii) deposits with or investment in any bonds issued by a financial corporation which is engaged in providing long-term finance for industrial development in India and ²which is eligible for deduction under clause (viii) of sub-section (1) of section 36 ;
- (ix) deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction of purchase of houses in India for residential purposes and ²which is eligible for deduction under clause (viii) of sub-section (1) of section 36 ;
- (x) Deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for urban infrastructure in India.
- (xi) investment in immovable property. "Immovable property" does not include any machinery or plant or plant (other than machinery or plant installed in a building for the convenient occupation of the building) even though attached to, or permanently fastened to, anything attached to the earth;
- (xii) Deposits with the Industrial Development Bank of India established under the Industrial Development Bank of India Act, 1964 (18 of 1964).
- (xiii) any other form or mode of investment or deposit as may be prescribed.

SECTION 11 EXEMPTION NOT AVAILABLE IF

- 1) Any part of the income from the property held under a trust for private religious purposes which does not enure for the benefit of the public
- 2) In the case of a trust for charitable purposes or a charitable institution created or established after the commencement of this Act, any income thereof if the trust or institution is created or established for the benefit of any particular religious community or caste
- 3) In the case of a trust for charitable or religious purposes or a charitable or religious institution, any income thereof any part of such income enures directly or indirectly for the benefit of any specified person.
- 4) In the case of a trust for charitable or religious purposes or a charitable or religious institution, any income thereof, if for any period during the previous year any funds of the trust or institution are invested or deposited otherwise than in any one or more of the forms or modes specified in section 11(5)

SPECIFIED PERSONS

- (a) The author of the trust or the founder of the institution ;
- (b) Any person who has made a substantial contribution to the trust or institution, that is to say, any person whose total contribution up to the end of the relevant previous year exceeds fifty thousand rupees ;
- (c) Where such author, founder or person is a Hindu undivided family, a member of the family ;
- (cc) Any trustee of the trust or manager (by whatever name called) of the institution ;
- (d) Any relative of any such author, founder, person, member, trustee or manager as aforesaid ;
- (e) Any concern in which any of the persons referred to in clauses (a), (b), (c), (cc) and (d) has a substantial interest.

SPECIAL TREATMENT FOR EDUCATIONAL OR MEDICAL INSTITUTION OR A HOSPITAL

In the case of a charitable or religious trust running an educational institution or a medical institution or a hospital, the exemption under section 11 or section 12 shall not be denied in relation to any income, other than the income as mentioned in Note No. 1 below , by reason only that such trust has provided educational or medical facilities to specified persons (Excluding (e) above). However the income referred to in note no. 1 below will be chargeable to tax in the hands of the trust.

NOTE NO. 1

The value of any services, being medical or educational services, made available by any charitable or religious trust running a hospital or medical institution or an educational institution, to any specified person [Excluding (e) above], shall be deemed to be income of such trust or institution derived from property held under trust wholly for charitable or religious purposes during the previous year in which such services are so provided and shall be chargeable to income-tax. "Value" shall be the value of any benefit or facility granted or provided free of cost or at concessional rate. (Now Kalpesh Classes is totally digital, and now coaching is 200 % better in performance with on screen presentations and professors explanation)

CHAPTER – 13

DETERMINATION OF RATES

ASSESSMENT OF NON-RESIDENTS

CHAPTER XII DETERMINATION OF TAX IN CERTAIN SPECIAL CASES

Section	115A	115A	115B
Assessee	NR or Foreign company	NR or Foreign company	Overseas financial organization
Income covered	a) Dividend (Other than 115-O) b) Interest received from Government or an India concern on moneys borrowed or debt incurred by Government or the Indian concern in foreign currency c) Income received in respect of units, purchased in foreign currency, of a mutual fund specified under clause (23D) of section 10 or of the unit trust of India	Royalty or technical fees	a) Income received in respect of units purchased in foreign currency b) Income by way of long-term capital gains arising from the transfer of units purchased in foreign currency
Rate of tax	20 %	10 % (if it is out of approved agreement) else tax rate applicable to foreign companies	10 % for both
TDS	20 % - 195	20 % - 195	10 % for both (196-B)
Return to be filed	NO	YES	YES
deduction u/s 28 to 44C	NO	NO	NO
Provisio 1 To 48	NA	NA	Not relevant (as it is applicable only in the case of shares / debentures)
Provisio 2 To 48	NA	NA	Second proviso to section 48 is not applicable

Section	115 AC	115ACA	115AD
Assessee	NR	Individual, who is a resident and an employee of an Indian company or its subsidiary engaged in specified knowledge based industry or service.	notified foreign institutional investor
Income covered	(a) Income by way of interest on bonds of an Indian company or on bonds of a public sector company sold by the Government, and purchased by him in foreign currency ; or (b) Income by way of dividends, (Other than 115-O) on Global Depository Receipts initially subscribed or issued or re-issued against shares issued, in accordance with approved scheme of an Indian company and purchased by him in foreign currency (c) any long term capital gains on its transfer.	Income from global depository receipts a) Dividend (Other than 115-O) on global depository receipts issued under notified employees stock option scheme and purchased in foreign currency b) Long-term capital gain on transfer of such receipts	a) Income received in respect of securities (other than units referred to in section 115AB) listed in a recognized stock exchange in India in accordance with the provisions of the securities contracts (Regulation) Act, 1956, and any rules made there under b) Income by way of short - term or long – term capital gains arising from the transfer of such securities
Rate of tax	10 % for both	10 % for both	20 % 10 % (LTCG) 30 % (STCG) (If covered by 111A then 10 %)
TDS	10 % for both (196-C)	NA	20 % for income from securities (196-D)
Return to be filed	No – for interest Dividend income Yes – for LTCG	YES	YES
deduction u/s 28 to 44C	NA	NA	NO
Provisio 1 To 48	NA	NA	NA
Provisio 2 To 48	NA	NA	NA

Section	115 BBA	115BB	111A
Assessee	Non-resident sportsman who is a foreign citizen	ANY	ANY
Income covered	I) Participation in India in any game (other than a game the winnings wherefrom are taxable under section 115BB) or sport or II) Advertisement; or III) Contribution of articles relating to any game or sport in India in newspapers, magazines or journals	Any income by way of winnings from any lottery or crossword puzzle or race including horse race (not being income from the activity of owning and maintaining race horses) or card game and other game of any sort or from gambling or betting of any form or nature whatsoever	Any income chargeable under the head “Capital gains”, arising from the transfer of a short-term capital asset, being an equity share in a company or a unit of an equity oriented fund and such transaction is chargeable to securities transaction tax under that Chapter.
Rate of tax	10 % for all	Thirty per cent	Ten per cent (however basic exemption limit is available) (No deduction under chapter VIA or rebates are available.)
TDS	10 % for all (194-E)	Thirty per cent – 194B	--
Return to be filed	NO	YES (as per 139(1))	YES (as per 139(1))
deduction u/s 28 to 44C	NA	NO	--
Provisio 1 To 48	NA	NA	
Provisio 2 To 48	NA	NA	

CHAPTER - 14

NON RESIDENTS INDIANS

CHAPTER XII-A INCOMES OF NON RESIDENT INDIANS

Section	115D	115F
Assessee	non-resident Indian	
Income covered	(a) any income from investment or income from long-term capital gains of an asset other than a specified asset; (b) income by way of long-term capital gains (Refer note no. 5 for definitions.)	SEE IT IN CAPITAL GAINS CHAPTER.
Rate of tax	Investment income 20 % LTCG 10 %	
TDS	As per 195	
Return to be filed	Refer note no. 1	
Deduction	Refer note no. 2	
Provisio 1 To 48	Refer note no. 2	
Provisio 2 To 48	Refer note no. 2	

NOTE NUMBER 1

115D. No deduction in respect of any expenditure or allowance or chapter VIA shall be allowed in computing the investment income of a non-resident Indian. Nothing contained in the provisions of the second proviso to section 48 shall apply to income chargeable under the head "Capital gains".

NOTE NUMBER 2

115G. It shall not be necessary for a non-resident Indian to furnish a return of his income if his total income in respect of which he is assessable under this Act during the previous year consisted only of investment income or income by way of long term capital gains or both; and the tax deductible at source under the provisions of Chapter XVII-B has been deducted from such income.

NOTE NUMBER 3

115H. Where a person, who is a non-resident Indian in any previous year, becomes assessable as resident in India in respect of the total income of any subsequent year, he may furnish to the Assessing Officer a declaration in writing along with his return of income under section 139 for the assessment year for which he is so assessable, to the effect that the provisions of this Chapter shall continue to apply to him and if he does so, the provisions of this Chapter shall continue to apply to him in relation to such income for that assessment year and for every subsequent assessment year until the transfer or conversion (otherwise than by transfer) into money of such assets. (Now Kalpesh Classes is totally digital, and now coaching is 200 % better in performance with on screen presentations and professors explanation)

NOTE NUMBER 4

115-I. A non-resident Indian may elect not to be governed by the provisions of this Chapter for any assessment year by furnishing his return of income for that assessment year under section 139 declaring therein that the provisions of this Chapter shall not apply to him for that assessment year and if he does so, the provisions of this Chapter shall not apply to him for that assessment year and his total income for that assessment year shall be computed and tax on such total income shall be charged in accordance with the other provisions of this Act.

NOTE NUMBER 5

"foreign exchange asset" means any specified asset which the assessee has acquired, or purchased with, or subscribed to in, convertible foreign exchange

"Investment income" means any *income derived other than dividends referred to in section 115-O from a foreign exchange asset;

"long-term capital gains" means income chargeable under the head "Capital gains" relating to a capital asset, being a foreign exchange asset which is not a short-term capital asset;

"non-resident Indian" means an individual, being a citizen of India or a person of Indian origin who is not a "resident".A person shall be deemed to be of Indian origin if he, or either of his parents or any of his grand parents, was born in undivided India;

"specified asset" means any of the following assets, namely (i) shares in an Indian company; (ii) debentures issued by an Indian company which is not a private company (iii) deposits with an Indian company which is not a private company (iv) any security of the Central Government (v) such other assets as the Central Government may specify in this behalf by notification in the official Gazette.

SEC. 179 LIABILITY OF DIRECTORS OF PRIVATE COMPANY IN LIQUIDATION.

Where any tax due from a private company of any income cannot be recovered, then, every person who was a director of the private company at any time during the relevant previous year shall be jointly and severally liable for the payment of such tax unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

It is only in cases where the tax cannot be recovered from the company that the liability of the director arises. The liability of the directors is joint and several. It is not a joint and several liability with the company. It is not a liability co-extensive with the liability of the company unlike a principal debtor and surety. In the case of the principal debtor and surety, the liability of the surety is co-extensive with that of the principal debtor and, therefore, both the principal debtor and the surety can be proceeded against simultaneously, whereas under section 179, it is only in case the tax cannot be recovered from the company that the liability of the director arises or the liability itself arises for the director. After that liability arises, the liability is joint and several amongst the directors and it is not a liability joint and several with that the company. Therefore, before the Assessing Officer proceeds against the directors personally he has to give a finding that the income-tax due for the previous year cannot be recovered from the company. In the absence of giving of a finding conferring jurisdiction on him to recover the income-tax from the director personally, the Assessing Officer does not get the jurisdiction to initiate proceedings under section 179

CHAPTER - 16

COMPANIES IN LIQUIDATION

SEC. 178 COMPANY IN LIQUIDATION.

Every person who is the liquidator of any company which is being wound up, whether under the orders of a court or otherwise ; or who has been appointed the receiver of any assets of a company, (hereinafter referred to as the liquidator) shall, within thirty days after he has become such liquidator, give notice of his appointment as such to the Assessing Officer who is entitled to assess the income of the company. The Assessing Officer shall, after making such inquiries or calling for such information as he may deem fit, notify to the liquidator within three months from the date on which he receives notice of the appointment of the liquidator the amount which, in the opinion of the Assessing Officer, would be sufficient to provide for any tax which is then, or is likely thereafter to become, payable by the company. The liquidator shall not, without the leave of the Chief Commissioner or Commissioner part with any of the assets of the company or the properties in his hands until he has been notified by the Assessing Officer and on being so notified, shall set aside an amount, equal to the amount notified and, until he so sets aside such amount, shall not part with any of the assets of the company or the properties in his hands.

If the liquidator fails to give the notice or fails to set aside the amount or parts with any of the assets of the company or the properties in his hands in contravention of the provisions, he shall be personally liable for the payment of the tax which the company would be liable to pay.

POINT TO BE NOTED

Notice has to be given to the authorities under the Act within 30 days after a person becomes a liquidator. The relevant time to compute the period of limitation would be the date of assumption of duties by the person as liquidator and not the date of the resolution of the company. The notice contemplated by section 178 is a notice by the liquidator and not by the company. Without assuming charge, it is inconceivable to except a notice from the liquidator.

The tax payment referred to in section 178 is in respect of the income of a company accrued before its winding up. It has no application to the income accruing to the company after the order for its winding up. Nor is the tax demand on such income a contingent debt falling under section 528 of the Companies Act.

SEC. 178 READ WITH 530(1)(a) OF COMPANY LAW

Due importance must be given to the legislative history and background that led to the enactment of section 178 of the Income-tax Act, 1961, and the crucial words occurring in sections 178(3) and 178(4) of the Income-tax Act to the effect that the official liquidator "shall set aside" the amount notified by the Income-tax Officer and that if it is not so done, the official liquidator shall personally be liable to pay the amount of tax which the company would be liable to pay. The object sought to be achieved by the provisions in is "to fasten liability to pay the tax" on the income received and to catch the income at the earliest point of time and tax the same where it is found, instead of waiting for long. The scope of section 530(1)(a) of the Companies Act, 1956, is different from that of section 178 of the Income-tax Act. Under section 530(1)(a) of the Companies Act, all taxes which have "become due and payable" alone are entitled to preferential payment. The amount should have crystallised into a liability. Under section 178(2) read with section 178(3) of the Income-tax Act, provision should be made for any tax which is then or is likely thereafter to become payable. Even the amounts which have not crystallised into a liability, but which are "likely to become due thereafter" should be taken note of. Moreover, there is a non obstante clause in section 178(6). On a total view of the relevant statutory provisions, the Income-tax Department is treated as a "secured creditor". 1996] 219 ITR 0498A Imperial Chit Funds (P.) Ltd. vs. Income-tax Officer (Supreme Court of India)

CHAPTER - 17

CO-OP SOCIETY

SEC.80P ASSESSMENT OF CO-OPERATIVE SOCIETIES.

NATURE OF INCOME	Deduction
In the case of a co-operative society engaged in carrying on the business of banking or providing credit facilities to its members	100 %
In the case of a co-operative society engaged in cottage industry	100 %
In the case of a co-operative society engaged in marketing of agricultural produce grown by its members	100 %
In the case of a co-operative society engaged in purchase of agricultural implements, seeds, livestock or other articles intended for agriculture for the purpose of supplying them to its members,	100 %
In the case of a co-operative society engaged in the processing, without the aid of power, of the agricultural produce of its members	100 %
In the case of a co-operative society engaged in collective disposal of the labour of its members (Refer Note 1)	100 %
In the case of a co-operative society engaged in fishing or allied activities, that is to say, the catching, curing, processing, preserving, storing or marketing of fish or the purchase of materials and equipment in connection therewith for the purpose of supplying them to its members (Refer Note 1)	100 %
In the case of a co-operative society, being a primary society engaged in supplying milk, oilseeds, fruits or vegetables raised or grown by its members to (i) a federal co-operative society, being a society engaged in the business of supplying milk, oilseeds, fruits, or vegetables, as the case may be; or (ii) the Government or a local authority; or (iii) a Government company or a corporation established by or under a Central, State or Provincial Act (being a company or corporation engaged in supplying milk, oilseeds, fruits or vegetables, as the case may be, to the public)	100 %
Where such co-operative society is a consumers' co-operative society,	100,000
In any other case,	50,000
In respect of any income by way of interest or dividends derived by the co-operative society from its investments with any other co-operative society	100 %
In respect of any income derived by the co-operative society from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities	100 %
In the case of a co-operative society, not being a housing society or an urban consumers' society or a society carrying on transport business or a society engaged in the performance of any manufacturing operations with the aid of power, where the gross total income does not exceed twenty thousand rupees, the amount of.	interest on securities or from house property.

Note.1 deduction is subject to condition that the rules and bye-laws of the society restrict the voting rights to the following classes of its members, namely:(1) the individuals who contribute their labour or, as the case may be, carry on the fishing or allied activities; (2) the co-operative credit societies which provide financial assistance to the society;(3) the State Government

MEANING OF CREDIT FACILITIES

A person who sells goods on credit cannot be said to be carrying on the business or providing credit facilities. His business will be the business of purchases and sale of goods which he supplies. Banking business is a wide term and includes many activities like discounting bills, hundis, cheques, accepting deposits and advancing loans, etc. Thus, it includes the providing of credit facility. A person or a society may not be a banker in that wide sense yet he maybe providing credit facilities which is a part of a banking business. The expression 'providing credit facility' does take its colour from the activity of banking. In order that a banking or providing

of credit facility may constitute a business, it is necessary that these activities must be chief source of income. A person who advances loans or supplies goods on credit in connection with and in the course of some other business of manufacturer or purchase or sale of goods, etc., cannot be said to be carrying on the business of banking or providing credit facilities.

MEANING OF COTTAGE INDUSTRY

The expression 'cottage industry' contemplates an industrial activity of which a well-recognised feature is that it is commonly located in the cottages or homes of the artisans. It is carried out on a small scale, with a small amount of capital and a small number of workers, and has a turnover which is correspondingly limited.

The number of persons working in a cottage industry and the amount of turnover are immaterial as long as the activity can be said to be a 'cottage industry'. The term 'cottage industry' has not been defined in the Act. However, it is a term of every day use and its meaning is well understood. According to Webster's New International Dictionary, 'cottage industry' means an industry based upon the family unit as a labour force in which workers using their own equipment at home process goods. It is true that primarily a cottage industry is carried on by the families in their dwelling houses but when the term 'cottage industry' is applied to co-operative societies the idea of a family unit does not fit in. The co-operative society can in a way be likened to a family constituted by its members. Where the members of a co-operative society are engaged in the manufacture of goods in their cottages or dwelling houses, it can be said that the family constituted by its members is engaged in industry. Before it can be said that a co-operative society is engaged in an industry, it is necessary that there must be an activity relating to an industry. An industry obviously implies manufacture of certain articles and it cannot embrace a business of a mere purchase and sale of goods - Addl. CIT v. Indian Co-operative Union Ltd. [1982] 134 ITR 108 (Delhi).

MEANING OF MARKETING

'Marketing' includes all business activities directed towards the flow of goods and services from producer to consumer, and the term could not be restricted only to buying and selling activity. If the narrow meaning were accepted, the whole purpose of the Legislature would be frustrated. Under these circumstances, the concept of 'marketing' will have to be interpreted as all activities connected with the process of taking over from the agricultural-producer member and handing over the marketable commodity to the purchaser and all the intermediate processes would be connected with 'marketing of the agricultural produce of the members.

CHAPTER - 18**LEGAL HEIRS & EXECUTORS****SEC. 159 LEGAL REPRESENTATIVES**

Where a person dies, his legal representative shall be liable to pay any sum which the deceased would have been liable to pay if he had not died, in the like manner and to the same extent as the deceased. The legal representative of the deceased shall, for the purposes of this Act, be deemed to be an assessee. Every legal representative shall be personally liable for any tax payable by him in his capacity as legal representative if, while his liability for tax remains undischarged, he creates a charge on or disposes of or parts with any assets of the estate of the deceased, which are in, or may come into, his possession, but such liability shall be limited to the value of the asset so charged, disposed of or parted with. The liability of a legal representative under this section shall, be limited to the extent to which the estate is capable of meeting the liability.

For the purpose of making an assessment (including an assessment, reassessment or recomputation under section 147) of the income of the deceased and for the purpose of levying any sum in the hands of the legal representative in accordance with this section

- (a) Any proceeding taken against the deceased before his death shall be deemed to have been taken against the legal representative and may be continued against the legal representative from the stage at which it stood on the date of the death of the deceased;
- (b) Any proceeding which could have been taken against the deceased if he had survived, may be taken against the legal representative; and
- (c) All the provisions of this Act shall apply accordingly.

OMISSION TO SERVE NOTICE ON ALL LEGAL REPRESENTATIVE

Where after death of one 'B' who had not filed returns, J, one of his ten legal representatives, filed returns, and notice was issued to J under sections 142(1) and 143(2) and he complied with it and assessment was duly completed, omission to serve notice on all legal representatives of 'B' was only an irregularity and not a nullity - CIT v. Jai Prakash Singh [1996] 85 Taxman 407 (SC).

PROCEDURAL OMISSIONS WILL NOT NULLIFY ASSESSMENT

If the legal representative (which term includes plurality of persons) is present before the taxing authority in some capacity or voluntarily appears in the proceeding without service of notice or upon service not addressed to him but to the deceased assessee, and does not object to the continuance of the proceeding against the deceased person, and is heard by the ITO in regard to the tax liability of the deceased and invites an assessment on merits, such a legal representative must be taken to have exercised the option of abandoning the technical plea that the proceeding has not been continued against him although in substance and reality it has been so continued. It would not be open to him to take up a plea at the appellate stage, as a last resort and as an after-thought, that the proceeding taken and the assessment order made against the deceased are a nullity - CIT v. Sumantbhai C. Munshaw [1981] 128 ITR 142 (Guj.).

SEC. 168 ASSESSMENT OF EXECUTORS.

The income of the estate of a deceased person shall be chargeable to tax in the hands of the executor, if there is only one executor, then, as if the executor were an individual; or if there are more executors than one, then, as if the executors were an association of persons; and for the purposes of this Act, the executor shall be deemed to be resident or non-resident according as the deceased person was a resident or non-resident during the previous year in which his death took place.

The assessment of an executor under this section shall be made separately from any assessment that may be made on him in respect of his own income. Separate assessments shall be made under this section on the total income of each completed previous year or part thereof as is included in the period from the date of the death to the date of complete distribution to the beneficiaries of the estate according to their several interests.

In computing the total income of any previous year under this section, any income of the estate of that previous year distributed to, or applied to the benefit of, any specific legatee of the estate during that previous year shall be excluded; but the income so excluded shall be included in the total income of the previous year of such specific legatee.

Explanation.—In this section, “executor” includes an administrator or other person administering the estate of a deceased person.

SECTION 168 AND SECTION 159 OPERATE IN DIFFERENT FIELDS

Section 159 and section 168 operate in different fields. Section 159 is concerned with the income of the deceased, while section 168 is attracted only in certain circumstances in regard to the income of the estate of the deceased.

ASSESSMENT OF “ADMINISTRATOR PENDENTE LITE”

An administrator or administratrix pendente lite was different from the administrator contemplated by section 168 did not apply in this case. [1980] 126 ITR 0748A Mahamaya Dassi vs. Commissioner of Income-tax (Calcutta High Court)

Section 168(1) of the Income-tax Act, 1961, which provides that the income of a deceased person shall be chargeable to tax in the hands of the executor does not leave any discretion to the Income-tax authorities in respect of assessing the income of the estate of a deceased person to tax. Such income is to be taxed in the hands of the executor. The term " executor is not to be understood in the restricted sense as the Expln. to the section gives an extended meaning to the word " executor " so as to include an administrator or other person administering the estate of the deceased person, that is, one who is in de facto management of the property of the deceased person. [1981] 127 ITR 0850- Commissioner of Income-tax vs. Usha D. Shah (Mrs.) (Bombay High Court)

CHAPTER – 19

REPRESENTATIVE ASSE.

SEC. 160 REPRESENTATIVE ASSESSEE.

“representative assessee” means

In respect of the income of a non-resident specified in section 9	The agent of the non-resident, including a person who is treated as an agent under section 163;
In respect of the income of a minor, lunatic or idiot	The guardian or manager who is entitled to receive or is in receipt of such income on behalf of such minor, lunatic or idiot
In respect of income which the Court of Wards, the Administrator- General	The Official Trustee or any receiver or manager
In respect of income which a trustee appointed under a trust or ORAL trust	Person receives or is entitled to receive on behalf or for the benefit of any person, such trustee or trustees. Where any income consists of, or includes, profits and gains of business, tax shall be charged on the whole of the income in respect of which such person is so liable at the maximum marginal rate. Maximum marginal rate shall not apply where such profits and gains are receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance, and such trust is the only trust so declared by him.

Every representative assessee shall be deemed to be an assessee for the purposes of this Act.

INHERITED BUSINESS

Where proprietary business inherited by widow and minor children on death of proprietor was run by widow on her behalf and on behalf of her three minor children, section 160 could not be applied so as to assess income of minors separately in hands of widow as a representative assessee - Meera & Co. v. CIT [1997] 91 Taxman 219/224 ITR 635 (SC).

SEC. 163 WHO MAY BE REGARDED AS AGENT OF NON RESIDENT.

“Agent”, in relation to a non-resident, includes any person in India (a) who is employed by or on behalf of the non-resident; or (b) who has any business connection with the non-resident; or (c) from or through whom the non-resident is in receipt of any income, whether directly or indirectly; or (d) who is the trustee of the non-resident; and includes also any other person who, whether a resident or non-resident, has acquired by means of a transfer, a capital asset in India:

A broker in India who, in respect of any transactions, does not deal directly with or on behalf of a non-resident principal but deals with or through a non-resident broker shall not be deemed to be an agent under this section in respect of such transactions, if the following conditions are fulfilled, namely: (i) the transactions are carried on in the ordinary course of business through the first-mentioned broker; and (ii) the non-resident broker is carrying on such transactions in the ordinary course of his business and not as a principal.

No person shall be treated as the agent of a non-resident unless he has had an opportunity of being heard by the Assessing Officer as to his liability to be treated as such.

The appellants who were partners of a firm of solicitors in Calcutta acted as the solicitors of a German corporation in certain patent suits filed in the Calcutta High Court. The firm was instructed by certain solicitors in London who were acting for the German corporation. In May, 1965, the London solicitors instructed the appellants to retain B, a U. K. barrister, in the suits. The appellants did not deliver any brief to B. Nor did they pay or undertake to pay any fees to B. The suits came up for hearing of which one was taken up and B appeared with counsel engaged by the appellants, presumably with the leave of the High Court under section 32 of the Advocates Act, 1961. The hearing lasted for 13 days and B left India without making any arrangement regarding payment of Indian income-tax on the fees earned by him by arguing the case of the German corporation. On the Income-tax Officer initiating proceedings to treat the appellants as the agent of B, under section 163(1) for the purpose of taxing B's income, the appellants filed a writ petition challenging the

proceedings. [1981] 129 ITR 0295A Barendra Prasad Ray vs. Income-tax Officer (Supreme Court of India) Held that

- 1) On the facts, there was connection between the appellants and B which was real and intimate and not a casual one, and B earned the fees for arguing the case in India only through that connection
- 2) B was not a stranger to the appellants: the appellants might not have engaged him to argue the case but they allowed him at the request of the London solicitors to argue the case and willingly co-operated with him in doing so. The appellants might not have undertaken to pay his fees but B could not have argued and earned the fees without associating himself with the appellants.
- 3) And the fact that B could not have filed a suit to recover the fees did not make any difference as B in fact had earned a fee
- 4) The professional connection between the appellants and B was a "business connection" within the meaning of section 9(1). Sections 9(1) and 163 are comprehensive enough to include all heads of income mentioned in section 14. The expression "business" does not necessarily mean trade or manufacture only: it is being used as including within its scope professions, vocations and callings for a fairly long time. The word "business" is one of wide import and it means an activity carried on continuously and systematically by a person by the application of his labour and skill with a view to earning an income. In the context in which the expression "business connection" is used in section 9(1), there is no warrant for giving a restricted meaning to it excluding "professional connections" from its scope.

The agent of a non-resident is a representative assessee in respect of the income of the non-resident irrespective of the fact whether he has been treated as agent under section 163 of the Income-tax Act, 1961, or not. Section 163 does not define the term "agent" but only states that the persons mentioned in it will be included in the term "agent" in relation to a non-resident. Section 182 of the Indian Contract Act, 1872, defines "agent" as a person employed to do any act for another or to represent another in dealing with third persons. For the appointment of an agent, it is not necessary that there must be written authority. The total income of any previous year of a person who is a non-resident includes income from whatever source derived which accrues or arises or is deemed to accrue or arise in India during such year. It is, therefore, evident that even if there is no known or disclosed source of income, the income would still be deemed to have accrued to a non-resident of India from undisclosed sources if it is actually found in the hands of his representative assessee. The income accruing to the non-resident from undisclosed sources was covered by the provisions of section 9(1) [also 163] and was liable to be included in his assessment. [1986] 160 ITR 0746B Hazoor Singh (Shri) vs. Commissioner of Income-tax (Punjab and Haryana High Court)

Under an agreement executed in England, the Performing Right Society, an association of composers, authors and publishers of copyright musical works incorporated as a company limited by guarantee, received in England royalties from the Government of India for broadcasting western music from the stations of All India Radio. Held that the royalties received from the Government of India under the agreement for broadcasting from the stations of All India Radio accrued or arose in India. [1977] 106 ITR 0011- Performing Right Society Ltd. vs. Commissioner of Income-tax (Supreme Court of India) (Now Kalpesh Classes is totally digital, and now coaching is 200 % better in performance with on screen presentations and professors explanation)

SEC. 161 LIABILITY OF REPRESENTATIVE ASSESSEE.

Every representative assessee, as regards the income in respect of which he is a representative assessee, shall be subject to the same duties, responsibilities and liabilities as if the income were income received by or accruing to or in favour of him beneficially, and shall be liable to assessment in his own name in respect of that income; but any such assessment shall be deemed to be made upon him in his representative capacity only, and the tax shall, subject to the other provisions contained in this Chapter, be levied upon and recovered from him in like manner and to the same extent as it would be leviable upon and recoverable from the person represented by him.

If an assessee was chargeable to tax in respect of his own income or income of others which was chargeable as his own income, those provisions would indisputably apply. It was clearly implicit in section 161 that a representative assessee was not exempt from liability to pay advance tax. [1970] 076 ITR 0001- Premier Automobiles Ltd. vs. Shrivastava (S.N.), ITO (Supreme Court of India)

SEC. 162 RIGHT OF REPRESENTATIVE ASSESSEE TO RECOVER TAX PAID.

Every representative assessee who, as such, pays any sum under this Act, shall be entitled to recover the sum so paid from the person on whose behalf it is paid, or to retain out of any moneys that may be in his possession or may come to him in his representative capacity, an amount equal to the sum so paid.

Any representative assessee, or any person who apprehends that he may be assessed as a representative assessee, may retain out of any money payable by him to the person on whose behalf he is liable to pay tax (hereinafter in this section referred to as the principal), a sum equal to his estimated liability, and in the event of any disagreement between the principal and such representative assessee or person as to the amount to be so retained, such representative assessee or person may secure from the Assessing Officer a certificate stating the amount to be so retained pending final settlement of the liability, and the certificate so obtained shall be his warrant for retaining that amount.

The amount recoverable from such representative assessee or person at the time of final settlement shall not exceed the amount specified in such certificate, except to the extent to which such representative assessee or person may at such time have in his hands additional assets of the principal.

CHAPTER - 20

ACCELERATED ASSESSMENT

SEC. 174 ASSESSMENT OF PERSONS LEAVING INDIA.

When it appears to the Assessing Officer that any individual may leave India during the current assessment year or shortly after its expiry and that he has no present intention of returning to India, the total income of such individual for the period from the expiry of the previous year for that assessment year up to the probable date of his departure from India shall be chargeable to tax in that assessment year. The total income of each completed previous year or part of any previous year included in such period shall be chargeable to tax at the rate or rates in force in that assessment year, and separate assessments shall be made in respect of each such completed previous year or part of any previous year.

The Assessing Officer may estimate the income of such individual for such period or any part thereof, where it cannot be readily determined in the manner provided in this Act.

For the purpose of making an assessment the Assessing Officer may serve a notice upon such individual requiring him to furnish within such time, not being less than seven days, as may be specified in the notice, a return in the same form and verified in the same manner as a return under section 142(1)(i), setting forth his total income for each completed previous year comprised in the period and his estimated total income for any part of the previous year comprised in that period.

An assessee's application for a tax clearance certificate is proof enough of his lack of intention to return to India, and that lack of intention is sufficient to attract 174 sustain an assessment under that section. [1967] 064 ITR 0074- Commissioner of Income-tax vs. Ramzan (Kerala High Court)

READ 174 WITH 160

Because the agent of the non-resident firm can be assessed under sections 160 and 163 of the Act, assessment and recovery of the income in the hands of the non-resident principal is not barred. Section 166 clearly indicates that the Income-tax Officer has got the jurisdiction to either assess a non-resident firm or its agent. The words "either" and "or" in section 166 refer to assessment and recovery of tax and not to non-resident and agent. As such, there is no question of exercise of option by the Income-tax Officer to assess and recover the tax either from the non-resident or its agent and the non-resident and its agents are equally liable for the tax. The initiation of proceedings of assessment against the principal nonresident cannot be a bar for either continuing those proceedings or initiating fresh proceedings against the resident agent of the non-resident. Merely because the Income-tax Officer did not choose to proceed against the partner of the non-resident firm who was produced before him, it does not relieve the obligation of the agent of the firm from the liability to pay tax, as section 174 is only an enabling provision. [1975] 100 ITR 0637- Barium Chemicals Ltd. vs. Income-tax Officer (Andhra Pradesh High Court)

174A. ASSESSMENT OF ASSOCIATION OF PERSONS OR BODY OF INDIVIDUALS OR ARTIFICIAL JURIDICAL PERSON FORMED FOR A PARTICULAR EVENT OR PURPOSE.

Where it appears to the Assessing Officer that any association of persons or a body of individuals or an artificial juridical person, formed or established or incorporated for a particular event or purpose is likely to be dissolved in the assessment year in which such association of persons or a body of individuals or an artificial juridical person was formed or established or incorporated or immediately after such assessment year, the total income of such association or body or juridical person for the period from the expiry of the previous year for that assessment year up to the date of its dissolution shall be chargeable to tax in that assessment year, and the provisions of section 174 shall, so far as may be, apply to any proceedings in the case of any such person as they apply in the case of persons leaving India.

SEC.175 ASSESSMENT OF PERSONS LIKELY TO TRANSFER PROPERTY TO AVOID TAX.

If it appears to the Assessing Officer during any current assessment year that any person is likely to charge, sell, transfer, dispose of or otherwise part with any of his assets with a view to avoiding payment of any liability under the provisions of this Act, the total income of such person for the period from the expiry of the previous year for that assessment year to the date when the Assessing Officer commences proceedings under this section shall be chargeable to tax in that assessment year, and the provisions of section 174 shall, so far as may be, apply to any proceedings in the case of any such person as they apply in the case of persons leaving India.

SEC. 115JB MINIMUM ALTERNATE TAX

Where in the case of an assessee, being a company, the income-tax, payable on the total income as computed under this Act in respect of any previous year relevant to the assessment year commencing on or after the 1st day of April, 2001, is less than seven and one-half per cent. of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable by the assessee on such total income shall be the amount of income-tax at the rate of seven and one-half per cent.

BOOK PROFITS MUST BE AS PER COMPANY LAW

Every assessee, being a company, shall, for the purposes of this section, prepare its profit and loss account for the relevant previous year in accordance with the provisions Schedule VI to the Companies Act:

Provided that while preparing the annual accounts including profit and loss account, The accounting policies, The accounting standards adopted for preparing such accounts including profit and loss account, The method and rates adopted for calculating the depreciation, shall be the same as have been adopted for the purpose of preparing such accounts including profit and loss account and laid before the company at its annual general meeting in accordance with the provisions of section 210 of the Companies Act.

MEANING OF BOOK PROFITS

For the purposes of this section, "book profit" means the net profit as shown in the profit and loss account for the relevant previous year.

Add:	X
1 The amount of income-tax paid or payable, and the provision therefore	X
2 The amounts carried to any reserves, by whatever name called other than a reserve specified under section 33AC	X
3 The amount or amounts set aside to provisions made for meeting liabilities, other than ascertained liabilities	X
4 The amount by way of provision for losses of subsidiary companies	X
5 The amount or amounts of dividends paid or proposed	X
6 The amount or amounts of expenditure relatable to any income to which section 10 [other than the provisions contained in clause (23G) thereof] or section 10A or section 10B or section 11 or section 12 apply	X

	X

LESS: if any amount referred is debited to the profit and loss account,

1 The amount withdrawn from any reserve or provision (excluding a reserve created before the 1st day of April, 1997 otherwise than by way of a debit to the profit and loss account), if any such amount is credited to the profit and loss account.	X
Provided that where this section is applicable to an assessee in any previous year, the amount withdrawn from reserves created or provisions made in a previous year relevant to the assessment year commencing on or after the 1st day of April, 1997 shall not be reduced from the book profit unless the book profit of such year has been increased by those reserves or provisions (out of which the said amount was withdrawn) under this Explanation or Explanation below second proviso to section 115JA, as the case may be.	
2 The amount of income to which any of the provisions of section 10 [other than the provisions contained in clause (23G) thereof] or section 10A or section 10B or section 11 or section 12 apply, if any such amount is credited to the profit and loss account	X
3 The amount of loss brought forward or unabsorbed depreciation, whichever is less as per books of account. For the purposes of this clause, (a) the loss shall not include depreciation (b) the provisions of this clause shall not apply if the amount of loss brought forward or unabsorbed depreciation, is nil	X

4	The amount of profits eligible for deduction under section 80HHC	X
5	The amount of profits eligible for deduction under section 80HHE	X
6	The amount of profits eligible for deduction under section 80HHF	X
7	The amount of profits of sick industrial company for the assessment year commencing on and from the assessment year relevant to the previous year in which the said company has become a sick industrial company.	X

		X

SET OFF UNDER INCOME TAX ACT IF DIFFERENT

Nothing shall affect the determination of the amounts in relation to the relevant previous year to be carried forward to the subsequent year or years under the provisions of section 32(2) or 32A(3) or 72(1) or 73 or 74 or 74A (3).

ACCOUNTANTS REPORT SHALL BE OBTAINED

Every company to which this section applies, shall furnish a report in the prescribed form from an chartered accountant, certifying that the book profit has been computed in accordance with the provisions of this section along with the return of income filed under section 139(1) or along with the return of income furnished in response to a notice section 142(1)(i).

SEC. 115JAA. TAX CREDIT IN RESPECT OF TAX PAID ON MAT

Where any amount of tax is paid under 115JB(1) by an assessee, being a company for the assessment year commencing on the 1st day of April, 2006 and any subsequent assessment year, then, credit in respect of tax so paid shall be allowed to him in accordance with the provisions of this section.

AMOUNT TO C/F	The tax credit to be allowed shall be the difference of the tax paid for any assessment year under 115JB, and the amount of tax payable by the assessee on his total income computed in accordance with the other provisions of this Act. 115JB(2) Provided that no interest shall be payable on the tax credit allowed.
YEARS TO C/F	Allowed for 5 years 115JB(3)
CONDITION FOR ALLOWING SET OFF	The tax credit shall be allowed set-off in a year when tax becomes payable on the total income computed in accordance with the provisions of this Act other than Section 115JB. 115JB(4)
AMOUNT OF SET OFF	Set off in respect of brought forward tax credit shall be allowed for any assessment year to the extent of the difference between the tax on his total income and the tax which would have been payable under the provisions of section 115JB. 115JB(5)

CHAPTER - 22

DIVIDEND TAX

TAX ON DISTRIBUTED PROFITS OF DOMESTIC COMPANIES.

	115O, 115P, 115Q	115R, 115S, 115T
Assessee	Domestic company	Unit trust of India Mutual funds
Distribution	Any amount declared, distributed or paid by way of dividends (whether interim or otherwise) whether out of current or accumulated profits	Any amount of income distributed by the specified company or a Mutual Fund to its unit holders
Rate of Tax	12.5 %	12.5 % if payee is Individual or HUF 20 % for others
No Dividend Tax When	--	When income distributed, (a)by the Administrator of the specified undertaking, to the unit holders; or (b) to a unit holder of open-ended equity oriented funds in respect of any distribution made from such funds.
Payment time	Within fourteen days from the date of declaration of any dividend; or (b) distribution of any dividend; or (c) payment of any dividend, whichever is earliest.	Within fourteen days from the date of distribution or payment of such income, whichever is earlier. (Must visit kalpeshclasses.com for downloading material for PE2 and Final)
Any Credit available to share holders	No	No
When assessee fails to pay tax	Simple interest at the rate of one per cent for every month or part thereof is leviable. Assessee shall be deemed to be an assessee in default (115P,115Q)	Simple interest at the rate of one per cent for every month or part thereof is leviable. Assessee shall be deemed to be an assessee in default (115S,115T)
Meaning of	“Dividends” shall have the same meaning as is given to “dividend” in section 2(22) but shall not include sub-clause (e) thereof.	“open-ended equity oriented fund” means the unit scheme, 1964 made by the unit trust of India; and such fund where the investible funds are invested by way of equity shares in domestic companies to the extent of more than fifty per cent of the total proceeds of such fund:

CHAPTER - 23**SEARCH AND SEIZURE****SEARCH AND SEIZURE****CONDITION PRECEDENT FOR CONDUCTING SEARCH (SECTION 132)**

Where the Director General or Director or the Chief Commissioner Commissioner or any such Joint Director or Joint Commissioner as may be empowered in this behalf by the Board, in consequence of information in his possession, has reason to believe that

- 1) Any person to whom a summons was issued to produce, or cause to be produced, any books of account or other documents has omitted or failed to produce, or cause to be produced, such books of account, or other documents as required by such summons or notice, [132(1)(a)]or
- 2) Any person to whom a summons or notice as aforesaid has been or might be issued will not, or would not, produce or cause to be produced, any books of account or other documents which will be useful for, or relevant to, any proceeding under the act [132(1)(b)]or
- 3) Any person is in possession of any money, bullion, jewellery or other valuable article or thing and such money, bullion, jewellery or other valuable article or thing represents either wholly or partly income or property which has not been, or would not be, disclosed for the purposes of the act (hereinafter in this section referred to as the undisclosed income or property) [132(1)(c)]

SEARCH POWERS

The power of search is an extraordinary power, so that it has to be confined strictly to what has been authorised by law. Where in a consequence of a survey in a hospital, which was run by a charitable institution, a search was authorised against an employee, who was having only income from salary, interest and dividend in the premises of her residence as well as the hospital and the bank lockers. The particular employee being in a position to explain the jewellery with reference to the wealth-tax return and the cash in hand with reference to the accounts, it was held after an elaborate review of the case law on the subject, that the jurisdiction for issue of a search warrant though available is required to be exercised with a sense of responsibility. But the conversion of a survey into a search by the Additional Director of Investigation was found not justified for lack of any material on which “reason to believe” could be based. There is nothing to indicate independent exercise of mind on the part of the additional director, when the hospital which is a charitable institution was sought to be searched in connection with the assessment of an employee. Since the authorisation was not against the trust but the employee, the search on the hospital in the facts of the case was held to be illegal. All places, where the Assessing Officer has reason to suspect sequestration of materials or assets belonging to the person in whose case the search is authorised can be authorised for search. There is apparently a limit to which this power could be exercised.

An elaborate review of case law on the subject indicates the consistent concern exhibited by the courts to ensure that the power of search is not exceeded and that the power given to do a certain thing in a certain manner must be done in that manner or not at all. The responsibility for authorising a search is to be exercised with caution and should not be based merely upon the recommendation of subordinate authorities. A search invades the privacy of a citizen which cannot be lightly invaded. This decision in *Dr. Nalini Mahajan v. Director of I. T. (Inv.)* [2002] 257 ITR 123 (Delhi) is a welcome decision which reiterates the parameters of search powers with reference to well established law. (Must visit kalpeshclasses.com for downloading material for PE2 and Final)

VALIDITY OF SEARCH OPERATION

The Delhi High Court, in *Ajit Jain v. Union of India* [2000] 242 ITR 302, in considering the validity of a search, held for a valid search there should be information which provides reason for believing that the person concerned is in possession of money or other assets representing, either wholly or in part, income which has not been or would not be disclosed by such person, and in the absence of such information a search could not be validly authorised and, intimation simpliciter from the CBI that money was found in the possession of a person, which according to the CBI was undisclosed, without something more would not constitute “information” for

the purpose of a search under section 132 of the Income-tax Act, 1961. The Department preferred an appeal to the Supreme Court and the Supreme Court dismissed the appeal holding that it had no reason to interfere with the decision of the Delhi High Court see *Union of India v. Ajit Jain* [2003] 260 ITR 80 (SC). In case of Supreme Court in *Union of India v. Ajit Jain* [2003] 260 ITR 80, the Supreme Court found that the search was invalid, since it was authorised on a mere communication of information from the Central Bureau of Investigation, that moneys were found in his possession, without any further basis for the inference that it constituted undisclosed income.

The conditions which require compliance before a search could be authorised, became the subject matter of decision in *Mahesh Kumar Agarwal v. Dy. Dir. of I. T.* [2003] 260 ITR 67 (Cal). There should be information giving rise to reason to believe. Reason to believe postulates belief itself and the existence of reasons for that belief held in good faith. It is not merely a matter of subjective satisfaction, but existence of a rational connection with information, which is relevant for the belief. In this case, search was authorised against a key-person, who was engaged in the business of preparation of food products in the brand name of “Haldiram Bhujiaiwala Group”, a business conducted under his proprietorship in the name of Pratik Food Products. One of the search warrants was issued in the name of Pratik Food Products. He was a regular assessee. The argument on behalf of the Revenue was that the transactions of the assessee, largely in cash were not recorded in the books of account. In the face of this and other general arguments like the likelihood of records, supposed to suggest evasion, the High Court inferred, that there was no material for even suspicion to justify the search. After review of the case law on the subject, the High Court in the facts of the case found that the requirement of the expression “reason to believe” both in the context of section 147 for reassessment and section 132 for search required objective criteria for exercise of the power of search, since any search authorised without such reason, would be a serious invasion against the privacy and freedom of the taxpayer and that the condition should be strictly construed.

VALIDITY CANNOT BE LIGHTLY QUESTIONED

In *Kamal Khosla v. Director of Income-tax (Investigation)* [2002] 258 ITR 43 (Delhi), a search which was duly authorised, was questioned on the ground that there was indiscriminate seizure and alleged bribery, the High Court pointed out that even if the taxpayer’s allegation of bribery was taken as true, the search does not get invalidated on that account. It was further found that the seizure of cash in the facts of the case does not vitiate the search, but even assuming there was valid explanation, it was for the assessee to furnish the same and satisfy the authorities with such explanation in post-search proceedings. The writ petition which had also demanded that the CBI at whose instance the search was presumed to have been authorised, should be made a party, was rejected in *Kamal Khosla’s* case.

POWERS OF AUTHORITIES

- 1) Enter and search any building, place, vessel, vehicle or aircraft where he has reason to suspect that such books of account, other documents, money, bullion, jewellery or other valuable article or thing are kept. (It shall be competent for authorized officer to exercise the powers in all cases where he has reason to believe that any delay in getting the authorisation from the Chief Commissioner or Commissioner having jurisdiction over such person may be prejudicial to the interests of the revenue.)
- 2) Break open the lock of any door, box, locker, safe, almirah or other receptacle for exercising the powers where the keys thereof are not available.
- 3) Search any person who has got out of, or is about to get into, or is in, the building, place, vessel, vehicle or aircraft, if the authorised officer has reason to suspect that such person has secreted about his person any such books of account, other documents, money, bullion, jewellery or other valuable article or thing.
- 4) Require any person who is found to be in possession or control of any books of account or other documents maintained in the form of electronic record to afford the authorised officer the necessary facility to inspect such books of account or other documents.
- 5) Seize any such books of account, other documents, money, bullion, jewellery or other valuable article or thing found as a result of such search. (Provided that bullion, jewellery or other valuable article or thing, being stock-in-trade of the business, found as a result of such search shall not be seized but the authorised officer shall make a note or inventory of such stock-in-trade of the business.)

- 6) Place marks of identification on any books of account or other documents or make or cause to be made extracts or copies therefrom. The person from whose custody any books of account or other documents are seized may make copies thereof, or take extracts therefrom, in the presence of the authorised officer or any other person empowered by him in this behalf, at such place and time as the authorised officer may appoint in this behalf.
- 7) Make a note or an inventory of any such money, bullion, jewellery or other valuable article or thing.
- 8) The authorised officer may requisition the services of any police officer or of any officer of the Central Government, or of both, to assist him for all or any of the purposes and it shall be the duty of every such officer to comply with such requisition. 132(2) (Must visit kalpeshclasses.com for downloading material for PE2 and Final)
- 9) The authorised officer may, during the course of the search or seizure, examine on oath any person who is found to be in possession or control of any books of account, documents, money, bullion, jewellery or other valuable article or thing and any statement made by such person during such examination may thereafter be used in evidence in any proceeding. Examination on oath can be for any purpose. 132(4)
- 10) The provisions of the Code of Criminal Procedure, relating to searches and seizure shall apply. 132(13)

VALIDITY OF STATEMENTS RECORDED DURING SEARCH OPERATION

In *Greenview Restaurant v. Asst. CIT* [2003] 263 ITR 169 (Gauhati), a partner of a firm having made a confession during search retracted from the statement during assessment. Since the retraction was long after the statement, the confession, it was held, could not be lightly dismissed. But all the same, when the Assessing Officer made an addition on the basis of the retracted statement, he was bound to have discussed the retraction and given an opportunity to disprove his own statement. The addition was deleted by the Commissioner of Income-tax (Appeals) on the ground of retraction while it was restored on the basis of the confessional statement by the Tribunal. The High Court found that the Assessing Officer should have addressed himself to the facts giving opportunity to the assessee to prove his income, so that the matter had to go back to the Assessing Officer for a finding, whether the statement was made without any intimidation, threat or coercion and to make a fresh assessment strictly following the procedure prescribed for assessment under section 143(3) of the Act.

In spite of the present Board Circular and frequent admonitions of the courts against statement recorded under inducement or compulsion, the law does not bar voluntary statements, so that the issue despite the latest circular would still be whether such statements recorded are voluntary. Unless the survey and search officers themselves are fair and devote their attention more to finding evidence than to extorting confessions, controversies evident from the decisions are bound to continue. Compliance with the circular is necessary not only for protection of the taxpayer against arbitrary exercise of power, but also required in public interest for better utilisation of such power to gather evidence and for enquiry enabling better assessments, which will stand the test of appeal.

DEEMED SEIZURE PROV. 2 TO 132(1)

Where it is not possible or practicable to take physical possession of any valuable article or thing and remove it to a safe place due to its volume, weight or other physical characteristics or due to its being of a dangerous nature, the authorised officer may serve an order on the owner or the person who is in immediate possession or control thereof that he shall not remove, part with or otherwise deal with it, except with the previous permission of such authorised officer and such action of the authorised officer shall be deemed to be seizure of such valuable article or thing. (Provided that nothing contained in the second proviso shall apply in case of any valuable article or thing, being stock-in-trade of the business. Thus deemed seizure of stock in trade is not possible.)

VALUABLE ARTICLE OR THING FOUND IN OTHER PLACE 132 (1A)

Where any Chief Commissioner or Commissioner, in consequence of information in his possession, has reason to suspect that any books of account, other documents, money, bullion, jewellery or other valuable article or thing in respect of which an officer has been authorised is kept in any building, place, vessel, vehicle or aircraft not mentioned in the authorization, such Chief Commissioner or Commissioner may, notwithstanding anything contained in section 120 authorise the said officer to take action under any of the clauses aforesaid in respect of such building, place, vessel, vehicle or aircraft.

WHERE IT IS NOT PRACTICAL TO SEIZE 132 (3)

The authorised officer may, where it is not practicable to seize any such books of account, other documents, money, bullion, jewellery or other valuable article or thing, for reasons other than those mentioned in the second proviso to 132(1), serve an order on the owner or the person who is in immediate possession or control thereof that he shall not remove, part with or otherwise deal with it except with the previous permission of such officer and such officer may take such steps as may be necessary for ensuring compliance of powers. It is declared that serving of an order as aforesaid shall not be deemed to be seizure of such books of account, other documents, money, bullion, jewellery or other valuable article or thing.

TIME LIMIT FOR ORDER UNDER SECTION 132(3) SECTION 132(8A)

An order under 132(3) shall not be in force for a period exceeding sixty days from the date of the order. Provided that the Director or, as the case may be, Commissioner shall not approve the extension of the period for any period beyond the expiry of thirty days after the completion of all the proceedings under this Act in respect of the years for which the books of account, other documents, money, bullion, jewellery or other valuable articles or things are relevant.

PRESUMPTION AS TO BOOKS AND DOCUMENTS 132 (4A)

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, it may be presumed--

- 1) That such books of account, other documents, money, bullion, jewellery or other valuable article or thing belong or belongs to such person;
- 2) That the contents of such books of account and other documents are true; and
- 3) That 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 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. (Must visit kalpeshclasses.com for downloading material for PE2 and Final)

PRESUMPTION OF OWNERSHIP OF ASSET FOUND DURING SEARCH

Section 132(4A) raises a presumption that what is found during search belongs to the occupant and that it is true. But such a rule is intended to help the search officer to seize the assets when there is no proper explanation for the same. It does not justify the assessment with reference to the seized records without any enquiry on the same. Where it was the assessee's case that the transactions contained in the papers were pertaining to a company of which he was a director, the presumption applicable in the search provisions cannot justify the assessment without any enquiry as to the true nature of the papers seized. This was the law that was decided in *Mansukhlal Nanjibhai Patel v. Deputy CIT* [2001] 251 ITR 341 (Guj). Similar view was taken in *CIT v. P. R. Metrani (HUF)* [2001] 251 ITR 244 (Kar).

LAW OF EVIDENCE-ROLE OF PRESUMPTION IN SEARCH CASES READ WITH SECTION 68

Section 68 provides that where any sum is found credited in the books of an assessee maintained for any previous year, and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the sum so credited may be charged to income-tax as the income of the assessee of that previous year.

Section 132(4A) has incorporated a rule of evidence relating to materials found during search raising a presumption that books of account and other documents belong to the person in whose place they were found and that their contents are true and that the documents in the handwriting of a person can be treated as having been executed by him. Hence, where there are borrowings in the books, could it be assumed that they are genuine without anything further to support the claim? This was the issue considered in *Daya Chand v. CIT* [2001] 250 ITR 327 (Delhi). The High Court found that section 68 requires an explanation as to the nature and source of every cash credit.

It cannot be said that section 132(4A) overrides section 68. Probably it could be said that what is good enough during search for purposes of seizure may not be good enough for assessment. The golden rule, which would reconcile the two conflicting rules of evidence in section 132(4A) and section 68 of the Act is that the cash

credits or any other material found during the search raises a prima facie inference of genuineness, because there is no reason why the assessee should make false entries in the books to be secreted from the authorities. But at the same time, it cannot offer such immunity as to dispense with the need for explaining them. Section 132(4A) may have its weight but cannot totally undo the effect of section 68.

TIME LIMIT FOR RETENTION OF SEIZED BOOKS OF ACCOUNTS 132 (8)

The books of account or other documents seized shall not be retained by the authorised officer for a period exceeding thirty days from the date of the order of assessment under section 153A or 158BC unless the reasons for retaining the same are recorded by him in writing and the approval of the Chief Commissioner, Commissioner, Director-General or Director for such retention is obtained. Provided that the Chief Commissioner, Commissioner, Director-General or Director shall not authorise the retention of the books of account and other documents for a period exceeding thirty days after all the proceedings under the act in respect of the years for which the books of account or other documents are relevant are completed.

WHERE AUTHORISED OFFICER HAS NO JURISDICTION 132 (9A)

Where the authorised officer has no jurisdiction over the person referred to 132(1), the books of account or other documents, or any money, bullion, jewellery or other valuable article or thing seized shall be handed over by the authorised officer to the Assessing Officer having jurisdiction over such person within a period of sixty days from the date on which the last of the authorisations for search was executed and thereupon the powers exercisable by the authorised officer shall be exercisable by such Assessing Officer.

APPLICATION OF SEIZED OR REQUISITIONED ASSETS SECTION 132B

The assets seized under section 132 or requisitioned under section 132A may be dealt with in the following manner,

- 1) The amount of any existing liability under this Act, the Wealth-tax Act, Expenditure-tax Act, Gift-tax Act, and the Interest-tax Act, and the amount of the liability determined on completion of the assessment under section 153A and the assessment of the year relevant to the previous year in which search is initiated or requisition is made, or the amount of liability determined on completion of the assessment under Chapter XIV-B for the block period, as the case may be (including any penalty levied or interest payable in connection with such assessment) and in respect of which such person is in default or is deemed to be in default, may be recovered out of such assets. [Where the person concerned makes an application to the Assessing Officer within thirty days from the end of the month in which the asset was seized, for release of asset and the nature and source of acquisition of any such asset is explained to the satisfaction of the Assessing Officer, the amount of any existing liability referred to in this clause may be recovered out of such asset and the remaining portion, if any, of the asset may be released, with the prior approval of the Chief Commissioner or Commissioner to the person from whose custody the assets were seized. Such asset or any portion thereof as is referred earlier shall be released within a period of one hundred and twenty days from the date on which the last of the authorisations for search under section 132 or for requisition under section 132A, as the case may be, was executed]
- 2) If the assets consist solely of money, or partly of money and partly of other assets, the Assessing Officer may apply such money in the discharge of the liabilities and the assessee shall be discharged of such liability to the extent of the money so applied.
- 3) The assets other than money may also be applied for the discharge of any such liability as remains undischarged and for this purpose such assets shall be deemed to be under distraint as if such distraint was effected by the Assessing Officer or, as the case may be, the Tax Recovery Officer under authorisation from the Chief Commissioner or Commissioner under 226(5) and the Assessing Officer or, as the case may be, the Tax Recovery Officer may recover the amount of such liabilities by the sale of such assets and such sale shall be effected in the manner laid down in the Third Schedule.

Any assets or proceeds thereof which remain after the liabilities referred to in clause (i) of sub-section (1) are discharged shall be forthwith made over or paid to the persons from whose custody the assets were seized. 132B(3)

ASSESSMENT IN CASE OF SEARCH OR REQUISITION SEC. 153A, 153B AND 153C

ASSESSMENT IN CASE OF SEARCH OR REQUISITION 153A.

Where a search is initiated under section 132 or books of account, other documents or any assets are requisitioned under section 132A after the 31st day of May, 2003, the Assessing Officer shall

- 1) Issue notice to such person requiring him to furnish within such period, as may be specified in the notice, the return of income in respect of each assessment year falling within six assessment years in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed and the provisions of this Act shall, so far as may be, apply accordingly as if such return were a return required to be furnished under section 139
- 2) Assess or reassess the total income of six assessment years immediately preceding the assessment year relevant to the previous year in which such search is conducted or requisition is made :
- 3) Assessment or reassessment, if any, relating to any assessment year falling within the period of six assessment years referred to in this section pending on the date of initiation of the search under section 132 or making of requisition under section 132A, as the case may be, shall abate.
- 4) All other provisions of this Act shall apply to the assessment made under this section
- 5) In an assessment or reassessment made in respect of an assessment year under this section, the tax shall be chargeable at the rate or rates as applicable to such assessment year.

TIME-LIMIT FOR COMPLETION OF ASSESSMENT. SECTION 153B.

The Assessing Officer shall make an order of assessment or reassessment, in respect of each assessment year falling within six assessment years / assessment year relevant to previous year within a period of two years from the end of the financial year in which the last of the authorisations for search under section 132 or for requisition under section 132A was executed.

In case of other person referred to in section 153C, the period of limitation for making the assessment or reassessment shall be the period as referred or one year from the end of the financial year in which books of account or documents or assets seized or requisitioned are handed over under section 153C to the Assessing Officer having jurisdiction over such other person, whichever is later.

ASSESSMENT OF INCOME OF ANY OTHER PERSON SECTION 153C

Where the Assessing Officer is satisfied that any money, bullion, jewellery or other valuable article or thing or books of account or documents seized or requisitioned belongs or belong to a person other than the person referred to in section 153A, then the books of account or documents or assets seized or requisitioned shall be handed over to the Assessing Officer having jurisdiction over such other person and that Assessing Officer shall proceed against each such other person and issue such other person notice and assess or reassess income of such other person in accordance with the provisions of section 153A.

Provided that in case of such other person, the reference to the date of initiation of the search under section 132 or making of requisition under section 132A in the second proviso to section 153A shall be construed as reference to the date of receiving the books of account or documents or assets seized or requisitioned by the Assessing Officer having jurisdiction over such other person.

(2) Where books of account or documents or assets seized or requisitioned have been received by the Assessing Officer having jurisdiction over such other person after the due date for furnishing the return of income for the assessment year relevant to the previous year in which search is conducted under section 132 or requisition is made under section 132A and in respect of such assessment year

- (i) No return of income has been furnished by such other person and no notice 142(1) has been issued to him, or
- (ii) A return of income has been furnished by such other person but no notice under 143(2) has been served and limitation of serving the notice under 143(2) has expired, or
- (iii) Assessment or reassessment, if any, has been made,

before the date of receiving the books of account or documents or assets seized or requisitioned by the Assessing Officer having jurisdiction over such other person, such Assessing Officer shall issue the notice and assess or reassess total income of such other person of such assessment year in the manner provided in section 153A.



CHAPTER - 24

POWERS OF ITA

POWER REGARDING DISCOVERY, PRODUCTION OF EVIDENCE, ETC. SEC. 131

The Assessing Officer, Deputy Commissioner (Appeals), Joint Commissioner, Commissioner (Appeals)] and Chief Com-missioner or Commissioner shall, for the purposes of this Act, have the same powers as are vested in a court under the Code of Civil Procedure, when trying a suit in respect of the following matters, namely :—

- (a) discovery and inspection;
- (b) enforcing the attendance of any person, including any officer of a banking company and examining him on oath;
- (c) compelling the production of books of account and other documents; and
- (d) issuing commissions.

ITA has reason to suspect that any income has been concealed, or is likely to be concealed, by any person or class of persons, within his jurisdiction, then, for the purposes of making any enquiry or investigation relating thereto, it shall be competent for him to exercise the powers conferred on the income-tax authorities referred to in that sub-section, notwithstanding that no proceedings with respect to such person or class of persons are pending before him or any other income-tax authority. (Must visit kalpeshclasses.com for downloading material for PE2 and Final)

POWER TO REQUISITION BOOKS SECTION 132A

Where the Director General or Director or the Chief Commissioner or Commissioner, in consequence of information in his possession, has reason to believe that

Any person to whom a summons or notice was issued to produce, any books of account or other documents has omitted or failed to produce,	Said books of account, documents or assets have been taken into custody or control by any officer or authority under any other law for the time being in force
Any books of account or other documents will be useful for, or relevant to, any proceeding and any person to whom a summons or notice as aforesaid has been or might be issued will not, or would not, produce or cause to be produced, such books of account or other documents.	
any assets represent either wholly or partly income or property which has not been, or would not have been, disclosed for the purposes of this Act	

Then, the ITA referre to as the requisitioning officer to require the officer or authority referred to deliver such books of account, other documents or assets to the requisitioning officer.

On a requisition being made the officer or authority shall deliver the books of account, other documents or assets to the requisitioning officer either forthwith or when such officer or authority is of the opinion that it is no longer necessary to retain the same in his or its custody.

Where any books of account, other documents or assets have been delivered to the requisitioning officer, the provisions of sub-sections (4A) to (14) (both inclusive) of section 132 and section 132B shall, so far as may be, apply as if such books of account, other documents or assets had been seized under of section 132.

POWER OF SURVEY. SEC. 133A

Notwithstanding anything contained in any other provision of this Act, an income-tax authority may enter

- (a) any place within the limits of the area assigned to him, or
- (b) any place occupied by any person in respect of whom he exercises jurisdiction,
- (c) any place in respect of which he is authorised for the purposes of this section by such income-tax authority, who is assigned the area within which such place is situated or who exercises jurisdiction in respect of any person occupying such place,

at which a business or profession is carried on, whether such place be the principal place or not of such business or profession, and require any proprietor, employee or any other person who may at that time and place be attending in any manner to, or helping in, the carrying on of such business or profession

For the purposes of this sub-section, a place where a business or profession is carried on shall also include any other place, whether any business or profession is carried on therein or not, in which the person carrying on the business or profession states that any of his books of account or other documents or any part of his cash or stock or other valuable article or thing relating to his business or profession are or is kept.

An income-tax authority may enter any place of business or profession only during the hours at which such place is open for the conduct of business or profession and, in the case of any other place, only after sunrise and before sunset. 133A(2)

DUTY OF ASSESSEE

- To afford him the necessary facility to inspect such books of account or other documents as he may require and which may be available at such place,
- To afford him the necessary facility to check or verify the cash, stock or other valuable article or thing which may be found therein, and
- To furnish such information as he may require as to any matter which may be useful for, or relevant to, any proceeding under this Act.

POWERS OF ITA 133A(3)

- If he so deems necessary, place marks of identification on the books of account or other documents inspected by him and make or cause to be made extracts or copies therefrom,
- Impound and retain in his custody for such period as he thinks fit any books of account or other documents inspected by him. Provided that such income-tax authority shall not impound any books of account or other documents except after recording his reasons for so doing (max : 10 days)
- Make an inventory of any cash, stock or other valuable article or thing checked or verified by him,
- Record the statement of any person which may be useful for, or relevant to, any proceeding under this Act.
- An income-tax authority acting under this section shall, on no account, remove or cause to be removed from the place wherein he has entered, any cash, stock or other valuable article or thing. 133A (4)

POWERS IN CASE OF FUNCTION / CEREMONY / EVENT SEC. 133A(5)

Where, having regard to the nature and scale of expenditure incurred by an assessee, in connection with any function, ceremony or event, the income-tax authority is of the opinion that it is necessary or expedient so to do, he may, at any time after such function, ceremony or event, require the assessee by whom such expenditure has been incurred or any person who, in the opinion of the income-tax authority, is likely to possess information as respects the expenditure incurred, to furnish such information as he may require as to any matter which may be useful for, or relevant to, any proceeding under this Act and may have the statements of the assessee or any other person recorded and any statement so recorded may thereafter be used in evidence in any proceeding under this Act.

CHAPTER – 25**CONDUCT FOR LOANS AND DEPOSITS.****SEC. 269SS MODE OF TAKING OR ACCEPTING CERTAIN LOANS AND DEPOSITS.**

No person shall, take or accept from any other person (hereafter in this section referred to as the depositor), any loan or deposit otherwise than by an account payee cheque or account payee bank draft if,

- (a) The amount of such loan or deposit or the aggregate amount of such loan and deposit ; or
- (b) On the date of taking or accepting such loan or deposit, any loan or deposit taken or accepted earlier by such person from the depositor is remaining unpaid (whether repayment has fallen due or not), the amount or the aggregate amount remaining unpaid ; or
- (c) The amount or the aggregate amount referred to in clause (a) together with the amount or the aggregate amount referred to in clause (b),

Is twenty thousand rupees or more

CERTAIN LOANS AND DEPOSITS EXCLUDED

Any loan or deposit taken or accepted from, or any loan or deposit taken or accepted by,

- (a) Government
- (b) Any banking company, post office savings bank or co-operative bank
- (c) Any corporation established by a Central, State or Provincial Act
- (d) Any Government company
- (e) Notified institution, association or body or class of institutions, associations or bodies

Is out side the perview of this section

Further this section shall not apply to any loan or deposit where the person from whom the loan or deposit is taken or accepted and the person by whom the loan or deposit is taken or accepted are both having agricultural income and neither of them has any income chargeable to tax under this Act.

SEC. 271D PENALTY FOR FAILURE TO COMPLY WITH THE PROVISIONS OF SECTION 269SS.

If a person takes or accepts any loan or deposits in contravention of the provisions of section 269SS, he shall be liable to pay, by way of penalty, a sum equal to the amount of the loan or deposit so taken or accepted. Any penalty imposable shall be imposed by the Joint Commissioner.

SEC. 269T MODE OF REPAYMENT OF CERTAIN DEPOSITS.

No branch of a banking company or a co-operative bank and no other company or co-operative society and no firm or other person shall repay any loan or deposit made with it otherwise than by an account payee cheque or account payee bank draft drawn in the name of the person who has made the loan or deposit if

1. The amount of the loan or deposit together with the interest, if any, payable thereon, or
2. The aggregate amount of the loans or deposits held by such person with the branch of the banking company or co-operative bank or, as the case may be, the other company or co-operative society or the firm, or other person either in his own name or jointly with any other person on the date of such repayment together with the interest, if any, payable on such loans or deposits,

Is twenty thousand rupees or more

Provided that where the repayment is by a branch of a banking company or co-operative bank, such repayment may also be made by crediting the amount of such loan or deposit to the savings bank account or the current account (if any) with such branch of the person to whom such loan or deposit has to be repaid.

Provided further that nothing contained in this section shall apply to repayment of any loan or deposit taken or accepted from

- 1) Government
- 2) Any banking company, post office savings bank or co-operative bank
- 3) Any corporation established by a central, state or provincial act
- 4) Any government company
- 5) Notified institution, association or body or class of institutions, associations or bodies

SEC. 271E PENALTY FOR FAILURE TO COMPLY WITH THE PROVISIONS OF SECTION 269T.

If a person repays any loans or deposit referred to in section 269T otherwise than in accordance with the provisions of that section, he shall be liable to pay, by way of penalty, a sum equal to the amount of the deposit so repaid. Any penalty imposable shall be imposed by the Joint Commissioner.

“DEPOSIT” WILL NOT INCLUDE LOANS

The provisions of section 271E, are penal in nature and must be strictly construed. Since the Legislature specifically used the word ‘deposit’ in contradistinction to the term ‘loan’, the provisions would only be attracted if the repayment has been made in respect of a deposit. The meaning of the word ‘deposit’ occurring in section 269T cannot be stretched to include loans - Baidya Nath Plastic Industries (P.) Ltd. v. K.L. Anand, ITO [1998] 230 ITR 522 (Delhi). (Must visit kalpeshclasses.com for downloading material for PE2 and Final)

SEC. 281 CERTAIN TRANSFERS TO BE VOID.

Where, during the pendency of any proceeding under this Act or after the completion thereof, but before the service of notice any assessee creates a charge on, or parts with the possession (by way of sale, mortgage, gift, exchange or any other mode of transfer whatsoever) of, any of his assets in favour of any other person, such charge or transfer shall be void as against any claim in respect of any tax or any other sum payable by the assessee as a result of the completion of the said proceeding or otherwise.

Such charge or transfer shall not be void if it is made

- (i) For adequate consideration and without notice of the pendency of such proceeding or, as the case may be, without notice of such tax or other sum payable by the assessee ; or
- (ii) With the previous permission of the 7[Assessing] Officer.

This section applies to cases where the amount of tax or other sum payable or likely to be payable exceeds five thousand rupees and the assets charged or transferred exceed ten thousand rupees in value.

“assets” means land, building, machinery, plant, shares, securities and fixed deposits in banks, to the extent to which any of the assets aforesaid does not form part of the stock-in-trade of the business of the assessee.

NO ORDER IS REQUIRED TO BE PASSED

Section 281 of the Income-tax Act, 1961, declares as void any transfer made by the assessee during the pendency of proceedings under the Act, with the intention to defraud the Revenue. He can only attach property in the possession of the assessee in his own right, or in possession of a tenant or a third party on behalf of/for the benefit of the assessee. He cannot declare any transfer made by the assessee in favour of a third party void. If the Department finds that a property of the assessee is transferred by him to a third party with the intention to defraud the Revenue, it will have to file a suit in civil court to have the transfer declared void under section 281. [1998] 234 ITR 0188- Tax Recovery Officer vs. Gangadhar Viswanath Ranade (Decd.) (Supreme Court of India)

ASSESSEE HAS NO CHOICE OF PROPERTY

Section 281 of the Income-tax Act, 1961, can be invoked either during the pendency of any proceeding under the Act or after the completion of such proceeding but before the service of a notice. The second condition required to be fulfilled is that there is either creation of a charge on a property or a transfer of any assets by any assessee in favour of any other person. If these two conditions are fulfilled, the transfer of property by way of sale, mortgage, gift, exchange or any other mode shall be void as against any claim in respect of any tax. There is no provision in law which would debar the Department from proceeding against a house which was attached much earlier. It is for the Department to see as to how to proceed for the recovery of tax. Once the gift deed had been declared to be void, there was no legal bar against proceeding to auction the house. [1999] 235 ITR 0197A Smt. Ramana vs. Commissioner of Income-tax (Punjab and Haryana High Court)

APPROVAL U/S 281 CAN NOT BE CANCELLED

Where there is any transfer during pendency of proceedings section 281 declares such transfers to be void. When assessee made application for no objection certificate for transfer it is duty of applicant to disclose all relevant material. It is an Duty of authority to consider application in a judicious manner. Authority has power to cancel a certificate which has been issued earlier and applicant must be given an opportunity of being heard before such cancellation. [1999] 236 ITR 0056- Atria Power Corporation Ltd. vs. Assistant Commissioner of Income-tax (Karnataka High Court)

TRANSFER FOR PURPOSE OF 281 DOES NOT INCLUDE COMPULSORY ACQUISITION

The object of section 281 is not to guard the Revenue against the actions of the Legislature or Parliament, but to protect the Revenue from the act of an assessee whose action is intended to defraud or to avoid payment of tax, by transferring the assets owned by the assessee to another without the permission of the Assessing Officer and for an inadequate consideration. No officer acting under the provisions of any law can assert a right to declare any other legislation void. Section 281 of the Act does not vest any such powers in the Assessing Officer. Compulsory acquisition by the State of the undertaking owned by an assessee, under a validly enacted law is wholly outside the purview of section 281. Section 170 of the Act deals with the succession to business otherwise than on death. When the undertaking of a sick industry is acquired compulsorily by a law enacted by a State Legislature for that specific purpose and the assets of the undertaking are vested with the Government, it cannot be said that there is succession to the business of the assessee whose undertaking has been acquired. The Government in whom the undertaking vested did not carry on the business that had been carried on by the company whose assets were acquired. [1999] 239 ITR 0457A Pondicherry Textile Corporation Ltd. vs. Union of India (Madras High Court)

SEC. 281B PROVISIONAL ATTACHMENT TO PROTECT REVENUE IN CERTAIN CASES.

Where, during the pendency of any proceeding for the assessment of any income or for the assessment or reassessment of any income which has escaped assessment, the Assessing Officer is of the opinion that for the purpose of protecting the interests of the revenue it is necessary so to do, he may, with the previous approval of the Chief Commissioner, Commissioner, Director General or Director, by order in writing, attach provisionally any property belonging to the assessee.

Every such provisional attachment shall cease to have effect after the expiry of a period of six months from the date of the order and the Chief Commissioner, Commissioner, Director General or Director may, for reasons to be recorded in writing, extend the aforesaid period by such further period or periods as he thinks fit, so, however, that the total period of extension shall not in any case exceed two years.

SCOPE OF 281B

The scope and ambit of section 281B is that where, during the pendency of any proceeding for the assessment of any income or for the assessment or reassessment of any income which has escaped assessment, the Assessing Officer is of the opinion that for the purpose of protecting the interests of the Revenue it is necessary so to do, he may with the previous approval of the Chief Commissioner, Commissioner, Director-General or Director, by order in writing, attach provisionally any property belonging to the assessee in the manner provided in the Second Schedule. In the given case it was apparent that the order was passed by the concerned Assessing Officer in a mechanical manner without giving any reasons in the order itself and without giving any indication as to the prior approval of the higher authority as provided under the section itself. The order was not valid and was liable to be quashed. [2000] 245 ITR 0169- Gaurav Goel vs. Commissioner of Income-tax (Calcutta High Court)

“Discretion” must be a sound one governed by law and guided by rule, not by humour. There is nothing like unfettered discretion immune from judicial reviewability. Courts stand between the executive and the subject, alert, to see that discretionary power is not exceeded or misused. Discretion is a science of understanding to discern between right or wrong, between shadow and substance, between equity and colourable glosses and pretence and not to do according to one’s will and private affections. The action of the State, an instrumentality, any public authority or person whose actions bear the insignia of public law element or public character are amenable to judicial review and the validity of such action would be tested on the anvil of article 14 of the Constitution. “Opinion” means something more than mere retailing of gossip or hearsay ; it means judgment or belief, that is, a belief or a conviction resulting from what one thinks on a particular question. It means : judgment or belief based on grounds short of proof. If a man is to form an opinion and his opinion is to govern, he must form it himself on such reasons and grounds as seem good to him. The question as to which of the assets of the assessee could have been attached, depended on the subjective satisfaction of the assessing authority. It was for the Assessing Officer to decide as to which of the assets could be liquidated without difficulty for realisation of tax assessed. The assessee could not compel the Assessing Officer to attach any particular property. The assets seized were those which were realisable without much difficulty and, therefore, the orders of attachment were passed in respect of those assets. Admittedly, since the matter lay within the subjective view of the Assessing Officer, no exception could be taken to the exercise of such power. [2000] 246 ITR 0707- VLS Finance Ltd. vs. Commissioner of Income-tax (Delhi High Court)

ASSESSEE HAS NO CHOICE OF PROPERTY

There was provisional attachment of assessee's property to protect revenue. High denomination notes deposited with state bank of India with direction to credit sum in personal account prohibitory order under section 281B was issued by ITO directing bank not to pay amount to petitioner or to her account. Original period of attachment extended by ITO for further period of 6 months. Such order extending period of attachment should have been issued by commissioner. Where there is no application of mind by commissioner for extension of period of attachment order extending period of provisional attachment is invalid. [1979] 118 ITR 0852- Ilaben Ramanlal Zariwala vs. Union of India (Gujarat High Court)

CHAPTER – 27**ASSESSMENT PROCEDURE****ASSESSMENT PROCEDURE****SECTION 139(1) VOLUNTARY RETURN OF INCOME**

Every person, being a company or firm [whether having income or loss] or being a person other than a company or firm, if his total income or the total income of any other person in respect of which he is assessable under this Act during the previous year exceeded the maximum amount which is not chargeable to income-tax, shall, on or before the due date, furnish a return of his income or the income of such other person during the previous year, in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed.

PROVISIO 1 TO 139(1)**ECONOMIC INDICATORS**

It is one of the possible ways by which a large number of persons can be brought under the tax net is to identify potential taxpayers through economic indicators. There could be a number of such economic indicators which may be employed for this purpose. The Act has, therefore, inserted a proviso to section 139 of the Income-tax Act as a result of which it has become mandatory for all persons who satisfy one of the above economic criteria to furnish their returns of income. Section 271F levy a penalty in cases where the return which was required to be filed under proviso to section 139(1) is not furnished.

Provided that a person other than company or firm, who is not required to furnish a return under 139(1) and residing in such area as may be specified by the Board in this behalf by notification in the Official Gazette, and who at any time during the previous year incurs Rs. 50,000 or more expenditure on consumption of electricity or fulfils any one of the following conditions, shall furnish a return, of his income during the previous year, on or before the due date in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed. [Central Government may, by notification in the Official Gazette, specify the class or classes of persons to whom the 1/6 test shall not apply].

- (i) Is in occupation of an immovable property exceeding a specified floor area, whether by way of ownership, tenancy or otherwise, as may be specified by the Board in this behalf; or
- (ii) Is the owner or the lessee of a motor vehicle other than a two-wheeled motor vehicle, whether having any detachable side car having extra wheel attached to such two-wheeled motor vehicle or not; [motor vehicle shall have the same meaning as assigned to in Motor Vehicles Act. Expl. 1 to 139(1)] or
- (iii) Has incurred expenditure for himself or any other person on travel to any foreign country; or
- (iv) Is the holder of a credit card, not being an "add-on" card, issued by any bank or institution; or
- (v) Is a member of a club where entrance fee charged is twenty-five thousand rupees or more,

PROVISIO 2 TO 139(1)

Central Government may, by notification¹⁴ in the Official Gazette, specify the class or classes of persons to whom the provisions of the first proviso shall not apply.

PROVISIO 3 TO 139(1)

every company or a firm shall furnish on or before the due date the return in respect of its income or loss in every previous year.

PROVISIO 4 TO 139(1)**PERSONS HAVING EXEMPT INCOMES**

Every person, being an individual or a Hindu undivided family or an association of persons or a body of individuals, whether incorporated or not, or an artificial juridical person, if his total income or the total income

of any other person in respect of which he is assessable under this Act during the previous year, without giving effect to the provisions of section 10A or section 10B or section 10BA or Chapter VI-A exceeded the maximum amount which is not chargeable to income-tax, shall, on or before the due date, furnish a return of his income or the income of such other person during the previous year, in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed.

EXPL 1. TO 139(1)

The expression “motor vehicle” shall have the meaning assigned to it in clause (28) of section 216 of the Motor Vehicles Act, 1988 (59 of 1988).

EXPL. 2 TO 139(1) :- "DUE DATE" MEANS

1.	Where the assessee is a company	Oct. 31
2.	Where the assessee is a person other than a company:	
	In case where accounts of the assessee are required to be audited under any law or under Income tax act.	Oct. 31
	Where the assessee is a “working partner” in a firm whose accounts are required to be audited under any law	Oct. 31
	Where assessee is other than company and covered by Provisio 1 to sec. 139	Oct. 31
3	In any other case	
	Where report of a chartered accountant is required to be furnished under section 80 HHC or 80HHD	July 31
	Where prescribed certificate is required to be furnished under section 80R, 80RR or 80RRA	July 31
	In any other case	July 31

Where the last day for filing return of income or loss is a day on which the office is closed, the assessee can file the return on the next day afterwards on which the office is open and, in such cases, the return will be considered to have been filed within the specified time limit - Circular No. 639, dated November 13, 1992.

If the loss is from a source or head of income not liable to tax or exempt from income-tax, neither the assessee is required to show the same in the return, nor is the Assessing Officer under any obligation to compute or assess it CIT v. Har Prasad & Co. (P) Ltd. 1975 99 ITR 118 (SC).

EXPL 3 TO 139(1)

The expression “travel to any foreign country” does not include travel to the neighbouring countries or to such places of pilgrimage as the Board may specify in this behalf by notification in the Official Gazette.

NOTIFICATIONS UNDER PROVISIO 1 TO 139(1), PROVISIONS RELATING TO OBLIGATORY

FILING OF RETURNS NOT TO APPLY TO CERTAIN CLASSES OF PERSONS

The Central Government hereby specifies following classes of persons to whom the provisions of the first proviso shall not apply,

- (a) Any person being a non-resident in regard to conditions specified in clause (i) to clause (vi) of the first proviso;
- (b) Any person being an individual who has attained 65 years of age but is not engaged in any business or profession during the previous year in regard to conditions specified in clause (i) of the first proviso.

NOTIFICATION UNDER PROVISIO 1 TO 139(1), PROVISIONS NOT TO APPLY TO TRAVEL TO CERTAIN NEIGHBOURING COUNTRIES. (EXPL. 3 TO 139(1))

In exercise of the powers conferred under Explanation 4 to sub-section (1) of section 139 of the Income-tax Act, 1961 (43 of 1961), the Central Board of Direct Taxes hereby specifies that the expression “travel to any foreign country” used in this sub-section shall not include travel to following neighbouring countries, namely (a) Bangladesh ; (b) Bhutan ; (c) Maldives ; (d) Nepal ; (e) Pakistan ; (f) Sri Lanka.

SUBMISSION OF RETURN TO EMPLOYER SEC. 139(1A)

Any person, being an individual who is in receipt of income chargeable under the head “Salaries” may, at his option, furnish a return of his income for any previous year to his employer, in accordance with such scheme as may be specified by the Board in this behalf, by notification in the Official Gazette, and subject to such conditions as may be specified therein, and such employer shall furnish all returns of income received by him on or before the due date, in such form (including on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media) and manner as may be specified in that scheme, and in such case, any employee who has filed a return of his income to his employer shall be deemed to have furnished a return of income under section 139(1), and the provisions of this Act shall apply accordingly.

FILING OF RETURN OF INCOME IN ELECTRONIC FORM SEC. 139(1B)

Where any person, being a company or being a person other than a company, required to furnish a return of income may, at his option, on or before the due date, furnish a return of his income for any previous year in accordance with such scheme as may be specified by the Board in this behalf by notification in the Official Gazette and subject to such conditions as may be specified therein, in such form (including on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media) and in the manner as may be specified in that scheme, and in such case, the return of income furnished under such scheme shall be deemed to be a return furnished under 139(1).

285BA. OBLIGATION TO FURNISH ANNUAL INFORMATION RETURN.

(1) Any person, being (a) an assessee; or (b) the prescribed person in the case of an office of Government; or (c) a local authority or other public body or association; or (d) the Registrar or Sub-Registrar appointed under section 6 of the Registration Act, or (e) the registering authority empowered to register motor vehicles or (f) the Post Master General or (g) the Collector of the Land Acquisition Act or (h) the recognised stock exchange or (i) an officer of the Reserve Bank of India or (j) a depository under Depositories Act.

who is responsible for registering, or, maintaining books of account or other documents containing a record of any specified financial transaction, under any law for the time being in force, shall furnish an annual information return, in respect of such specified financial transaction to the prescribed income-tax authority or such other authority or agency as may be prescribed. (Must visit kalpeshclasses.com for downloading material for PE2 and Final)

The annual information return shall be furnished within the prescribed time after the end of such financial year, in such form and manner (including on a floppy, diskette, magnetic cartridge tape, CD-ROM or any computer readable media) as may be prescribed.

“specified financial transaction” means any (a) transaction of purchase, sale or exchange of goods or property or right or interest in a property; or (b) transaction for rendering any service; or (c) transaction under a works contract; or (d) transaction by way of an investment made or an expenditure incurred; or (e) a transaction for taking or accepting any loan or deposit, which may be prescribed. Provided that the Board may prescribe different values for different transactions in respect of different persons having regard to the nature of such transactions. The aggregate value of such transactions during a financial year so prescribed shall not be less than fifty thousand rupees.

271FA. PENALTY FOR FAILURE TO FURNISH ANNUAL INFORMATION RETURN.

If a person who is required to furnish an annual information return, as required under 285BA(1) fails to furnish such return within the time prescribed the income-tax authority prescribed may direct that such person shall pay, by way of penalty, a sum of one hundred rupees for every day during which the failure continues.

271F. PENALTY - FAILURE TO FURNISH RETURN OF INCOME.

If a person who is required to furnish a return of his income, as required under section 139(1) or by the provisos to that sub-section, fails to furnish such return before the end of the relevant assessment year, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of five thousand rupees.

It is seen that a large number of persons having salary income which are subject to deduction of tax at source do not file their returns. The penal provisions are also necessary to ensure that all such persons having taxable income file their returns of income. Therefore, section 271F provide for a penalty for not filing of return.

RETURN IN RESPONSE OF NOTICE 142(1)(i)

For the purpose of making an assessment under this Act, the Assessing Officer may serve on any person who has made a return under section 139 or in whose case the time allowed under sub-section (1) of that section for furnishing the return has expired a notice requiring him, on a date to be therein specified, Where such person has not made a return within the time allowed under sub section 1 of section 139 to furnish a return of his income or the income of any other person in respect of which he is assessable under this Act, in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed, or

276CC. FAILURE TO FURNISH RETURNS OF INCOME.

If a person wilfully fails to furnish in due time the return of income which he is required to furnish under section 139(1) or 142(1)(i) or 148 or 153A or 115WD or 115WH, he shall be punishable,

- (i) In a case where the amount of tax, which would have been evaded if the failure had not been discovered, exceeds one hundred thousand rupees, with rigorous imprisonment for a term which shall not be less than six months but which may extend to seven years and with fine;
- (ii) In any other case, with imprisonment of a term which shall not be less than three months but which may extend to three years and with fine:

Provided that a person shall not be proceeded against under this section for failure to furnish in due time the return of income -

- (a) The return is furnished by him before the expiry of the assessment year; or
- (b) The tax payable by him on the total income determined on regular assessment, as reduced by the advance tax, if any, paid, and any tax deducted at source, does not exceed **three thousand** rupees.

285BA. ANNUAL INFORMATION RETURN.

Any assessee, who enters into any financial transaction, as may be prescribed, with any other person, shall furnish, within the prescribed time, an annual information return in such form and manner, as may be prescribed, in respect of such financial transaction entered into by him during any previous year.

139 (3) LOSS RETURN

If any person who has sustained a loss in any previous year under the head "Profits and gains of business or profession" or under the head "Capital gains" and claims that the loss or any part thereof should be carried forward under sub-section (1) of section 72, or sub-section (2) of section 73, or sub-section (1) of section 74 he may furnish, within the time allowed under sub-section (1) a return of such other particulars as may be prescribed, and all the provisions of this Act shall apply as if it were a return under sub-section (1).

139 (4) BELATED RETURN

Any person who has not furnished a return within the time allowed to him under section 139(1); or within the time allowed under a notice issued under section 142(1), may furnish the return for any previous year at any time before the expiry of one year from the end of the relevant assessment year or before the completion of the assessment, whichever is earlier:

FILLING OF VOLUNTARY RETURN

Section 139 (4) does not use the expression 'voluntary return'. Whatever the impelling cause or motive, if a return otherwise valid is filed before the receipt of a valid notice for reassessment, it is to be treated as a return within section 139 (4), for it falls within the language of that section - CIT v. S. Raman Chettiar 1965 55 ITR 630 (SC).

An assessee cannot seek to rectify his return on which assessment has already been made. The Act does not provide for any machinery for dealing with voluntary returns filed by an assessee after assessment of income for the year of assessment is completed - Balchand v. ITO 1969 72 ITR 197 (SC).

139 (4A) RETURN OF TRUST

Every person in respect of income derived from property held under trust or other legal obligation wholly for charitable or religious purposes or in part only for such purposes, or of income being voluntary contributions referred to in sub-clause (iia) of clause (24) of section 2, shall, if the total income in respect of which he is assessable as a representative assessee (the total income for this purpose being computed under this Act without

giving effect to the provisions of sections 11 and 12 exceeds the maximum amount which is not chargeable to income-tax, furnish a return of such income of the previous year in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed and all the provisions of this Act shall, so far as may be, apply as if it were a return required to be furnished under sub-section (1).

139 (4B) RETURN OF POLITICAL PARTIES

The chief executive officer (whether such chief executive officer is known as Secretary or by any other designation) of every political party shall, if the total income in respect of which the political party is assessable (the total income for this purpose being computed under this Act without giving effect to the provisions of section 13A) exceeds the maximum amount which is not chargeable to income-tax, furnish a return of such income of the previous year in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed and all the provisions of this Act, shall, so far as may be, apply as if it were a return required to be furnished under sub-section (1).

Sub-section (4B) in section 139 which casts an obligation on the chief executive officer (where such chief executive officer is known as Secretary or by any other designation) of every political party to furnish a return of income of the political party, if the total income of the political party, as computed under the provisions of the Income-tax Act without giving effect to the exemption under new section 13A, exceeds the maximum amount which is not chargeable to income-tax. The term "political party" has been defined for the purposes of section 139(4B) and, as such, for the purposes of this provision also, it will bear its ordinary and wider meaning.

[1996] 222 ITR 0260- COMMON CAUSE, A REGISTERED SOCIETY VS. UNION OF INDIA (SUPREME COURT OF INDIA)

- 1) That the political parties are under a statutory obligation to file returns of income in respect of each assessment year in accordance with the provisions of the Income-tax Act. The political parties who had not been filing returns of income for several years had prima facie violated the statutory provisions of the Income-tax Act.
- 2) That the income-tax authorities had been wholly remiss in the performance of their statutory duties under law. The said authorities had for a long period failed to take appropriate action against the defaulter political parties.
- 3) The Secretary, Ministry of Finance, Department of Revenue, the Government of India, was to have an investigation/inquiry conducted against each of the defaulter political parties and initiate necessary action in accordance with law including penal action under section 276CC of the Income-tax Act.
- 4) A political party which is not maintaining, audited and authenticated, accounts and has not filed the return of income for the relevant period, cannot, ordinarily, be permitted to say that it has incurred or authorised expenditure in connection with the election of its candidates in terms of Explanation 1 to section 77 of the Representation of the People Act, 1951.

PROVISION RELATING TO INCOMES OF POLITICAL PARTIES SECTION 13A.

Any income of a political party which is chargeable under the head "Income from house property" or "Income from other sources" or any income by way of voluntary contributions received by a political party from any person shall not be included in the total income of the previous year of such political party. Provided that

- (a) Such political party keeps and maintains such books of account and other documents as would enable the Assessing Officer to properly deduce its income there from;
- (b) In respect of each such voluntary contribution in excess of ten thousand rupees, such political party keeps and maintains a record of such contribution and the name and address of the person who has made such contribution; and
- (c) The accounts of such political party are audited by an accountant as defined in the Explanation below sub-section (2) of section 288.

Explanation. - For the purposes of this section, "political party" means an association or body of individual citizens of India registered with the Election Commission of India as a political party under paragraph 3 of the Election Symbols (Reservation and Allotment) Order, 1968, and includes a political party deemed to be registered with that Commission under the proviso to sub-paragraph (2) of that paragraph.]

RETURN BY SPECIFIED PERSONS SECTION 139 (4C)

Every (a) scientific research association referred to in 10(21) (b) news agency referred to in 10(22B) (c) association or institution referred to in 10(23A) (d) institution referred to in 10(23B) (e) fund or institution referred to in sub-clause (iv) or trust or institution referred to in sub-clause (v) or any university or other educational institution referred to in sub-clause (vi) or any hospital or other medical institution referred to in sub-clause (via) of clause (23C) of section 10 (f) trade union referred to in sub-clause (a) or association referred to in sub-clause (b) of clause (24) of section 10, ~ shall, if the total income in respect of which such scientific research association, news agency, association or institution, fund or trust or university or other educational institution or any hospital or other medical institution or trade union is assessable, without giving effect to the provisions of section 10, exceeds the maximum amount which is not chargeable to income-tax, furnish a return of such income of the previous year in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed and all the provisions of this Act shall, so far as may be, apply as if it were a return required to be furnished under sub-section (1).

139 (5) REVISED RETURN

If any person, having furnished a return under sub-section (1), or in pursuance of a notice issued under sub-section (1) of section 142, discovers any omission or any wrong statement therein, he may furnish a revised return at any time before the expiry of one year from the end of the relevant assessment year or before the completion of the assessment, whichever is earlier.

SECTION 139(5) WILL APPLY ONLY TO A LIMITED CATEGORY OF CASES

Namely, where in the original return there was an omission or any wrong statement. The very word 'omission' connotes an unintentional act. Equally the words 'wrong statement' will not take in 'a statement known to be false to the person who made the statement'. However, the word 'discovers' occurring in section 139(5) will make it clear that at the time of discovery only, a person who has furnished a return finds out that an inadvertent omission or an unintended wrong statement has crept in the return filed by him.

Voluntary return under section 139(4) cannot be revised. Section 139(5) permits a later or revised return to be filed only when the return was filed under section 139(1). Filing of revised return is not contemplated under section 139(5) in cases governed by section 139(4). Section 139 (5) permits a later or revised return to be filed only where the return was filed under section 139(1). Filing of revised return is not contemplated under section 139 (5) in cases governed by section 139(4)- Kumar Jagdish Chandra Singha v. CIT 1996 86 Taxman 122 (SC).

Under section 139(5), a revised return can be filed only if there is an omission or wrong statement in the original return. Where in the original return, the profit and loss account containing the provision for depreciation had been filed. In the circumstances, it could not be said that there was any wrong statement in the original return which could enable the assessee to file a revised return under section 139(5). Since that revised return itself was not a valid return for being processed by the Income-tax Officer, the claim of the assessee that the particulars of depreciation were not given in the revised return and, therefore, depreciation should not be given, was untenable. [1996] 219 ITR 0404B Commissioner of Income-tax vs. Andhra Cotton Mills Ltd. (Andhra Pradesh High Court)

139 (9) DEFECTIVE RETURN

Where the Officer considers that the return of income furnished by the assessee is defective, he may intimate the defect to the assessee and give him an opportunity to rectify the defect within a period of fifteen days from the date of such intimation or within such further period which, on an application made in this behalf, the Officer may, in his discretion, allow, and if the defect is not rectified within the said period of fifteen days or, as the case may be, the further period so allowed, then, not with standing anything contained in any other provision of this Act, the return shall be treated as an invalid return and the provisions of this Act shall apply as if the assessee had failed to furnish the return:

Provided, that where the assessee rectifies the defect after the expiry of the said period of fifteen days or the further period allowed, but before the assessment is made, the Officer may condone the delay and treat the return as a valid return.

A RETURN OF INCOME SHALL BE REGARDED AS DEFECTIVE UNLESS THE FOLLOWING CONDITIONS ARE FULFILLED,

- (a) The annexures, statements and columns in the return of income relating to computation of income chargeable under each the head of income, computation of gross total income and total income have been duly filled in;
- (b) The return is accompanied by a statement showing the computation of the tax payable on the basis of the return;;
- (bb) The return is accompanied by the report of the audit referred to in section 44AB, or, where the report has been furnished prior to the furnishing of the return, by a copy of such report together with proof of furnishing the report;;
- (c) The return is accompanied by proof of-
 - 1. The tax, if any, claimed to have been deducted at source before the 1st day of April, 2006 and the advance tax and tax on self-assessment, if any, claimed to have been paid. Provided that where the return is not accompanied by proof of the tax, if any, claimed to have been deducted at source, the return of income shall not be regarded as defective if (a) a certificate for tax deducted was not furnished under section 203 to the person furnishing his return of income (b) such certificate is produced within a period of two years specified under sub-section (14) of section 155.
 - 2. The amount of compulsory deposit, if any, claimed to have been made under the Compulsory Deposit Scheme (Income-tax Payers) Act, 1974 (38 of 1974);
- (d) Where regular books of account are maintained by the assessee, the return is accompanied by copies of-
 - (i) Manufacturing account, trading account, profit and loss account or, as the case may be, income and expenditure account or any other similar account and balance sheet;
 - (ii) In the case of a proprietary business or profession, the personal account of the proprietor; in the case of a firm, association of persons or body of individuals, personal accounts of the partners or members;; and in the case of a partner or member of a firm, association of persons or body of individuals, also his personal account in the firm, association of persons or body of individuals;
- (e) Where the accounts of the assessee have been audited, the return is accompanied by copies of the audited profit and loss account and balance sheet and the auditor's report .
- (f) Where regular books of account are not maintained by the assessee, the return is accompanied by a statement indicating the amounts of turnover or, as the case may be, gross receipts, gross profit, expenses and net profit of the business or profession and the basis on which such amounts have been computed, and also disclosing the amounts of total sundry debtors, sundry creditors, stock-in-trade and cash balance as at the end of the previous year

EXPLANATION TO 139(9) IS ILLUSTRATIVE

The defects specified in 139(9) are illustrative and not exhaustive. The object of 139(5) and 139(9) is to get removed and rectified all defects and omissions in the return filed, whether they are discovered by the assessee or by the Assessing Officer. Both the provisions are enabling provisions inserted to facilitate reflection of correct income in the return and assessment thereof. These provisions can be simultaneously applied. Thus, documents placed on record with or without covering letters with intention to remove any omission or wrong in the return or record cannot be ignored simply because the revised return was not furnished unless it is shown that the purpose of the Act is not satisfied. [1992] 195 ITR 0825- Commissioner of Income-tax vs. Rai Bahadur Bissesswarlal Motilal Malwasie Trust (Calcutta High Court)

PERMANENT ACCOUNT NUMBER SEC. 139(A)

139A (1) Every person-

- (i) If his total income or the total income of any other person in respect of which he is assessable under this Act during any previous year exceeded the maximum amount which is not chargeable to income-tax; or
- (ii) Carrying on any business or profession whose total sales, turnover or gross receipts are or is likely to exceed FIVE LAKH rupees in any previous year; or

- (iii) Who is required to furnish a return of income under sub-section (4A) of section 139,
- (iv) Being an employer for fringe benefit tax.

and who has not been allotted a permanent account number shall, within such time, as may be prescribed, apply to the Assessing Officer for the allotment of a permanent account number.

Provisions of section 139A of the Income-tax Act provide for compulsory quoting of Permanent Account Number (PAN) in all documents pertaining to transactions as may be prescribed by Board and entered into by the concerned persons. This section provide that a person shall quote his Permanent Account Number or his General Index Register (GIR) Number till such time PAN is allotted. The section also provides that Board may notify a class or classes of persons to whom the provision regarding compulsory quoting of PAN shall not apply and further delegates power to Board to prescribe the form and manner of declaration which shall be furnished by a person not having either General Index Register Number or Permanent Account Number and the time and manner in which transactions subject to compulsory quoting of PAN/GIR No. shall be intimated to the prescribed authority.

Power is given to Central Government to specify other classes of persons. The Central Government has been empowered to specify by notification any class or classes of persons by whom tax is payable under the Income-tax Act or any tax or duty is payable under any other law, including importers and exporters, whether any tax is payable by them or not, and such persons have to apply for the allotment of a permanent account number. Such power is given with a view to progressively making PAN a common business identification number for other departments such as the Central Board of Excise and Customs and the Director General of Foreign Trade, it is proposed to delegate power to the Central Government to notify class or classes of persons for whom it will be obligatory to apply for PAN, provided tax is payable by them under the Income-tax Act or any tax or duty is payable by them under any other law in force. (Must visit kalpeshclasses.com for downloading material for PE2 and Final)

COMPULSORY QUOTING OF PERMANENT ACCOUNT NUMBER (PAN) BY EVERY PERSON DEDUCTING OR COLLECTING TAX AT SOURCE IN CERTAIN RETURNS AND CERTIFICATES.

Persons responsible for deducting tax from certain payments, and persons responsible for collecting tax from buyers of certain goods, are required to deliver returns and issue certificates in respect of such tax deducted or collected by them. The forms prescribed for delivering such returns or issuing such certificates contain columns for mentioning the permanent account number (PAN) of the persons from whose income the tax is deducted, or from whom the tax is collected. However, in many cases, such number is not so mentioned. With a view to enable processing of the information contained in such returns or certificates for the purposes of unearthing undisclosed income and discovering new taxpayers, sub-sections (5A), (5B), (5C) and (5D) in section 139A make it obligatory for every person receiving income from which tax has been deducted or from whom tax is collectible, to furnish his PAN to the person responsible for deducting or collecting such tax, and also to make it obligatory for the person deducting or collecting tax to quote the PAN of such persons in the returns of tax deducted or collected at source prescribed under sections 206 and 206C respectively and in the certificates issued under sections 203 and 206C(5) respectively. Such number will also be required to be quoted in statements of perquisites proposed to be provided for vide clause 63 of the Bill. The requirement will not apply in respect of certain persons who are not required to file returns of income. Further, the Government may notify separately the dates from which such requirement will apply in respect of any class or classes of persons.

BOARD HAS SINCE AMENDED INCOME-TAX RULES, 1962 VIDE SO 889(E) DATED 9-10-1998 SPECIFYING FOLLOWING TRANSACTIONS WHERE IT WILL BE NECESSARY TO QUOTE PAN OR GIR.

- (a) Sale or purchase of any immovable property valued at five lakh rupees or more;
- (b) Sale or purchase of a motor vehicle or vehicle, which requires registration by a registering authority under Chapter IV of that Act. Two wheeled vehicles have been kept outside the ambit of the definition of motor vehicle vide Notification S.O. 939(E) dated 29-10-1998.
- (c) A time deposit, exceeding fifty thousand rupees, with a banking company to which the Banking Regulation Act, 1949.
- (d) A deposit, exceeding fifty thousand rupees, in any account with Post Office Saving Bank;
- (e) A contract of a value exceeding ten lakh rupees for sale or purchase of securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956);
- (f) Opening an account with a banking company to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in section 51 of that Act);

- (g) Making an application for installation of a telephone connection (including a cellular telephone connection);
- (h) Payment to hotels and restaurants against their bills for an amount exceeding twenty-five thousand rupees at any one time.

The rules further provide that if a person has not been allotted PAN, he may quote his GIR No. till such time PAN is allotted to him. If he does not have either PAN or GIR No. and is making transactions in cash or otherwise than by way of crossed bank cheque or crossed bank draft, he is required to fill declaration in Form No. 60 giving his name and address and particulars of the transaction along with proof of his residential address. Persons having income from agriculture and not having any other income chargeable to tax are required to file similar declarations in Form No. 61. Non-residents visiting the country can produce copies of their passports.

RETURN BY WHOM TO BE SIGNED SEC. 140.

INDIVIDUAL 1) By the individual himself: 2) Where he is absent from India, by the individual himself or by some person duly authorised by him in this behalf;; 3) Where he is mentally incapacitated from attending to his affairs, by his guardian or any other person competent to act on his behalf ; and 4) Where, for any other reason, it is not possible for the individual to sign the return, by any person duly authorised by him in this behalf: Provided that in a case referred to in sub-clause (ii) or sub-clause (iv) the person signing the return holds a valid power of attorney from the individual to do so, which shall be attached to the return;
HINDU UNDIVIDED FAMILY By the karta, and, where the karta is absent from India or is mentally incapacitated from attending to his affairs, by any other adult member of such family;
COMPANY By the managing director thereof, or where for any unavoidable reason such managing director is not able to sign and verify the return, or where there is no managing director, by any director thereof: Provided that where the company is not resident in India, the return may be signed and verified by a person who holds a valid power of attorney from such company to do so, Which shall be attached to the return:
COMPANY IN LIQUIDATION Where any person has been appointed as the receiver of any assets of the company, the return shall be signed and verified by the liquidator.
COMPANY UNDER THE MANAGEMENT OF GOVERNMENT The return of the company shall be signed and verified by the principal officer thereof.
PARTNERSHIP FIRM In the case of a firm, by the managing partner there, or where for any unavoidable reason such managing partner is not able to sign and verify the return, or where there is no managing partner as such, by any partner thereof, not being a minor
LOCAL AUTHORITY By the principal officer thereof
POLITICAL PARTY By the chief executive officer of such party
OTHER ASSOCIATION By any member of the association or the principal officer thereof; and
OTHER PERSON By that person or by some person competent to act on his behalf.

SIGNATURE MUST BE PERSONAL

When signature by an agent is permissible, the writing of the name of the principal by the agent is regarded as the signature of the principal himself. But this result only follows when it is permissible for the agent to sign the name of the principal. If, on a construction of a statute, signature by an agent is not found permissible, then the writing of the name of the principal by the agent,. However clearly he may have been authorised by the principal, cannot possibly be regarded as the signature of the principal for the purposes of that statute. If a statute requires personal signature of a person, which includes a mark, the signature or the mark must be that of the man himself. There must be physical contact between that person and the signature or the mark put on the document. Where in the return of income of an illiterate assessee, the physical act of putting the mark was found to have been made by his son who was not authorised in this behalf, the return must be treated as not properly signed, and consequently, invalid - CAIT v. Sri Keshab Chandra Mandal 1950 18 ITR 569 (SC). (Must visit kalpeshclasses.com for downloading material for PE2 and Final)

CAN MINOR SIGN THE RETURN OF INCOME

Since a junior member could act as karta with the consent of other members, a return of income of a HUF can be signed by such a junior member - Narendrakumar J. Modi v. CIT 1976 105 ITR 109 (SC).

143 (1)(a) INTIMATION TO ASSESSEE

Where a return has been made under section 139, or in response to a notice under sub-section (1) of section 142,

- 1) If any tax or interest is found due on the basis of such return, after adjustment of any tax deducted at source, any advance tax paid, any tax paid on self-assessment and any amount paid otherwise by way of tax or interest, then, without prejudice to the provisions of sub-section (2), an intimation shall be sent to the assessee specifying the sum so payable, and such intimation shall be deemed to be a notice of demand issued under section 156 and all the provisions of this Act shall apply accordingly; and
- 2) If any refund is due on the basis of such return, it shall be granted to the assessee and an intimation to this effect shall be sent to the assessee:
- 3) The acknowledgment of the return shall be deemed to be intimation where either no sum is payable by the assessee or no refund is due to him.

TIME LIMIT FOR SENDING THE INTIMATION

No intimation shall be sent after the expiry of One year from the end of the financial year in which the return is made.

143(3) SCRUTINY ASSESSMENT**FULL SCRUTINY**

On the day specified in the notice, issued under clause 143(2)(ii) or as soon afterwards as may be, after hearing such evidence as the assessee may produce and such other evidence as the Assessing Officer may require on specified points, and after taking into account all relevant material which he has gathered, the Assessing Officer shall, by an order in writing, make an assessment of the total income or loss of the assessee, and determine the sum payable by him or refund of any amount due to him on the basis of such assessment. (Must visit kalpeshclasses.com for downloading material for PE2 and Final)

MEANING OF 'ASSESSMENT'

The word 'assessment' is used in the Act in a number of places in a comprehensive sense and includes all proceedings starting with the filing of the return or issue or notice and ending with determination of the tax payable by the assessee. Though in some section the word 'assessment' is used with reference to computation of income, in other sections it has the more comprehensive meaning - S. Sankappa v. ITO 1968 68 ITR 760 (SC).

LAW APPLICABLE

In the case of the assessment of income and the determination of the consequent tax liability, the relevant law is the law which rules during the assessment year in respect of which the total income is assessed and the tax liability determined - Brij Mohan v. CIT 1979 120 ITR (SC).

AUTHORITIES SHOULD ACT JUDICIALLY

The authorities under the Act have to act judicially and one of the requirements of judicial actions is to give a fair hearing to a person before deciding against him. M. Chockalingam and M. Meyyappan v. CIT 1963 48 ITR 34 (SC).

ACTION OF AUTHORITIES SHOULD BE FAIR AND NON-PARTISAN

The taxing authorities exercise quasi-judicial powers and in doing so they must act in a fair and not a partisan manner. It is impossible to subscribe to the view that unless those authorities exercise the power in a manner most beneficial to the revenue and consequently most adverse to the assessee, they should be deemed not to have exercised it in a proper and judicious manner - CIT v. Simon Carves Ltd. 1976 105 ITR 212 (SC).

PROCEEDINGS ARE QUASI-JUDICIAL

An assessment proceeding is a quasi-judicial proceeding - Indian & Eastern Newspaper Society v. CIT 1979 119 ITR 996 (SC).

PROCEEDINGS AGAINST MORE THAN ONE PERSON

Where it appears prima facie that the income may have been received either by A or B or by both together, it would be open to the income-tax authorities to determine the question as to in whose hands the income is taxable, by taking appropriate proceedings against A and B - Lalji Harida v. ITO/Chhotala Harida v. M.D. Karnik 1961 43 ITR 387 (SC).

LIFTING THE CORPORATE VEIL

In certain exceptional cases the Court is entitled to lift the veil of corporate entity and to pay regard to the economic realities behind the legal facade. For example the Court has power to disregard the corporate entity if it is used for tax evasion or to circumvent tax obligations CIT v. Sri meehakshi Mills Ltd/Sri Rajendra Mills Ltd./Sri Saroja Mills Ltd. 1967 63 ITR 609 (SC).

RETURN FILED AFTER COMPLETION OF ASSESSMENT

After the completion of an assessment, the assessee is not entitled to take the benefit of another return filed by him, nor is the ITO obliged or entitled to take that return into consideration except by the process of reopening the assessment - Niranjani & Co. (P) Ltd. v. CIT 1986 159 ITR 153 (SC).

ASSESSMENT OF SPECIFIED PERSONS

Provided that in the case of a (a) scientific research association referred to in 10(21) (b) news agency referred to in 10(22B) (c) association or institution referred to in 10(23A) (d) institution referred to in 10(23B) (e) fund or institution referred to in sub-clause (iv) or trust or institution referred to in sub-clause (v) or any university or other educational institution referred to in sub-clause (vi) or any hospital or other medical institution referred to in sub-clause (via) of clause (23C) of section 10, ~ which is required to furnish the return of income under section 139(4C), no order making an assessment of the total income or loss of such scientific research association, news agency, association or institution or fund or trust or university or other educational institution or any hospital or other medical institution, shall be made by the Assessing Officer, without giving effect to the provisions of section 10, unless

1. The Assessing Officer has intimated the Central Government or the prescribed authority the contravention of the relevant provisions as the case may be, by such scientific research association, news agency, association or institution or fund or trust or university or other educational institution or any hospital or other medical institution, where in his view such contravention has taken place ; and
2. The approval granted to such scientific research association or other association or institution or university or other educational institution or hospital or other medical institution has been withdrawn or notification issued in respect of such news agency or fund or trust or institution has been rescinded.

143(2) NOTICE TO ATTEND THE OFFICE

NOTICE FOR FULL SCRUTINY

Where a return has been furnished under section 139, or 142(1)(i) the Assessing Officer shall, If he considers it necessary or expedient to ensure that the assessee has not under stated the income or has not computed excessive loss or has not under paid the tax in any manner, serve on the assessee a notice requiring him, on a date to be specified therein, either to attend his office or to produce, or cause to be produced there, any evidence on which the assessee may rely in support of the return [143(2)(ii)]

TIME LIMIT FOR THE ISSUE OF NOTICE IN CASE OF FULL SCRUTINY

No notice be served on the assessee after the expiry of twelve months from the end of the month in which the return is furnished.

SEC. 153 TIME LIMIT FOR COMPLETION OF ASSESSMENTS

No order of assessment shall be made under section 143 or section 144 at any time after the expiry of two years from the end of the assessment year in which the income was first assessable.

POWER TO CALL THE DOCUMENTS AND EVIDENCES AS HE MAY REQUIRE 142(1)(ii)

For the purpose of making an assessment under this Act, the Assessing Officer may serve on any person a notice requiring him, on a date to be therein specified, to produce, or cause to be produced, such accounts or documents as the Officer may require provided that the Officer shall not require the production of any accounts relating to a period more than three years prior to the previous year.

SECTION 142A. ESTIMATE BY VALUATION OFFICER IN CERTAIN CASES.

(1) For the purposes of making an assessment or reassessment under this Act, where an estimate of the value of any investment referred to in section 69 or section 69B or the value of any bullion, jewellery or other valuable article referred to in section 69A or section 69B is required to be made, the Assessing Officer may require the Valuation Officer to make an estimate of such value and report the same to him.

(2) The Valuation Officer to whom a reference is made shall, for the purposes of dealing with such reference, have all the powers that he has under section 38A of the Wealth-tax Act.

(3) On receipt of the report from the Valuation Officer, the Assessing Officer may, after giving the assessee an opportunity of being heard, take into account such report in making such assessment or reassessment.

Provided that nothing contained in this section shall apply in respect of an assessment made on or before the 30th day of September, 2004, and where such assessment has become final and conclusive on or before that date, except in cases where a reassessment is required to be made in accordance with the provisions of section 153A.

POWER TO CALL THE STATEMENT OF ASSETS AND LIABILITIES NOT DISCLOSED IN THE RETURN OF INCOME. 142 (1)(iii)

For the purpose of making an assessment under this Act, the Assessing Officer may serve on any person a notice to furnish in writing and verified in the prescribed manner information in such form and on such points or matters including statement of all assets and liabilities of the assessee, whether included in the accounts or not) as the Officer may require. Provided that the previous approval of the Commissioner shall be obtained before requiring the assessee to furnish a statement of all assets and liabilities not included in the accounts;

142 (2) INQUIRY BEFORE ASSESSMENT

For the purpose of obtaining full information in respect of the income or loss of any person, the Officer may make such inquiry as he considers necessary.

142 (2A TO 2D) SPECIAL AUDIT

- (2A) If, at any stage of the proceedings before him, the Officer, having regard to the nature and **complexity** of the accounts of the assessee and the interests of the revenue, is of the opinion that it is necessary so to do, he may with the previous approval of the direct the assessee to get the accounts audited by an accountant, as defined in the Explanation below sub-section (2) of section 288, nominated by the Chief Commissioner or Commissioner in this behalf and to furnish a report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particular as may be prescribed and such other particulars as the Officer may require.
- (2B) The provisions of sub-section 2(A) shall have effect notwithstanding that the accounts of the assessee have been audited under any other law for the time being in force or otherwise.
- (2C) Every report under sub-section (2A) shall be furnished by the assessee to the Officer within such period as may be specified by the Officer:

Provided that the Officer may, on an application made in this behalf by the assessee and for any good and sufficient reason, extend the said period by such further period or periods as he thinks fit; so, however, that the aggregate of the period originally fixed and the period or periods so extended shall not, in any case, exceed one hundred and eighty days from the date on which the direction under sub-section (2A) is received by the assessee.

- (2D) The expenses of, and incidental to, any audit under sub-section (2A) (including the remuneration of the accountant) shall be determined by the (which determination shall be final) and paid by the assessee and in default of such payment, shall be recoverable from the assessee in the manner provided in chapter XVII-D for the recovery of arrears of tax.

142 (3) FAIR OPPORTUNITY OF BEING HEARD

The assessee shall, except where the assessment is made under section 144, be given an opportunity of being heard in respect of any material gathered on the basis of any inquiry and proposed to be utilised for the purpose of the assessment.

THE WORD ‘COMPLEXITY’ USED IN SUB-SECTION (2A) IS A NEBULOUS WORD. ITS DICTIONARY MEANING IS

“The state of quality of being intricate or complex ‘or’ that is difficult to understand.” However, all that are difficult to understand should not be regarded as complex. What is complex to one may be simple to another. It depends upon one’s level of understanding or comprehension. Sometime, what appears to be complex on the face of it, may not be really so if one tries to understand it carefully *Swadeshi Cotton Mills Co. Ltd. v. CIT* [1987] 171 ITR 634 (All.)

ASSESSMENT ORDER

Its format, nature and validity - the ITO has to determine, by an order in writing, not only the total income but also the net sum payable by the assessee for the assessment year in question. The statute does not however require that both the computations should be done on the same sheet of paper. It does not prescribe any form for the purpose. If the ITO first draws up an order assessing the total income, indicating the adjustments to be

made, and then directs the office to compute the tax payable on that basis and then approves it, either immediately or some time later, no fault can be found with the process, though it is only when both the computation sheets are signed or initialled by the ITO that the process described in section 143 (3) will be complete - Kalyankumar Ray v.CIT 1991 191 ITR 634 (SC).

BEST JUDGEMENT ASSESSMENT -- SEC. 144

- (1) If any person
 - (a) Fails to make the return required and has not made a return or a revised return under sub-section (4) or sub-section (5) of that section, or
 - (b) Fails to comply with all the terms of a notice issued under sub-section (1) of section 142, 142 (2A TO 2D), or
 - (c) Having made a return, fails to comply with all the terms of a notice issued under sub-section (2) of section 143,
- (2) Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of accounting provided have not been regularly followed by the assessee, the Assessing Officer may make an assessment in the manner provided in section 144.

The Assessing Officer, after taking into account all relevant material which the Assessing Officer has gathered, shall, after giving the assessee an opportunity of being heard, make the assessment of the total income or loss to the best of his judgment and determine the sum payable by the assessee on the basis of such assessment:

Provided that such opportunity shall be given by the Assessing Officer by serving a notice calling upon the assessee to show cause, on a date and time to be specified in the notice, why the assessment should not be completed to the best of his judgement:

Provided further that it shall not be necessary to give such opportunity in a case where a notice under sub-section (1) of section 142 has been issued prior to the making of an assessment under this section.

SEC. 153 TIME LIMIT FOR COMPLETION OF 144 ASSESSMENTS

No order of assessment shall be made under section 143 or section 144 at any time after the expiry of two years from the end of the assessment year in which the income was first assessable.

SCOPE OF SHOW CAUSE NOTICE

The show cause notice does not take away the right of appeal in cases where an assessee upon whom an assessment has been made ex-parte does not challenge the assessment itself, but only challenges his liability to be assessed in the capacity in which he has been assessed. [1934] 002 ITR 0216E Khemchand Ramdas vs. Commissioner of Income-tax (Sind High Court)

BEST JUDGEMENT ASSESSMENT V. REGULAR ASSESSMENT

The assessments made on the basis of the assessee's accounts and those made on 'best judgement' basis' are totally different types of assessments - CST v. H.M.Esufali H.M. Abdulali 1973 90 ITR 271 (SC).

SCOPE OF THE POWER

The mere fact that the material placed by the assessee before the assessing officer is unreliable does not empower the officer to make an arbitrary order. The power to make a best judgement assessment is not an arbitrary power, it is an assessment on the basis of best judgement. In other words, that assessment must be based on some relevant material. It is not a power that can be exercised at the sweet will and pleasure of the concerned authorities - State of Orissa v. Maharaja Shri B.P.Singh Deo 1970 76 ITR 690 (SC).

NORMS TO BE OBSERVED WHILE ESTIMATING INCOME

Estimate must be honest and fair. The authority making a best judgment assessment must make an honest and fair estimate of the income of the assessee and though arbitrariness cannot be avoided in such an estimate, the same must not be capricious but should have a reasonable nexus to the available material and the circumstances of the case. In this case the question that fell for consideration was whether in the execution of a work the cost of materials, supplied by the Government for executing the work, could be taken into consideration, while estimating the profits of a contractor. In the facts of that case, it was held that in cases of 'lump sum contracts' where in substance and in reality stores and materials supplied to the contractor by the department were fixed or incorporated into the work, the cost of such stores and materials could not be included in the turnover of the contractor as there was not even a theoretical possibility of any profit being made by the contractor from such stores or materials. Brij Bhushan Lal Parduma Kumar v. CIT 1978 115 ITR 524 (SC).

THE LIMITS ON THE POWER ARE IMPLICIT IN THE EXPRESSION 'BEST OF HIS JUDGEMENT'

Guesswork should not be wild but reasonably connected to available material. Though there is an element of guesswork in a 'best judgment assessment', it should not be a wild one, but should have a reasonable nexus to the available material and the circumstances of each case. Though the section provides for a summary method because of the default of the assessee, it does not enable the assessing authority to function capriciously without regard to the available material. Judgement is a facility to decide matters with wisdom, truly and legally. Judgement does not depend upon the arbitrary caprice of a judge, but on settled and invariable principles of justice. Though there is an element of guesswork in a 'best judgement assessment', it should not be a wild one, but should have a reasonable nexus to the available material and the circumstances of each case. Though the section provides for a summary method because of the default of the assessee, it does not enable the assessing authority to function capriciously without regard to the available material - State of Kerala v. C. velukutty 1966 60 ITR 239 (SC).

WHEN CHARTERED ACCOUNTANT REFUSES TO UNDERTAKE SPECIAL AUDIT

If, for a frivolous reason, the chartered accountant declines to undertake the audit of a company's accounts under a direction issued under section 142 (2A), obviously the company could not be held responsible. There is neither default nor failure to comply with the direction issued under section 142 (2A) on the part of the company so as to attract a best judgement assessment by invoking section 144 (b) - Swadeshi Polytex Ltd. v. ITO 1983 144 ITR 171 (SC).

POWER OF COMMISSIONER TO ISSUE DIRECTIONS IN CERTAIN CASES – SEC. 144A.

A Commissioner may, on his own motion or on a reference being made to him by the Officer or on the application of an assessee, call for and examine the record of any proceeding in which an assessment is pending and, if he considers that, having regard to the nature of the case or the amount involved or for any other reason, it is necessary or expedient so to do, he may issue such directions as he thinks fit for the guidance of the Office to enable him to complete the assessment and such directions shall be binding on the Officer:

Provided that no directions which are prejudicial to the assessee shall be issued before an opportunity is given to the assessee to be heard.

Explanation - For the purposes of this no direction as to the lines on which an investigation connected with the assessment should be made, shall be deemed to be a direction prejudicial to the assessee.

SECTION 145 METHOD OF ACCOUNTING

- (1) Income chargeable under the head Profits and gains of business or profession or Income from other sources shall, subject to the provisions of sub-section (2), be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.
- (2) The Central Government may notify in the Official Gazette from time to time accounting standards to be followed by any class of assessee or in respect of any class of income.
- (3) Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of accounting provided in sub-section (1) or accounting standards as notified under sub-section (2), have not been regularly followed by the assessee, the Assessing Officer may make an assessment in the manner provided in section 144.

145A. METHOD OF STOCK VALUATION

Notwithstanding any-thing to the contrary contained in section 145, the valuation of purchase and sale of goods and inventory for the purposes of determining the income chargeable under the head "Profits and gains of business or profession" shall be in accordance with the method of accounting regularly employed by the assessee; and

- (a) Further adjusted to include the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods to the place of its location and condition as on the date of valuation.

Explanation.--For the purposes of this section, any tax, duty, cess or fee (by whatever name called) under any law for the time being in force, shall include all such payment notwithstanding any right arising as a consequence to such payment."

BOOK ENTRIES NOT RELEVANT TO ALLOW DEDUCTIONS

Whether the assessee is entitled to a particular deduction or not will depend on the provision of law relating thereto and not on the view which the assessee might take of his rights nor can the existence or absence of entries in the books of account be decisive or conclusive in the matter - *Kedarnath Jute Mfg. Co. Ltd. v. CIT* 1971, 82 ITR 363 (SC).

ITO IS NOT COMPELLED TO ACCEPT ACCOUNTS/SYSTEM OF ACCOUNTING IN ALL CASES

Section 145 does not compel the ITO to accept a balance sheet of cash receipts and outgoings prepared from the books of account - *CIT v. A. Krishnaswami Mudaliar* 1964, 53 ITR 122 (SC).

ITO IS NOT BOUND TO ACCEPT SYSTEM OF ACCOUNTING

It is not only the right but the duty of the Assessing Officer to consider whether or not the books disclose the true state of accounts and the correct income can be deduced there from. It is incorrect to say that the officer is bound to accept the system of accounting regularly employed by the assessee, the correctness of which had not been questioned in the past. There is no estoppel in these matters, and the officer is not bound by the method followed in the earlier years - *CIT v. British Paints India Ltd.* 1991, 188 ITR 44 (SC).

ITO IS NOT BOUND BY THE DECLARED PROFITS

The ITO, even when he accepts the assessee's method of accounting, is not bound by the figure of profits shown in the accounts - *CIT v. Mcmillan & Co.* 1958, 33 ITR 182 (SC).

POWER TO EXAMINE ACCOUNTING METHOD IS STATUTORY

The words 'in the opinion of the Income-tax Officer' are not to be construed in the sense of a mere discretionary power, but in the context of the words used in section 145, they impose a statutory duty on the ITO to examine in every case the method of accounting and to see (i) whether or not it is regularly employed, and (ii) to determine whether the income, profits and gains can properly be deduced there from - *CIT v. Mcmillan & Co.*

NON-EXERCISE OF POWER BY ITO IS ALSO A DECISION

It is not correct to say that only when the ITO determines that the method of accounting adopted by the assessee is unacceptable, there is a decision, and that where he does not so decide, there is no decision but a mere non-exercise of the power. Non-exercise of the power under section 145 is also a decision in as much as it amounts to an acceptance of the method of accounting on the ground that the income, profits and gains can be properly deduced there from.

ESTIMATION OF PROFITS IN WORKS CONTRACT CASES

It is true that, ordinarily, when a works contract is put through or completed by a contractor, the income or profits derived by the contractor from such contract is determined on the value of the contract as a whole and cannot be determined by considering several items that go to form such value of the contract. However, where certain stores/materials are supplied at fixed rates by the department to the contractor solely for being used on fixed or incorporated in the works undertaken on terms and conditions mentioned in the contract, the real total value of the entire contract will be the value minus the cost of such stores/material so supplied. Therefore, since no element of profit is involved in the turnover represented by the cost of stores/materials supplied by the department to the assessee, the income or profit derived by the assessee from such contracts will have to be determined on the basis of the value of the contracts represented by the cash payment received by the assessee exclusive of the cost of the material/stores received for being fixed, used or incorporated in the works undertaken by them - *Brij Bhushan Lal Parduman Kumar v. CIT* 1978 115 ITR 524 (SC).

PROVISION RELATING TO SERVICE OF NOTICE.

A notice or requisition under this Act may be served on the person therein named either by post or as if it were a summons issued by a court under the Code of Civil Procedure. Any such notice or requisition may be addressed to,

Sec.	SITUATION	NOTICE TO BE SERVED ON
282	In the case of a firm or a Hindu undivided family	To any member of the firm or to the manager or any adult member of the family
282	In the case of a local authority or company	To the principal officer thereof
282	In the case of any other association or body of individuals	To the principal officer or any member thereof
282	In the case of any other person (not being an individual)	To the person who manages or controls his affairs
283	Service of notice when family is disrupted	Person who was the last manager of the Hindu family, or, if such person is dead, then on all adults who were members of the Hindu family immediately before the partition.
283	Service of notice when or firm etc., is dissolved.	Any person who was a partner (not being a minor) or member of the association, as the case may be, immediately before its dissolution.
284	Service of notice in the case of discontinued business.	On the person whose income is to be assessed, or, in the case of a firm or an association of persons, on any person who was a member of such firm or association at the time of its discontinuance or, in the case of a company, on the principal officer thereof,

CHAPTER - 28**RE-ASSESSMENT****SECTION 147 INCOME ESCAPING ASSESSMENT.**

If the Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section, or re compute the loss or the depreciation allowance or any other allowance, as the case may be, for the assessment year concerned.

EXPLANATION 2 TO 147 FOLLOWING SHALL BE DEEMED TO BE CASES WHERE INCOME CHARGEABLE TO TAX HAS ESCAPED ASSESSMENT

- (a) Where no return of income has been furnished by the assessee although his total income or the total income of any other person in respect of which he is assessable under this Act during the previous year exceeded the maximum amount which is not chargeable to income-tax;
- (b) Where a return of income has been furnished by the assessee but no assessment has been made and it is noticed by the Assessing Officer that the assessee has understated the income or has claimed excessive loss, deduction, allowance or relief in the return;
- (c) Where an assessment has been made, but -
 - (i) Income chargeable to tax has been under -assessed; or
 - (ii) Such income has been assessed at too low a rate; or
 - (iii) Such income has been made the subject of excessive relief under this Act; or
 - (iv) Excessive loss or depreciation allowance or any other allowance under this Act has been computed.

PROCEEDINGS ARE FOR THE BENEFIT OF REVENUE ONLY

Proceedings are for the benefit of revenue only. Since the proceedings under section 147 are for the benefit of the revenue and not an assessee, and are aimed at gathering the 'escaped income' of an assessee, the same cannot be allowed to be converted as 'revisional' or 'review' proceedings at the instance of the assessee, thereby making the machinery unworkable. [1992] 198 ITR 0297A Commissioner of Income-tax vs. Sun Engineering Works P. Ltd. (Supreme Court of India)

WHEN THERE IS NO REASONS TO BELIEVE

Where the Officer had not even come to prima facie conclusion that the loan transactions to which he referred were not genuine transactions. He appeared to have only a vague feeling that they might be bogus transactions. Such a conclusion did not fulfil the requirements of reopening. He had to give reasons for issuing a notice under section 148. He should have some prima facie grounds before him for taking action under section 148. His conclusion that there was a case for investigating the truth of the alleged transactions was not the same thing as saying that there were reasons for the issue of the notice. The Commissioner had mechanically accorded permission. The important safeguards provided in sections 147 and 151 were lightly treated by the officer and the Commissioner. The Officer could not have had reason to believe that income had escaped assessment. [1971] 079 ITR 0603- Chhugamal Rajpal vs. Chaliha (S.P.) (Supreme Court of India)

SCOPE OF REASONS TO BELIEVE

That the belief must be that of an honest and reasonable person based upon reasonable grounds, and that the ITO may act on direct or circumstantial evidence but not on mere suspicion, gossip or rumour. The ITO would be acting without jurisdiction if the reason for his belief that the conditions are satisfied does not exist or is not material or relevant to the belief required by the section - Sheo Nath Singh v. AAC 1971 82 ITR 147 (SC).

Notices of re-assessment issued on the basis of a letter from the Chief Mining Officer showing that a joint inspection was conducted in the colliery of the respondent-assessee by the officers of the Mining Department in the presence of the representatives of the respondent-assessee and that according to the opinion of the officers of the Mining Department there was under-reporting of the raising figure to the extent indicated in the said letter. The report was made by a Government Department after conducting a joint inspection. It gave a reasonably specific estimate of the excessive coal mining said to have been done by the respondent over and

above the figure disclosed by it in its returns. The letter could constitute the basis for the formation of the requisite belief for re-assessment. The reassessment notices were valid. [1996] 217 ITR 0597B ITO vs. Selected Dalurband Coal Co. Pvt. Ltd. (Supreme Court of India)

The powers of the ITO to reopen assessment, though wide, are not plenary. The words of the statute are 'reason to believe' and not 'reason to suspect'. The reopening of an assessment after a lapse of many years is a serious matter - ITO v. Lakhmani Mewal Das 1976 103 ITR 437 (SC).

When the primary facts necessary for assessment are fully and truly disclosed, the ITO will not be entitled on change of opinion to commence proceedings for reassessment. Similarly, if he has raised a wrong legal inference from the facts disclosed, he will not, on that account, be competent to commence reassessment proceedings - CIT v. Bhanji Lavji 1971 79 ITR 582 (SC).

There should be some direct nexus between the conclusion of fact arrived at by the authority concerned and the primary facts upon which that conclusion is based. The use of extraneous and irrelevant material in arriving at that conclusion would vitiate the conclusion of fact because it is difficult to predicate as to what extent the extraneous and irrelevant material has influenced the authority in arriving at the conclusion of fact - CIT v. Daulat Ram Rawatmull 1973 87 ITR 349 (SC); ITO v. Lakhmani Mewal Das 1976 103 ITR 437 (SC).

The expression 'reason to believe' does not mean a purely subjective satisfaction on the part of the ITO. The belief must be held in good faith, it cannot merely be a pretence. To put it differently, it is open to the Court to examine the question whether the reasons for the belief have a rational connection or a relevant bearing on the formation of the belief and are not extraneous or irrelevant to the purpose of the section. To this limited extent, the action of the ITO is assailable in a court of law - S. Narayanappa v. CIT 1967 63 ITR 219 (SC).

CASES OF REOPENING OF ASSESSMENT

Interest paid to creditors were allowed as deduction. Subsequently information was obtained that creditors were name lenders. Based on the information the re-assessment proceeding initiated are valid. [1976] 103 ITR 0437- ITO vs. Lakhmani Mewal Das (Supreme Court of India)

Assessment was completed accepting claim to loss on sale of shares on basis of value quoted on stock exchange. Subsequently officer received letter of deputy director of investigation giving information that company prospering at relevant time and low stock exchange quotation was owing to manipulation. This letter is information from which ITO could have reason to believe income escaped assessment. Notice issued on next day after receipt of letter from deputy director does not preclude application of mind by ITO. The notice of re-assessment is valid. [1997] 224 ITR 0362- ITO vs. Puroshottam Das Bangur (Supreme Court of India)

Where the assessee was charging to its profit and loss account, fiscal duties paid during the year as well as labour charges, power, fuel, wages, chemicals, etc. However, while valuing its closing stock, the elements of fiscal duty and the other direct manufacturing costs were not included. This resulted in undervaluation of inventories and understatement of profits. This information was obtained by the Revenue in a subsequent year's assessment proceedings. The commencement of reassessment proceedings was valid. [1999] 236 ITR 0034A Raymond Woollen Mills Ltd. vs. ITO (Supreme Court of India)

Where the internal audit party had merely pointed out a fact which had been overlooked by the Income-tax Officer in the assessment. The fact that the recognition granted to the charitable trust had expired, was not noticed by the Income-tax Officer. This was not a case of information on a question of law. The internal audit party was entitled to point out a factual error or omission in the assessment. Reopening of a case on the basis of a factual error pointed out by the audit party was permissible under law. Therefore, the reopening of the assessment was valid. [1999] 237 ITR 0013- Commissioner of Income-tax vs. P.V.S. Beedies Pvt. Ltd. (Supreme Court of India)

BENEFICIAL PROVISIO TO 147 FOR THE ASSESSEE MAKING FULL AND TRUE DISCLOSURE

Where an assessment under sub-section (3) of section 143 or this section has been made for the relevant assessment year, no action shall be taken under this section after the expiry of four years from the end of the relevant assessment year, unless any income chargeable to tax has escaped assessment for such assessment year by reason of the failure on the part of the assessee to make a return under section 139 or in response to a notice issued under sub-section (1) of section 142 or section 148 or to disclose fully and truly all material facts necessary for his assessment, for that assessment year.

The power conferred upon the ITO by section 147 and 148 is not an unbridled one. It is hedged with several safeguards conceived in the interest of eliminating room for abuse of this power by the Assessing Officer. The idea was to save the assessee from harassment resulting from mechanical reopening of assessment, but this

protection is available only to those assessees who disclose all material facts truly and fully - Sri Krishna (P.)(Ltd.) v. ITO 1996 87 Taxman 315/221 ITR 538 (SC).

Bank changed method of accounting in respect of interest on securities on account of difficulties. Excess on sale of securities was also claimed as capital receipt. The change was accepted by ITO and assessments was made allowing the claim. Later on assessment was reopened to disregard the change. It was a case of change of opinion and reopening held not valid. [1997] 225 ITR 0447- Andhra Bank Ltd. vs. Commissioner of Income-tax (Supreme Court of India)

It is well established that there should be some fresh information and not mere reappraisal of evidence on record to justify jurisdiction as was pointed out in thus decision. The Supreme Court found that even where the information was new, it should be relevant. The Assessing Officer in this case completed the assessment after enquiry, regarding the extent of admissible overhead expenses in the home accounts in the assessment of the non-resident. Later it was noticed that Foreign Exchange Regulation Act had a ceiling on the amount of remittance with the result that it was found that the amount allowed as a deduction was higher than what was permissible for purposes of remittance. The Supreme Court found that the information related to the Foreign Exchange Regulation Act (FERA), which was in a different field. [1998] 231 ITR 0200- Coco-Cola Export Corporation vs. Income-tax Officer (Supreme Court of India)

NO RE-ASSESSMENT COULD BE DONE

Scope of duty to disclose. Duty to disclose arises only when assessee has knowledge of the facts. Embezzlement by employee and inflation by him of purchase account discovered by assessee subsequent to original assessment, reassessment on the ground that assessee had failed to disclose inflation of purchase account is not valid. [1989] 176 ITR 0340A Canara Sales Corporation Ltd. vs. Commissioner of Income-tax (Karnataka High Court)

Condition precedent for notice under section 147(a) is failure to disclose material facts must be deliberate. There was inadvertent error in the allocation of expenditure which was voluntary disclosed. Income arose as a consequence of such error and tax on such income was paid on self-assessment. Held that there is no failure to disclose material facts and notice under section 147(a) not valid. [1995] 216 ITR 0811- Bhatt (N.D.), IAC of I.T. vs. I.B.M. World Trade Corporation (Bombay High Court)

EXPLANATION 1 TO 147 WHAT IS FULL AND TRUE DISCLOSURE

Production before the Assessing officer of account books or other evidence from which material evidence could with due diligence have been discovered by the Assessing Officer will **not** necessarily amount to FULL AND TRUE disclosure.

SEC. 148 ISSUE OF NOTICE WHERE INCOME HAS ESCAPED ASSESSMENT.

Before making the assessment, reassessment or re-computation under section 147, the Assessing Officer shall serve on the assessee a notice requiring him to furnish within such period, as may be specified in the notice, a return of his income or the income and the Assessing Officer shall, before issuing any notice under this section record his reasons for doing so.

While it is not open to the assessee to straightaway call upon the Assessing Officer to disclose or indicate the reasons on the basis of which the notice was issued under section 148(1) the Assessing Officer is obliged to disclose the reasons once the proceedings assume quasi-judicial character. [1992] 198 ITR 0554- Herbs (India) Pvt. Ltd. vs. Deputy Commissioner of Income-tax (Allahabad High Court)

SEC. 149 TIME LIMIT FOR ISSUE OF NOTICE

Time limit and other conditions for issue of notice - Time limit and other conditions for issue of notice under section 148 given below:

UP TO FOUR YEARS FROM THE END OF THE RELEVANT ASSESSMENT YEAR	BEYOND FOUR YEARS BUT UP TO SIX YEARS FROM THE END OF THE RELEVANT ASSESSMENT YEAR
Assessment can be re-opened whatever is the amount of income escaped.	If the escaped income is Rs. 1,00,000 or more for that year.

EXCEPTIONS - THE FOLLOWING EXCEPTIONS ARE APPLICABLE TO TIME LIMITS GIVEN IN

- 1) If the person on whom notice under section 148 is to be served is a person treated as an agent of non-resident (under section 163), then notice shall not be issued after the expiry of 2 years from the end of the relevant assessment year.
- 2) If an assessment has been made for the relevant assessment year under section 143 (3) or under section 147, no action shall be taken under section 147 after the expiry of four years from the end of the relevant assessment year, unless the income has escaped assessment due to the failure on the part of the assessee to file a return under section 139 or in response to a notice under section 142 (1) or 148 or to disclose fully and truly all material facts necessary for this assessment. For this purpose production before the Assessing Officer of account books or other evidence from which material evidence could with due diligence have been discovered by the Assessing Officer will not necessarily amount to disclosure.

153(2) TIME LIMIT FOR THE COMPLETION OF REASSESSMENT

No order or assessment, reassessment or recomputation shall be made under section 147 after the expiry of one year from the end of the financial year in which the notice under section 148 was served.

ASSESSEE CANNOT REAGITATE QUESTIONS AND CLAIMS WHICH HAVE BECOME FINAL

The principle laid down in V. Jaganmohan Rao's case is only to the extent that once an assessment is validly, reopened by issuance of notice under section 147, the previous under assessment is set aside and the ITO has the jurisdiction and duty to levy tax on the entire income that has escaped assessment during that year. What is set aside is thus only the previous under assessment and not the original assessment proceedings. Of course, in the reassessment proceedings it is open to an assessee to show that the income alleged to have escaped assessment had in truth and in fact not escaped assessment and that the same had been shown under some inappropriate head in the original return, but to read the judgement in Jaganmohan Rao's case as laying down that the reassessment wipes out the original assessment and that reassessment is not only confined to 'escaped assessment' or 'underassessment' but to the entire assessment for the year and it would start the assessment proceedings de novo giving right to an assessee to reagitate matters which he had lost during the original assessment proceedings which had acquired finality, is not only erroneous but also against the phraseology of section 147 and the object of reassessment proceedings - CIT. V. Sun Engineering Works (P) Ltd. 1992 198 ITR297 (SC).

WHEN RETURNED INCOME IS BELOW TAXABLE LIMIT

A return showing income below taxable limit is a valid return. The ITO cannot therefore ignore such return and issue a notice for reassessment. A notice so issued would be improper since there was neither an omission nor a failure on the part of the assessee, nor was there any question of assessment 'escaping' - CIT v. Ranchhoddas Karsondas 1959 36 ITR 569 (SC).

PROCEEDINGS UNDER SECTION 147 SHALL BE DROPPED . SECTION 152

Where an assessment is reopened the assessee may, claim that the proceedings under section 147 shall be dropped

1. If he has not impugned any part of the original assessment order for that year either under sections 246 to 248 or under section 264,
2. If he can show that he had been assessed on an amount or to a sum not lower than what he would be rightly liable for even if the income alleged to have escaped assessment had been taken into account, or the assessment or computation had been properly made:

Provided that in so doing he shall not be entitled to reopen matters concluded by an order under section 154,155,260,262, or 263.

TIME LIMIT FOR COMPLETION OF ASSESSMENTS

The general time limit for completion of an assessment, as laid down is two years for assessment and one year for re-assessment from the end of assessment year / financial year in which the income was first assessable. Under the existing provisions of the Income-tax Act, the time limit for making an order of assessment is two years from the end of the assessment year in which the income was first assessable. However, in certain circumstances the time is extended, or certain periods are excluded from the period of limitation.

COURT CANNOT DIRECT ITO TO PASS ORDER BEYOND LIMITATION PERIOD

A writ of mandamus can be issued to a statutory authority to compel it to perform its statutory obligation. It cannot be issued to compel him to pass an order in violation of a statutory provision. Section 153 (3)(ii) contemplates a situation where certain orders have to be passed in consequence of or to give effect to any finding or direction contained in any order passed under the provisions referred to therein or in an order of any court in a proceeding otherwise than by way of appeal or reference under the Act. This sub-clause cannot be understood as empowering the High Court to give a direction to the authority under the Act to ignore the period of limitation prescribed in the Act. The ITO has no power to make a reassessment beyond the period prescribed by section 153(2), unless the case falls under any of the other sub-sections under section 153 or other provisions extending the said period of limitation. Writ of mandamus cannot therefore be issued to compel the ITO to pass order of assessment beyond period of limitation - Hope textiles Ltd. v. Union of India 1994 205 ITR 508 (SC).

IN COMPUTING THE PERIOD OF LIMITATION FOR THE PURPOSES OF THIS SECTION, THERE SHALL BE EXCLUDED

- (i) The time taken in reopening the whole or any part of the proceeding or in giving an opportunity to the assessee to be re-heard under the proviso to section 129, or
- (ii) The period during which the assessment proceeding is stayed by an order or injunction of any court, or
- (iii) The period commencing from the date on which the 66 [Assessing] Officer directs the assessee to get his accounts audited under sub-section (2A) of section 142 and ending with 67 [the last date on which the assessee is required to furnish] a report of such audit under that sub-section, or
- (iva) The period (not exceeding sixty days) commencing from the date on which the Assessing Officer received the declaration under sub-section (1) of section 158A and ending with the date on which the order under sub-section (3) of that section is made by him, or]
- (v) In a case where an application made before the Income-tax Settlement Commission under section 245C is rejected by it or is not allowed to be proceeded with by it, the period commencing from the date on which such application is made and ending with the date on which the order under sub-section (1) of section 245D is received by the Commissioner under sub-section (2) of that section,
- (vi) the period commencing from the date on which an application is made before the Authority for Advance Rulings under sub-section (1) of section 245Q and ending with the date on which the order rejecting the application is received by the Commissioner under sub-section (3) of section 245R,

Provided that where immediately after the exclusion of the aforesaid time or period, the period of limitation available to the Assessing Officer for making an order of assessment, reassessment or re-computation, as the case may be, is less than sixty days, such remaining period shall be extended to sixty days and the aforesaid period of limitation shall be deemed to be extended accordingly.]

CHAPTER – 29**RECTIFICATION OF MISTAKE****RECTIFICATION OF MISTAKE.154**

With a view to rectifying any mistake apparent from the record an income-tax authority may, Amend any order passed by it or Amend any intimation or deemed intimation under section 143(1). Where any matter has been considered and decided in any proceeding by way of appeal or revision relating to an order, the authority passing such order may, amend the order in relation to any matter other than the matter which has been so considered and decided. The authority concerned may make an amendment by its own motion, and Shall make such amendment for rectifying any such mistake which has been brought to its notice by the assessee.

An amendment, which has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee, shall not be made unless the authority concerned has given notice to the assessee of its intention so to do and has allowed the assessee a reasonable opportunity of being heard. An order shall be passed in writing by the income-tax authority concerned. Where any such amendment has the effect of reducing the assessment, the Officer shall make any refund which may be due to such assessee.

Where any such amendment has the effect of enhancing the assessment or reducing a refund already made, the Officer shall serve on the assessee a notice of demand in the prescribed form specifying the sum payable.

TIME LIMIT TO ENTERTAIN THE CLAIM OF 154

Where an application for amendment is made by the assessee to an income-tax authority, the authority shall pass an order, within a period of six months from the end of the month in which the application is received by it. Making the amendment or refusing to allow the claim.

The word "order" in the expression "from the date of the order sought to be amended" in section 154(7) was not qualified in any way, it did not necessarily mean the original order. It could be any order including the amended or rectified order. [1995] 212 ITR 0639- Hind Wire Industries Ltd. vs. Commissioner of Income-tax (Supreme Court of India)

TIME LIMIT FOR PASSING THE ORDER

No amendment shall be made after the expiry of four years from the end of the financial year in which the order sought to be amended was passed.

MISTAKE MUST BE OBVIOUS AND PATENT

A mistake apparent on the record must be an obvious and patent mistake and not something which can be established by a long-drawn process of reasoning on points on which there may conceivably be two opinions. A decision on a debatable point of law is not a mistake apparent from the record - T.S. Balaram, ITO v. Volkart Bros. 1971 82 ITR 50 (SC).

A GLARING AND OBVIOUS MISTAKE OF LAW IS RECTIFIABLE

If a mistake of fact apparent from the record of the assessment order can be rectified, there is no reason why a mistake of law which is glaring and obvious cannot be similarly rectified - M.K. Venkatachalam, ITO v. Bombay Dyeing & Mfg.Co.Ltd. 1958 34 ITR 143 (SC).

POWER TO RECTIFY IS MANDATORY AND NOT DISCRETIONARY

The ITO is an officer concerned with assessment and collection of revenue, and the power to rectify the order of assessment conferred upon him is to ensure that injustice to the assessee or to the revenue may be avoided. It is implicit in the nature of the power and its entrustment to the authority invested with quasi-judicial functions under the Act, that to do justice it shall be exercised when a mistake apparent from the record is brought to his notice by a person concerned with or interested in the proceedings - L. Hirday Narain v. ITO 1970 78 ITR 26 (SC).

NOTICE TO ASSESSEE IS NOT ALWAYS MANDATORY

The object of providing for issue of a notice in section 154 is that no order should be passed to the detriment of an assessee without affording him an opportunity, but it cannot be said that the rule is so rigid that, if as a matter of course the assessee knows about the proceedings and the matter had been discussed with him then an adverse order would be invalid merely because no notice was given. Of course this postulates that a reasonable opportunity has been given to show cause - Secondly, this provision is applicable only where the assessment is enhanced or refund is reduced - Maharana Mills (P.)Ltd. v. ITO 1959, 36 ITR 350 (SC).

CBDT'S CLARIFICATION

[1990] 186 ITR (Stat) 0002 - Circular Number: 581. Filing of evidence in support of an exemption/ deduction at the time of furnishing the return of income has been prescribed as a necessary condition in certain other sections of the Income-tax Act, such as sections 32AB(5), 33AB(2), 54(2), 54B(2), 54D(2), 54F(4), 54G(2), 80HH(5), 80HHA(4), 35D(4), 35E(6), 80HHB(3), 80HHC(4), 80HHD(6), 80-I(7), etc. In such cases also, where the exemption/ deduction claimed is disallowed as prima facie inadmissible for want of evidence in support thereof, it cannot be subsequently allowed by a rectification order under section 154 if the assessee later on furnishes evidence in support thereof. Such a view is also necessary from the administrative angle as, if the department condones such lapses in the initial stages, a tendency may develop amongst the taxpayers not to file relevant evidence at the time of filing the return and then make a claim by putting in an application under section 154. This tendency would unnecessarily increase infructuous work for the department. Hence, a strict view which is in accordance with the legal provisions is necessary in such cases.

[1993] 204 ITR (Stat) 0105 - Circular Number: 669 The Board have considered the matter and are of the opinion that where the sums referred to in the first proviso under section 43B had in fact been paid on or before the due dates mentioned therein, but the evidence therefor had been omitted to be furnished along with the return, the Assessing Officers can entertain applications under section 154 for rectification of the intimation under section 143(1) or orders under section 143(3), as the case may be, and decide the same on merits.

RECTIFICATION BASED ON SUPREME COURT DECISION

A decision of the Supreme Court declaring a particular tax levy as invalid has the effect that such levy was at no time good. Consequently where the ITO levied tax and subsequently the levy was rendered invalid by the supreme Court, there was a mistake apparent from the record which could be rectified by the ITO - Walchand Nagar Industries Ltd. v. V.S. Gaitonde, ITO 1962 44 ITR 260 (Bom.)

If there is a divergence of judicial opinion on a question of law or two conceivable views are possible on it, proceedings for rectification under section 154 or under section 254(2) of the Income-tax Act, 1961, cannot be taken at all. The Income-tax Officer or the appellate authorities under the I.T. Act, when dealing with a rectification application, should not look only at the decisions of the particular High Court under whose advisory jurisdiction it acts in order to find out whether that High Court has taken different views on the question of law involved before it. As the Supreme Court has decided that goodwill is a capital asset of a business, it cannot be contended that there is any longer divergence of judicial opinion on this question. [1979] 117 ITR 0838A Sonti (V.R.) vs. Commissioner of Income-tax (Calcutta High Court)

NO RECTIFICATION IS PERMISSIBLE FOR CHANGE IN OPINION

Rectification under section 154 can only be made when a glaring mistake of fact or law committed by the officer passing the order becomes apparent from the record. Rectification is not possible if the question is debatable. Moreover a point which was not examined on facts or in law cannot be dealt with as a mistake apparent from the record. [1997] 228 ITR 0463E Commissioner of Income-tax vs. Hero Cycles Pvt. Ltd. (Supreme Court of India)

RECTIFICATION IN SPECIFIED CASES OF DEDUCTION 155(13)

Where in the assessment for any year, the deduction under section 80HHB or section 80HHC or section 80HHD or section 80HHE or section 80-O or section 80R or section 80RR or section 80RRA has not been allowed on the ground that such income has not been received in convertible foreign exchange in India, or having been received in convertible foreign exchange outside India, or having been converted into convertible foreign exchange outside India, has not been brought into India, by or on behalf of the assessee with the approval of the Reserve Bank of India or such other authority as is authorised under any law for the time being in force for regulating payments and dealings in foreign exchange and subsequently such income or part thereof has been or is received in, or brought into, India in the manner aforesaid, the Assessing Officer shall amend the order of assessment so as to allow deduction under section 80HHB or section 80HHC or section 80HHD or section 80HHE or section 80-O or section 80R or section 80RR or section 80RRA, as the case may be, in respect of such income or part thereof as is so received in, or brought into, India ; and the provisions of section 154 shall, so far as may be, apply thereto, and the period of four years shall be reckoned from the end of the previous year in which such income is so received in, or brought into India.

RECTIFICATION IN SPECIFIED CASES OF NON SUBMISSION OF TDS CERTIFICATE 155(14)

Where in the assessment for any previous year or in any intimation or deemed intimation under section 143(1) for any previous year, credit for tax deducted in accordance with the provisions of section 199 has not been given on the ground that the certificate furnished under section 203 was not filed with the return and subsequently such certificate is produced before the Assessing Officer within two years from the end of the

assessment year in which such income is assessable, the Assessing Officer shall amend the order of assessment or any intimation or deemed intimation under section 143(1) as the case may be, and the provisions of section 154 shall, so far as may be, apply thereto. Provided that nothing contained in this sub-section shall apply unless the income from which the tax has been deducted has been disclosed in the return of income filed by the assessee for the relevant assessment year.

RECTIFICATION IN SPECIFIED CASES OF STAMP DUTY VALUATION, 155(15)

Where in the assessment for any year, a capital gain arising from the transfer of a capital asset, being land or building or both, is computed by taking the full value of the consideration received or accruing as a result of the transfer to be the value adopted or assessed by any authority of a State Government for the purpose of payment of stamp duty in accordance with sub-section (1) of section 50C, and subsequently such value is revised in any appeal or revision or reference referred to in clause (b) of sub-section (2) of that section, the Assessing Officer shall amend the order of assessment so as to compute the capital gain by taking the full value of the consideration to be the value as so revised in such appeal or revision or reference ; and the provisions of section 154 shall, so far as may be, apply thereto, and the period of four years shall be reckoned from the end of the previous year in which the order revising the value was passed in that appeal or revision or reference.

RECTIFICATION IN SPECIFIED CASES OF COMPULSORY ACQUISITION, 155(16)

Where in the assessment for any year, a capital gain arising from the transfer of a capital asset, being a transfer by way of compulsory acquisition under any law, or a transfer, the consideration for which was determined or approved by the Central Government or the Reserve Bank of India, is computed by taking the compensation or consideration or the compensation or consideration enhanced or further enhanced. The full value of consideration deemed to be received or accruing as a result of the transfer of the asset and subsequently such compensation or consideration is reduced by any court, the Assessing Officer shall amend the order of assessment so as to compute the capital gain by taking the compensation or consideration as so reduced by the court, to be the full value of consideration; and the provisions of section 154 shall, so far as may be, apply thereto, and the period of four years shall be reckoned from the end of the previous year in which the order reducing the compensation was passed by the court, Tribunal or other authority.

RECTIFICATION IN SPECIFIED CASES DEDUCTIONS IN RESPECT OF PATENTS, 155(17)

Where a deduction has been allowed to an assessee in any assessment year under section 80RRB in respect of any patent, and subsequently by an order of the Controller or the High Court (i) the patent was revoked, or (ii) the name of the assessee was excluded from the patents register as patentee in respect of that patent, the deduction from the income by way of royalty attributable to the period during which the patent had been revoked or the period for which the assessee's name was excluded as patentee in respect of that patent, shall be deemed to have been wrongly allowed and the Assessing Officer may, recompute the total income of the assessee for the relevant previous year and make necessary amendment; and the provisions of section 154 shall, so far as may be, apply thereto, the period of four years specified shall be reckoned from the end of the previous year in which such order of the Controller or the High Court as the case may be, was passed.

CHAPTER - 30**POWERS OF CIT****SECTION 263 REVISION OF ORDERS PREJUDICIAL TO REVENUE.**

The Commissioner may call for and examine the record of any proceeding under this Act, and if he considers that a order passed therein by the Officer is erroneous in so far as it is prejudicial to the interests of the revenue, he may, after giving the assessee an opportunity of being heard and after making or causing to be made such inquiry as he deem a necessary, pass such order thereon as the circumstances of the case justify, including an order enhancing or modifying the assessment, or cancelling the assessment and directing a fresh assessment.

Explanation - For the removal of doubts, it is hereby declared that, for the purposes of this sub-section,

- 1) An order passed on or before or after the 1st days of June, 1988 by Assessing Officer shall include-
 - a. An order of assessment made by the Assistant Commissioner or the Income-tax Officer on the basis of the directions issued by the Deputy Commissioner under section 144A;
 - b. An order made by the Deputy Commissioner in exercise of the powers or in the performance of the functions of an Assessing Officer conferred on, or assigned to, him under the orders or directions issued by the Board or by the Chief Commissioner or Director General or Commissioner authorised by the Board in this behalf under section 120;

MEANING OF “RECORD”

“Record” shall include and shall be deemed always to have included all records relating to any proceeding under this Act available at the time of examination by the Commissioner;

CONCEPT OF MERGING OF ORDERS DIS-ABLED

Where any order referred to in this sub-section and passed by the Assessing Officer had been the subject matter of any appeal filed the powers of the Commissioner shall extend and shall be deemed a always to have extended to such matters as had not been considered and decided in such appeal.

TIME LIMIT FOR PASSING THE ORDER

No order shall be made after the expiry of two years from the end of the financial year in which the order sought to be revised was passed. In computing the period of limitation the time taken in giving an opportunity to the assessee to be reheard and any period during which any proceeding under this section is stayed by an order or injunction of any court shall be excluded.

SCOPE OF OF ‘ERRONEOUS AND PREJUDICIAL TO THE INTERESTS OF REVENUE’

Scope and meaning of ‘erroneous and prejudicial to the interests of revenue’ - even where an income has not been earned and is not assessable, merely because the assessee wants it to be assessed in his or her hands in order to assist someone else who would have been assessed to a larger amount, an assessment so made can certainly be erroneous and prejudicial to the interests of the revenue. The Commissioner has ample jurisdiction under section 263 to cancel the assessment and may initiate proceedings for assessment under the provisions of the Act against some other assessee who according to the income-tax authorities is liable for the income thereof. *Smt. Tara Devi Aggarwal v. CIT 1973 88 ITR 323 (SC).*

The assessment order was rectified under section 154. The original assessment was held erroneous and prejudicial and proceedings under section 263 were initiated by the Commissioner of Income-tax. On a reference of the question whether the Commissioner had jurisdiction to revise held that when the power of revision was exercised the order was not in existence. On that day, there was no order which could have been considered as erroneous and prejudicial to the interests of the Revenue because that order was superseded by the order of rectification. The order of revision was not valid. [1997] 224 ITR 0233- *Chunnilal Onkarmal Pvt. Ltd. vs. Commissioner of Income-tax (Madhya Pradesh High Court)*

The operation of sections 147 and 263 is somewhat similar and it is the Income-tax Officer who under section 147 and 148 of the Act can reopen the assessment on account of the income escaping assessment. As against this if the Commissioner under sections 263 of the Act finds that the assessment order is prejudicial to the interests of the Revenue, then he can reopen the issue. Therefore, virtually, both these provisions are for reopening the assessment_one at the Income-tax Officer level and other at the level of the Commissioner. Both can invoke their power after the assessment order, but both are not exclusive of each other. [1997] 225 ITR 0904- *Commissioner of Income-tax vs. Gulam Rasool (Madhya Pradesh High Court)*

ISSUE OF NOTICE IS NOT MANDATORY

Section 263 does not in express terms require a notice to be served as in the case of section, 147. Section 263 merely requires that an opportunity of being heard should be given to the assessee and the stringent requirement of service of notice under section 147 cannot therefore be applied to a proceeding under section 263 - Gita Devi Aggarwal v. CIT 197- 76 ITR 496 (SC); CIT v. Hukumchand Mohanlal 1971 82 ITR 624 (SC).

TIME-BAR APPLIES TO SUO MOTU ORDERS ONLY

The time-bar under section 263(2) should be taken to apply to only suo-moto orders of revision by the Commissioner, and not to orders made by him pursuant to a direction or order passed by the Tribunal or by any other higher authority. Section 263(3) must be regarded as an ex majore cautela provision and must be regarded as declaratory of the law which was already prevailing - CIT v. National Taj Traders 1980 121 ITR 535 (SC).

REVISION OF OTHER ORDERS. 264

In the case of any order other than an order to which section 263 applies passed by an authority subordinate to him, the Commissioner may, either of his own motion or on an application by the assessee for revision, call for the record of any proceeding under this Act in which any such order has been passed and may make such inquiry or cause such inquiry to be made and subject to the provisions of this Act, may pass such order thereon, not being an order prejudicial to the assessee, as he thinks fit.

TIME LIMIT FOR APPLICATION U/S 264

In the case of an application for revision under this section by the assessee the application must be made within one year from the date on which the order in question was communicated to him or the date on which he otherwise came to know of it, whichever is earlier. Provided that the commissioner may, if he is satisfied that the assessee was prevented by sufficient cause from making the application within that period admit an application made after the expiry of that period.

NO APPLICATION CAN BE ENTERTAINED

- 1) Where an appeal against the order lies to the Deputy Commissioner (Appeals) or to the Commissioner (Appeals) or to the Appellate Tribunal but has not been made and the time within which such appeal may be made has not expired, or, in the case of an appeal to the Commissioner (Appeals) to the Appellate Tribunal, the assessee has not waived his right of appeal; or
- 2) Where the order is pending on an appeal before the Deputy Commissioner (Appeals); or
- 3) Where the order has been made the subject of an appeal to the Commissioner (Appeals) or to the Appellate Tribunal.

PRESCRIBED AMOUNT OF FEES

Every application by an assessee for revision under this section shall be accompanied by a fee of five hundred rupees.

TIME LIMIT FOR PASSING THE ORDER

On every application by an assessee for revision, made on or after the 1st day of October, 1998, an order shall be passed within one year from the end of the financial year in which such application is made by the assessee for revision. The Commissioner shall not of his own motion revise any order under this section if the order has been made more than one year previously. In computing the period of limitation, the time taken in giving an opportunity to the assessee to be re-heard and any period during which any proceeding under this section is stayed by an order or injunction of any court shall be excluded.

Point to be noted

An order by the Commissioner declining to interfere shall, for the purposes of this section, be deemed not to be an order prejudicial to the assessee. For the purposes of this sections, the Deputy Commissioner (Appeals) shall be deemed to be an authority subordinate to the Commissioner.

JURISDICTION IS JUDICIAL

Prima facie, the jurisdiction conferred under section 264 is a judicial one. The order that is brought before the Commissioner affects the rights of the assessee. It is implicit in revisional jurisdiction that the revising authority shall give an opportunity to the parties affected to put forward their case in the manner prescribed - Dwarka Nath v. ITO 1965 57 ITR 349 (SC).

POWER CAN BE EXERCISED WHEN NO APPEAL LIES TO THE AAC

A revision does not lie to the Commissioner against an order where an appeal against that order lies to the AAC but has not been made and the time within which such an appeal may be made has not expired or where an

appeal against the order to the AAC, the Commissioner can revise that order under section 264 - Dwarka Nath v. ITO 1965 57 ITR 349 (SC).

An order can be said to be the subject-matter of an appeal only if the appeal was considered and disposed of on merits. Where an appeal was dismissed as withdrawn at the instance of the assessee or where an appeal was dismissed on the ground that the same was incompetent or where an appeal was dismissed as barred by limitation or where the appeal was dismissed for non-payment of undisputed tax as a condition precedent for entertaining the appeal, the assessment order could not be said to have been made 'subject of an appeal' - C.C. Jayaram v. CIT 1994 207 ITR 662 (Ker.).

WRIT JURISDICTION CAN BE INVOKED

The orders passed by the Commissioner under section 264 satisfy the well settled tests of 'judicial act'. Therefore a petition for a writ of certiorari for quashing the orders of the Commissioner is maintainable - Dwarka Nath v. ITO 1965 57 ITR 349 (SC).

It is a settled position of law that once an assessment order has been made, the subject of an appeal to the Commissioner of Income-tax (Appeals) or to the Tribunal, the Commissioner's revisional power under section 264 comes to an end and it cannot be exercised at all while the appeal is pending or even after it is disposed of. Appeal and revision are not concurrent remedies. [1995] 211 ITR 0641- Coimbatore Cotton Mills Ltd. vs. Commissioner of Income-tax (Madras High Court)

CHAPTER - 31

ADVANCE RULING

ADVANCE RULING

DIFINITIONS

Advance Ruling	Applicant
Advance ruling means a determination by the Authority in relation to a transaction which has been undertaken or is proposed to be undertaken by a non-resident applicant.	Any person who is a non-resident
Advance ruling means a determination by the Authority in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such non-resident.	Is a resident person
Advance ruling means a determination or decision by the Authority in respect of an issue relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal and such determination or decision shall include the determination or decision of any question of law or of fact relating to such computation of total income specified in the application.	Is a resident falling within any such class or category of persons as the Central Government may, by notification in the Official Gazette, specify in this behalf.
	Must makes an application as per section 245Q (1)

Where an advance ruling has been pronounced, before the date on which the Finance Bill, 2003 receives the assent of the President, by the Authority in respect of an application by a resident applicant as it stood immediately before such date, such ruling shall be binding on the specified persons.

SEC. 245Q. APPLICATION FOR ADVANCE RULING

An applicant desirous of obtaining an advance ruling may make an application in such form and in such manner as may be prescribed, stating the question on which the advance ruling is sought. The application shall be made in quadruplicate and be accompanied by a fee of two thousand five hundred rupees. An applicant may withdraw an application within thirty days from the date of the application.

SEC. 245R. PROCEDURE OF ADVANCE RULING

On receipt of an application, the Authority shall cause a copy thereof to be forwarded to the Commissioner and, if necessary, call upon him to furnish the relevant records. The Authority may, after examining the application and the records called for, by order, either allow or reject the application:

Every application shall be rejected if matter -		
1	Is already pending before any income-tax authority or Appellate Tribunal or any court except in the case of a notified class or category of resident applicant;	Opportunity has to be been given to the applicant of being heard and reasons for such rejection shall be given in the order.
2	Involves determination of fair market value of any property ;	
3	relates to a transaction or issue which is designed prima facie for the avoidance of income-tax except in the case of a notified class or category of resident applicant	

A copy of every order made shall be sent to the applicant and to the Commissioner.

Where an application is allowed the Authority shall, after examining such further material as may be placed before it by the applicant or obtained by the Authority, pronounce its advance ruling on the question specified in the application.

TIME LIMIT FOR PRONOUNCEING A RULING

The Authority shall pronounce its advance ruling in writing within six months of the receipt of application. A copy of the order made shall be sent to the applicant and the Commissioner.

SEC. 245RR. APPELLATE AUTHORITY NOT TO PROCEED IN CERTAIN CASES.

No Income-tax authority or the Appellate Tribunal shall proceed to decide any issue in respect to which an application has been made by an applicant, being a resident.

SEC. 245S. BINDING FORCE OF RULING

- 1) On the applicant who had sought it;
- 2) In respect of the transaction in relation to which the ruling had been sought; and
- 3) On the Commissioner, and the income-tax authorities subordinate to him, in respect of the applicant and the said transaction.

The advance ruling shall be binding as aforesaid unless there is a change in law or facts on the basis of which the advance ruling has been pronounced.

SEC. 245T. ADVANCE RULING TO BE VOID

Where the Authority finds, on a representation made to it by the Commissioner or otherwise, that an advance ruling pronounced by it has been obtained by the applicant by fraud or misrepresentation of facts, it may, by order, declare such ruling to be void ab initio and thereupon all the provisions of this Act shall apply.

SEC. 245U. POWERS OF THE AUTHORITY

The Authority shall, for the purpose of exercising its powers, have all the powers of a civil court under the Code of Civil Procedure,

The Authority shall be deemed to be a civil court but not for the purposes of Chapter XXVI, of the Code of Criminal Procedure, and every proceeding before the Authority shall be deemed to be a judicial proceeding and for the purpose of Indian Penal Code.

MEANING OF "PENDING"

Section 245R lays down that the Authority shall not allow the application where the question raised in the application is already pending before any income-tax authority. The date on which the Authority hears the application and the date on which it disposes of application may not be the same and the maintainability of the application cannot be made to depend on the pendency of the issue before the income-tax authorities on varying dates. It would appear more correct and practical to construe the embargo as applicable to cases where, while the issue is already pending before the income-tax authorities, the Appellate Tribunal or any court, the applicant also seeks recourse under section 245Q. The words "already pending" should, therefore, be interpreted to mean: "already pending as on the date of the application" and not with reference to any future date. No applicant can afford to ignore the mandatory provision requiring a return of income to be filed within the prescribed time merely because he has filed an application before the Authority. [1996] 218 ITR 0413B Monte Harris vs. Commissioner of Income-tax (Authority for Advance Ruling)

CHAPTER - 32

SETTLEMENT COMMISSION

SETTLEMENT COMMISSION

DEFINITIONS

CASE	Case means any proceeding under this Act for the assessment or reassessment of any person in respect of any year or years, or by way of appeal or revision in connection with such assessment or reassessment, which may be pending before an income-tax authority on the date on which an application is made.
APPLICATION	An assessee may, at any stage of a case relating to him, make an application in such form and in such manner as may be prescribed, and containing a full and true disclosure of his income which has not been disclosed before the Assessing Officer, the manner in which such income has been derived, the additional amount of income-tax payable on such income and such other particulars as may be prescribed, to the Settlement Commission to have the case settled and any such application shall be disposed of in the manner hereinafter provided: Provided that no such application shall be made unless, 1. The assessee has furnished the return of income which he is or was required to furnish under any of the provisions of this Act; and 2. The additional amount of income-tax payable on the income disclosed in the application exceeds one hundred thousand rupees.
	Every application made shall be accompanied by such fees as may be prescribed. An application made shall not be allowed to be withdrawn by the applicant.

ADDITIONAL TAX

GROSS AMOUNT	ADDITIONAL TAX
If the applicant has not furnished a return in respect of the total income of that year whether or not an assessment has been made in respect of the total income of that year, then, tax shall be calculated on the income disclosed in the application as if such income were the total income;	The amount of tax calculated under that clause;
If the applicant has furnished a return in respect of the total income of that year (whether or not an assessment has been made in pursuance of such return), tax shall be calculated on the aggregate of the total income returned and the income disclosed in the application as if such aggregate were the total income;	Te amount of tax calculated as reduced by the amount of tax calculated on the total income returned for that year.
If the proceeding pending before the income-tax authority is in the nature of a proceeding for reassessment of the applicant under section 147 or by way of appeal or revision in connection with such reassessment, and the applicant has not furnished a return in respect of the total income of that year in the course of such proceeding for reassessment, tax shall be calculated on the aggregate of the total income as assessed in the earlier proceeding for assessment under section 143 or section 144 or section 147 and the income disclosed in the application as if such aggregate were the total income.	The amount of tax calculated as reduced by the amount of tax calculated on the total income assessed in the earlier proceeding for assessment under section 143 or section 144 or section 147.

Where the income disclosed in the application relates to more than one previous year, the additional amount of income-tax payable in respect of the income disclosed for each of the years shall first be calculated and the aggregate of the amount so arrived at in respect of each of the years for which the application has been made shall be the additional amount of income-tax payable in respect of the income disclosed in the application.

245D. PROCEDURE ON RECEIPT OF AN APPLICATION.

Settlement commission call for the report of CIT	On receipt of an application, the Settlement Commission shall call for a report from the Commissioner and on the basis of the materials contained in such report and having regard to the nature and circumstances of the case or the complexity of the investigation involved therein, the Settlement Commission, shall, where it is possible, by order, reject the application or allow the application to be proceeded with within a period of one year from the end of the month in which such application was made. Provided that an application shall not be rejected under this sub-section unless an opportunity has been given to the applicant of being heard. Commissioner shall furnish the report within a period of forty-five days of the receipt of communication from the Settlement Commission. A copy of every order allowing the application shall be sent to the applicant and to the Commissioner.
Assessee shall pay the additional tax in 35 days.	The assessee shall, within thirty-five days of the receipt of a copy of the order allowing the application to be proceeded with, pay the additional amount of income-tax payable on the income disclosed in the application and shall furnish proof of such payment to the Settlement Commission.
Time to pay additional tax may be extended.	If the Settlement Commission is satisfied, on an application made in this behalf by the assessee, that he is unable for good and sufficient reasons to pay the additional amount of income-tax within the time specified it may extend the time for payment of the amount which remains unpaid or allow payment thereof by installments if the assessee furnishes adequate security for the payment thereof.
When additional tax is not paid interest shall be charged @ 15 % p.a.	Where the additional amount of income-tax is not paid within the time specified then, whether or not the Settlement Commission has extended the time for payment of the amount which remains unpaid or has allowed payment thereof by instalments the assessee shall be liable to pay simple interest at fifteen per cent per annum on the amount remaining unpaid from the date of expiry of the period of thirty-five days.
When application is allowed SC call for the report of cit	Where an application is allowed to be proceeded with the Settlement Commission may call for the relevant records from the Commissioner and after examination of such records, if the Settlement Commission is of the opinion that any further enquiry or investigation in the matter is necessary, it may direct the Commissioner to make or cause to be made such further enquiry or investigation and furnish a report on the matters covered by the application and any other matter relating to the case.
SC shall pass the appropriate orders	After examination of the records and the report of the Commissioner, and after giving an opportunity to the applicant and to the Commissioner to be heard, either in person or through a representative duly authorised in this behalf, and after examining such further evidence as may be placed before it or obtained by it, the Settlement Commission may, in accordance with the provisions of this Act, pass such order as it thinks fit on the matters covered by the application and any other matter relating to the case not covered by the application, but referred to in the report of the Commissioner. In every application allowed to be proceeded the Settlement Commission shall, where it is possible, pass an order within a period of four years from the end of the financial year in which such application was allowed to be proceeded with.

ORDERS OF THE SETTLEMENT COMMISSION

Shall provide for the terms of the settlement.	Every order passed shall provide for the terms of settlement including any demand by way of tax, penalty or interest, the manner in which any sum due under the settlement shall be paid and all other matters to make the settlement effective and shall also provide that the settlement shall be void if it is subsequently found by the Settlement Commission that it has been obtained by fraud or misrepresentation of facts.
When orders become void.	Where a settlement becomes void the proceedings with respect to the matters covered by the settlement shall be deemed to have been revived from the stage at which the application was allowed to be proceeded with by the Settlement Commission and the income-tax

	authority concerned, may, notwithstanding anything contained in any other provision of this Act, complete such proceedings at any time before the expiry of two years from the end of the financial year in which the settlement became void.
Order of settlement to be conclusive.	Every order of settlement passed shall be conclusive as to the matters stated therein and no matter covered by such order shall, save as otherwise provided in this Chapter, be reopened in any proceeding under this Act or under any other law for the time being in force.

POWERS OF THE SETTLEMENT COMMISSION

Provisional attachment	Where, during the pendency of any proceeding before it, the Settlement Commission is of the opinion that for the purpose of protecting the interests of the revenue it is necessary so to do, it may, by order, attach provisionally any property belonging to the applicant. SIMILAR TO 281B
Reopen completed proceedings.	If the Settlement Commission is of the opinion the reasons for such opinion to be recorded by it in writing that, for the proper disposal of the case pending before it, it is necessary or expedient to reopen any proceeding connected with the case but which has been completed by any income-tax authority before the application was made, it may, with the concurrence of the applicant, reopen such proceeding and pass such order thereon as it thinks fit. Provided that no proceeding shall be reopened by the Settlement Commission under this section if the period between the end of the assessment year to which such a proceeding relates and the date of application for settlement exceeds nine years.
All the powers of income tax authority	In addition to the powers conferred on the Settlement Commission, it shall have all the powers which are vested in an income-tax authority under this Act.
Shall regulate its own procedure	The Settlement Commission shall, have power to regulate its own procedure and the procedure of Benches thereof in all matters arising out of the exercise of its powers or of the discharge of its functions, including the places at which the Benches shall hold their sittings.
May allow to inspect the copies/reports of income tax authorities.	No person shall be entitled to inspect, or obtain copies of, any reports made by any income-tax authority to the Settlement Commission; but the Settlement Commission may, in its discretion, furnish copies thereof to any such person on an application made to it in this behalf and on payment of the prescribed fee.
May grant immunity from prosecution and penalty.	The Settlement Commission may, if it is satisfied that any person who made the application, co-operated with the Settlement Commission in the proceedings before it and has made a full and true disclosure of his income and the manner in which such income has been derived, grant to such person, subject to such conditions as it may think fit to impose, immunity from prosecution for any offence under this Act or under the Indian Penal Code or under any other Central Act for the time being in force and also either wholly or in part from the imposition of any penalty under this Act, with respect to the case covered by the settlement. However no such immunity shall be granted by the Settlement Commission in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of the application. An immunity granted to a person may, at any time, be withdrawn by the Settlement Commission, if it is satisfied that such person had, in the course of the settlement proceedings, concealed any particulars material to the settlement or had given false evidence.
Send a case back to the assessing officer if the assessee does not co-operate.	NOT AVAILABLE from 01-06-2002 on wards.

PROCEEDINGS ARE NOT CONFINED TO INCOME DISCLOSED

The proceedings before the Commission are not confined to the income disclosed before it alone. Once the application is allowed to be proceeded with by the Commission, the proceedings pending before any authority under the Act relating to that assessment year have to be transferred to the Commission and the entire case for that assessment year will be dealt with by the Commission itself - CIT v. Express Newspapers Ltd.(SC)

DISCLOSURE BEFORE ASSESSING OFFICER

Assessee made application for settlement in respect of three assessment years. Assessee admitted that no manufacturing was done and losses claimed were untrue for all three years. Also submitted combined computation of income given for all three years. Dismissal of application for one year and admission of application for other two years was misdirection in law. Application for all three years to be dismissed. [1997] 223 ITR 0840B Kuldeep Industrial Corporation vs. Income-tax Officer (Supreme Court of India)

REOPENING OF ASSESSMENT

It was a case where the assessee was requesting for a benefit and for the purpose of obtaining that benefit, it was requesting the reopening of the earlier assessments. Even this request of the assessee was for a limited purpose, viz., for spreading over the enhanced value of opening stock disclosed by it over the said six assessment years. It was not a request or concurrence to reopen the entire assessment and penalty proceedings relating to the said earlier assessment years. Moreover even assuming that the commission could exercise the power under section 147, the said power has to be exercised in accordance with the provisions contained in sections 147 to 150. Admittedly, they were not complied with, in this case. That this was not a case where the commission wanted to reopen the concluded assessments because it was found necessary or expedient to do so for the proper disposal of the case pending before it [1996] 219 ITR 0618- Commissioner of Income-tax vs. Paharpur Cooling Towers Pvt. Ltd. (Supreme Court of India)

CHAPTER - 33**MISC. PROCEDURES****SEC. 158A AVOIDANCE OF REPETITIVE APPEAL**

Where an assessee claims that any question of law arising in his case for an assessment year which is pending before the Assessing Officer or any appellate authority is identical with a question of law arising in his case for another assessment year which is pending before the High Court or Supreme Court or in appeal before supreme court, he may furnish to the Assessing Officer or the appellate authority, as the case may be, a declaration in the prescribed form that if the Assessing Officer or the appellate authority, as the case may be, agrees to apply in the relevant case the final decision on the question of law in the other case, he shall not raise such question of law in the relevant case in appeal before any appellate authority or for a reference before the High Court or Supreme Court or in appeal before the Supreme Court.

Where a declaration is furnished to any appellate authority, the appellate authority shall call for a report from the Assessing Officer on the correctness of the claim made by the assessee and, where the Assessing Officer makes a request to the appellate authority to give him an opportunity of being heard in the matter, the appellate authority shall allow him such opportunity.

MAY ADMIT OR REJECT AN APPLICATION

The Assessing Officer or the appellate authority, as the case may be, may, by order in writing,

- (i) Admit the claim of the assessee if he or it is satisfied that the question of law arising in the relevant case is identical with the question of law in the other case; or
- (ii) Reject the claim if he or it is not so satisfied.

An order shall be final and shall not be called in question in any proceeding by way of appeal, reference or revision under this Act.

Where a claim is admitted

- (a) The Assessing Officer or, as the case may be, the appellate authority may make an order disposing of the relevant case without awaiting the final decision on the question of law in the other case; and
- (b) The assessee shall not be entitled to raise, in relation to the relevant case, such question of law in appeal before any appellate authority or for a reference before the High Court or the Supreme Court or in appeal before the Supreme Court.

APPLICATION OF JUDEGEMENT

When the decision on the question of law in the other case becomes final, it shall be applied to the relevant case and the Assessing Officer or the appellate authority, as the case may be, shall, if necessary, amend the order.

SEC. 138 DISCLOSURE OF INFORMATION RESPECTING ASSESSEES.

The Board or any other income-tax authority specified by it by a general or special order in this behalf may furnish any such information received or obtained by any income-tax authority as may, in the opinion of the Board or other income-tax authority, be necessary for the purpose of enabling the officer, authority or body to perform his or its functions under that law,

Such information may be furnished to

1. Any officer, authority or body performing any functions under any law relating to the imposition of any tax, duty or cess, or to dealings in foreign exchange OR
2. Such officer, authority or body performing functions under any other law as the Central Government may, if in its opinion it is necessary so to do in the public interest, specify by notification in the Official Gazette in this behalf,

SEC. 138 DISCLOSURE OF INFORMATION ON AN APPLICATION BY ANOTHER PERSON.

Where a person makes an application to the Chief Commissioner or Commissioner for any information relating to any assessee the Chief Commissioner or Commissioner may, if he is satisfied that it is in the public interest so to do, furnish the information asked for and his decision in this behalf shall be final and shall not be called in question in any court of law.

SEC. 287 PUBLICATION OF INFORMATION RESPECTING ASSESSEES IN CERTAIN CASES.

If the Central Government is of opinion that it is necessary or expedient in the public interest to publish the names of any assessee's and any other particulars relating to any proceedings or prosecutions under this Act in respect of such assessee's, it may cause to be published such names and particulars in such manner as it thinks fit.

No publication shall be made in relation to any penalty imposed under this Act until the time for presenting an appeal to the Commissioner (Appeals) has expired without an appeal having been presented or the appeal, if presented, has been disposed of.

Dear Student,

The Taxation is a subject Subject which is **ever changing** and very frequently. *Every 6 months it's a new subject.* Its also new for us if its new for you. However we work very professionally for this dynamically changing subject. Thus we have decided to give you all the legal updates and other recent issues in form of down load from our website. This down load is at additional cost (**however we may decide to waive the cost for our existing students or for some class of students say for those who secured advance admission with us**). All debates and discussion regarding the same updates is already made in the class room but official studynotes will be made available online only. This down load is optional for students, in case you are not interested in this online material please ignore this communication.

We believe that this **online material has great advantage to students because students will be timely and frequently updated**, also we can provide **better quality of services** to students community by giving them most **timely and latest information**. Thus it is very much advisable for one to register online and get the material.

*What you can download and what online content you can have refer annexure A
In order to enable the download refer annexure B.*

Thanking You
Kalpeshclasses.com

ANNEXURE – A
KNOW YOUR STUDY MATERIAL NOW.

PARTICULARS	A.Y.	Identify	Status
Study Notes			Printed Here
Study Notes (Supplements)	06-07	S1	Down Load
Study Notes (Supplements) so on	06-07	S2	Down Load
Problems and Solutions (Chapter wise)	06-07	C1	Down Load
Problems and Solutions (Chapter wise)	06-07	C2	Down Load
Problems and Solutions (Chapter wise) so on	06-07	C3	Down Load
Legal Updates (professional write up on cases and opinions)	06-07	L1	Down Load
Legal Updates (professional write up on cases and opinions) so on	06-07	L2	Down Load

• You are strongly advised to see the assessment year online before you down load and print.
 • We advise you to take the prints and organize the supplements in above mentioned sequence.
 • Also the material for PE2 will also be made online for free, thus inform your friends well in advance to grab the opportunity.

ANNEXURE – B

HOW TO GET THE ONLINE MEMBERSHIP

- (i) You should register with our website. (ignore this step if you are already registered with our website)
- (ii) Go to “My account” option on our website and take one printout of registration certificate
- (iii) Hand it over personally to professor and collect the membership card which will allow you to download the content.

POINTS TO BE NOTED

- Necessary announcement regarding the same will also be made in the class room.
- When you register to our website you agree to the terms and condition of the site, for example we have reserved our right to communicate to you in future with legal updates / mailers. Read the terms and conditions very perfectly before you register.
- If you are not agreeing to the terms please do not register to our website.
- In the registration if any information is not correct or misleading we reserve our right to cancel the online membership at any point of time.