PART A

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'.

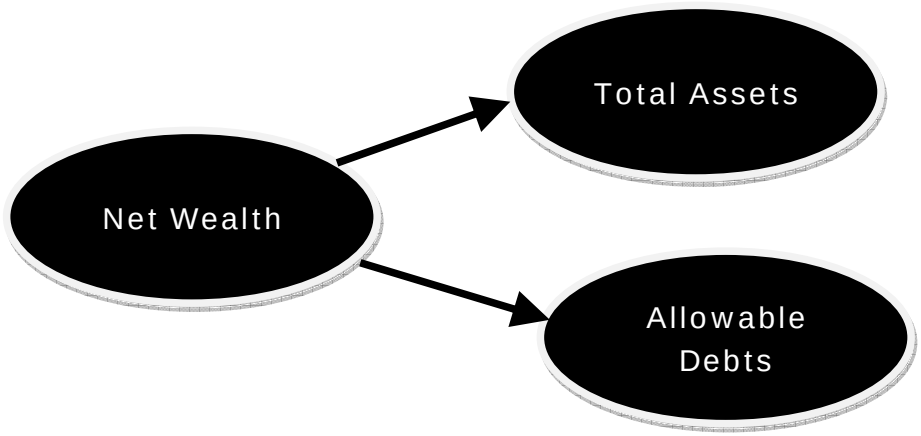
Assessment year (A.Y.)

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. 30,00,000. The rate is same for individuals, HUF's and companies.

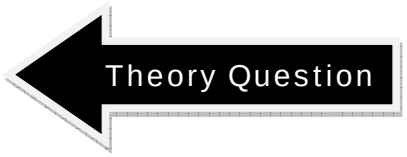
System of accounting.

System of accounting has no relevance to the assessment under Wealth Tax Act [M. Ramanamma *v.* CWT (1986) 157ITR 555 (AP)]. For example, J, a wealth-tax assessee, follows cash system of accounting. He borrowed money to purchase a motor car. Accrued interest on such loan is deducted as a debt owed even though it does not appear in books of account.

Tax base of wealth tax.

Net wealth, as on the valuation date, is the tax-base for the levy of wealth tax. If there is any change in the wealth of an assessee even on the valuation date by way of transfer, sale or gift, and any asset has changed hands or does not exist on valuation date, the same cannot be included in the net wealth. Similarly, an asset received or purchased by an assessee even in the closing hours of valuation date, is inclusible in net wealth and liable to tax. Thus, net wealth on the last moment of the valuation date is the tax-base for the levy of wealth tax.

SECTION 45, NO WEALTH-TAX IS CHARGEABLE FOR



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.

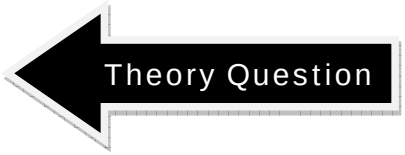
SECTION 3, CHARGE OF WEALTH-TAX



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.

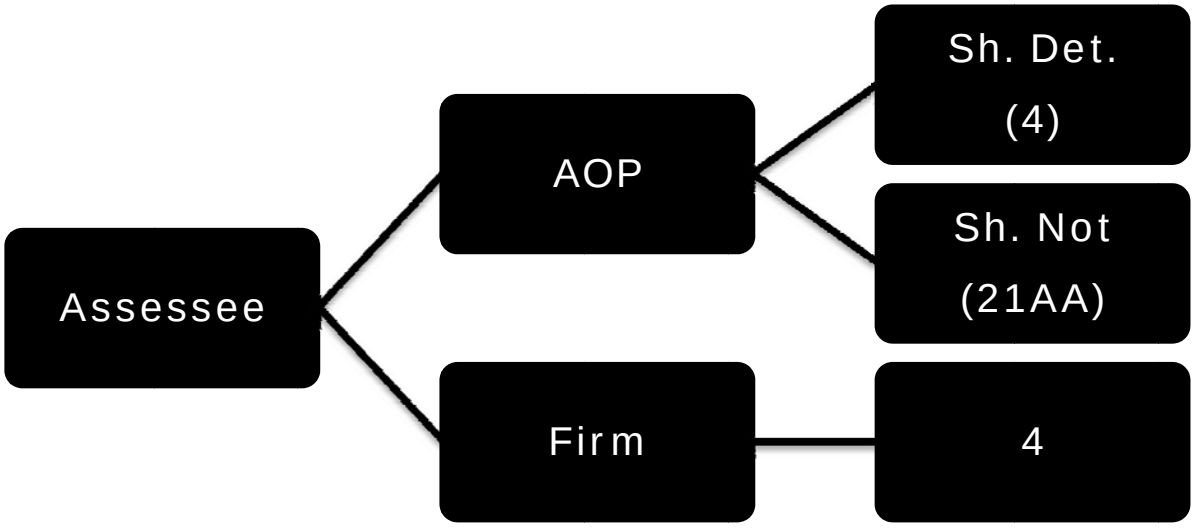
Madras high court in case of Halai Menon Association [2000] 244 ITR 0357 has held that Association of persons are not liable to wealth-tax as individual. The reasons given by the court is that the expression "individual" cannot be stretched to include entities which were deliberately omitted and left 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.

21 AA DEEMED INDIVIDUAL



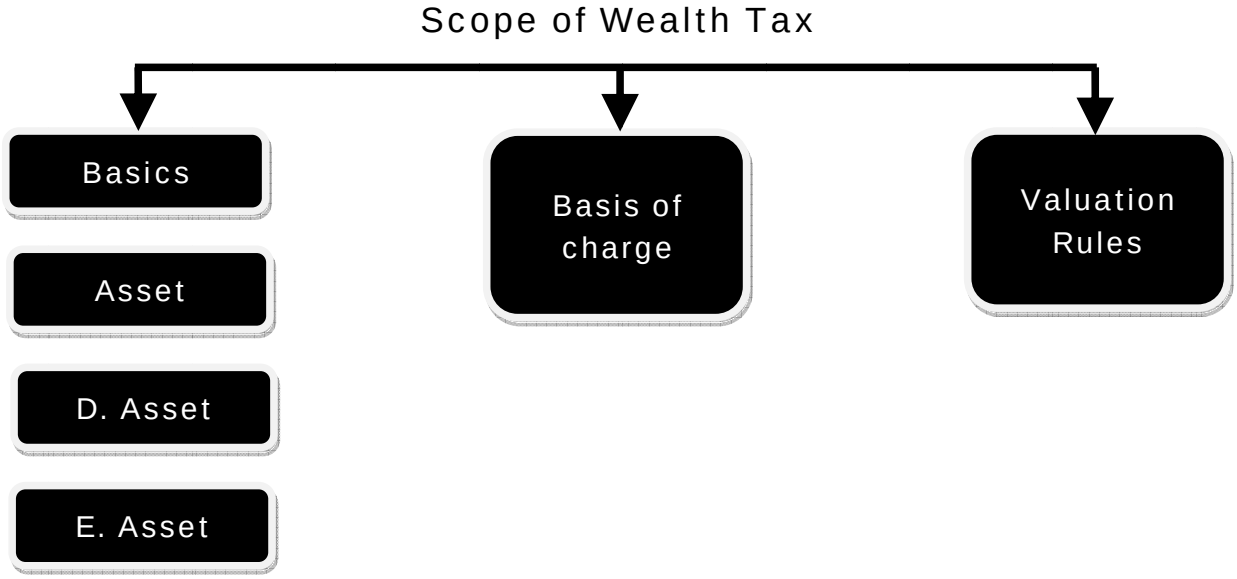
21AA of the wealth tax provides for assessment of associations of persons in certain special cases and not otherwise. Assessment as an association of persons can be made only when the individual shares of the members of the association in the income or assets or both of the association on the date of 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.

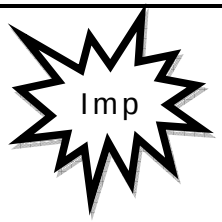


Scheme of law

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 31 lakhs than 31-30 = 1 lakh * 1% = 1000 Rs. Is wealth tax liability.

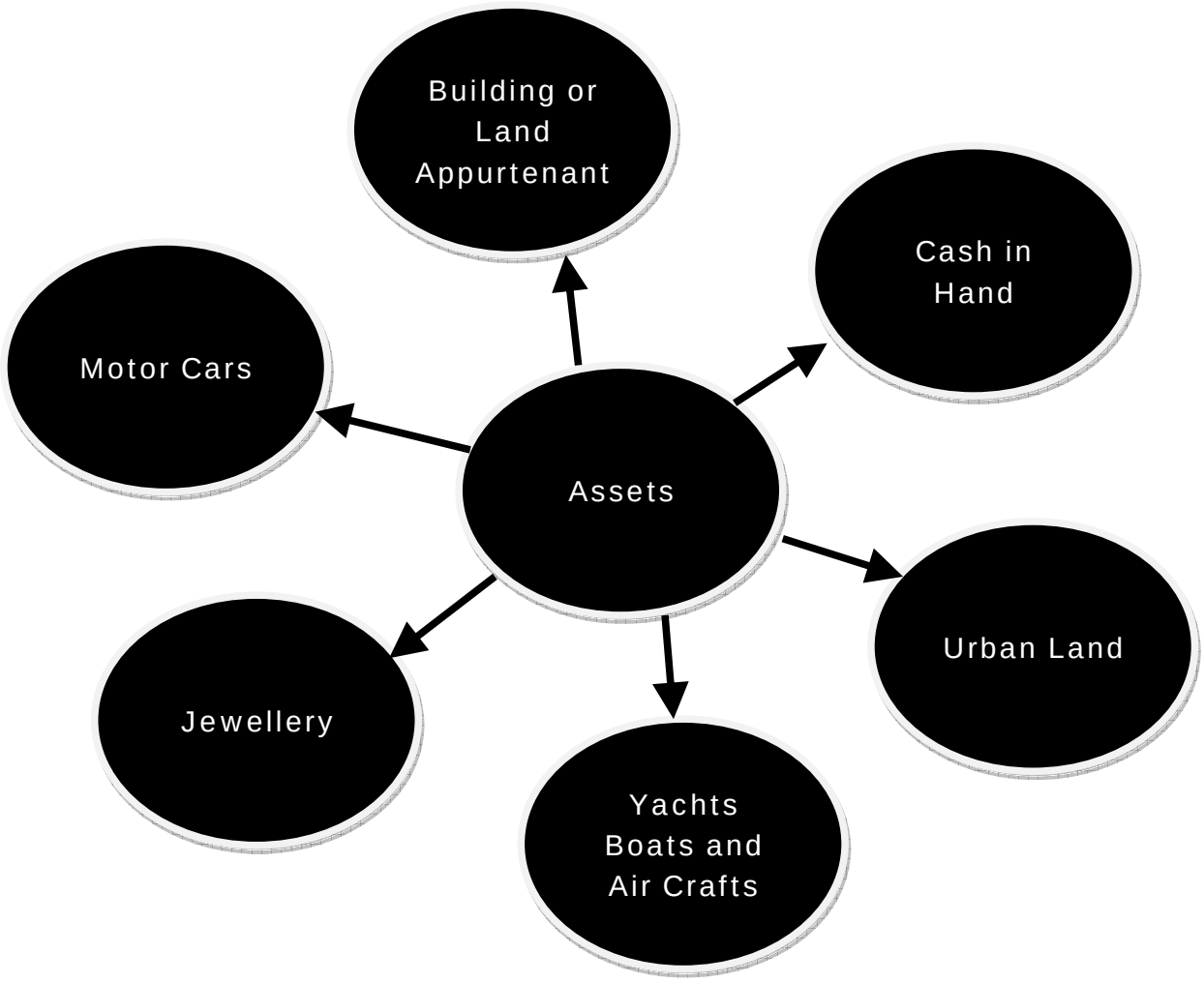


"ASSETS" DEFINED U/S 2(ea):



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 25 kms. 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.



Illegal asset.

There is no difference between legal asset and illegal asset. The revenue is not concerned with the illegality of the transaction. Thus, cash-in-hand representing sale proceeds of smuggled items is chargeable to wealth tax, provided the statutory condition regarding chargeability is satisfied. Thus, where the assessee is an individual, cash sale of smuggled goods on valuation date amounting Rs 1,20,000 is taxable to the extent of Rs 70,000 (1,20,000 - 50,000).

Legal ownership.

An asset belongs to its legal owner. For example, an assessee has purchased the jewellery. The jewellery belongs to him as he is its legal owner. Where the assessee is the legal owner of an asset, the lack of possession is no criterion to hold that the asset does not belong to the assessee. Take an example. J purchased a residential house in April. Conveyance deed was executed. However, the possession could not be taken over as the validity of the sale deed was disputed by K, brother of J. The suit is pending on 31 March being the valuation date. The value of the residential house is to be

included in the net wealth of J as the house legally belongs to him [U.S. Nayak v. CWT (1968) 65 ITR ITI (Mys.)].

Articles seized by excise authorities but not confiscated are included in net wealth as they belong to the assessee. Mere seizure of an asset does not in any way impair the ownership of an assessee in the asset. unless it is confiscated lawfully, it belongs to the assessee and is inclusible in his net wealth [CWT v. Meghji Girdharilal (1989) 176 ITR 63 (MP)]. Thus, cash, jewellery, gold, silver, etc., seized in tax raids belong to the assessee.

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Building or land appurtenant scope of :

Multi storayed house

Residential house: A building used for human habitation is a residential house [Shiv Narain Chaudharv (1997) 108 1TR 104 (All.)] In the present times when multi-storeyed flats are becoming the order of the day, a flat may also be considered as a residential unit or a residential house [Vidva Vakash Talwar (1981) 132 1TR 661 (Del.)]. Thus, a house or a flat used as a dwelling place is residential house. It is an asset.

Guest house:

A house used for the purpose of maintaining a "guest house" is an asset, liable to wealth tax. Guest house refers to a place where the guests of the assessee are received gratuitously or at a concessional rate [Sliri Durga Enterprises *v.* I.T.O. (1976) 102 ITR 745 (Ker.)]. Where an accommodation is maintained either in the principal place of business or in a place of business or in place where the factory is located for directors and other employees, the accommodation cannot be described a "guest house". It is a "residential accommodation". The term "guest house" refers to a place for the reception of strangers. Employees cannot be treated as strangers. Hence, unless the guest house is intended for use by a complete stranger, it cannot be called a guest house [CIT *v.* Aruna Sugars Ltd. (1980) 123 ITR 6l9(Mad.)j.

Farm house:

A farm house is an asset, provided it is situated within 25 km from the local limits of any municipality or cantonment board. For example, Mr J owns a farm house on Delhi-Mathura Road. It is located at 30 km from Delhi but 15 km from Faridabad. It is an asset because it is situated within 25 km from the municipality of Faridabad. The municipality may be known by any name, that is, municipal corporation, notified area committee, town area committee, town committee or by any other name.

A "farm house" would mean a house for dwelling on a farm (that is, a tract of land, held for the purpose of cultivation). Thus, a house on an agriculture land may constitute a farm house, provided it is situated within 25 km from the local limits of any municipality or cantonment board.

If there is no municipality within a radius of 25 km around a farm house, it is not an asset.

House maintained otherwise

A house which is not used either for residential or commercial purpose or which is not maintained as a guest, or farm house, within the radius of 25 km for the local limits of any municipality or cantonment board, but used for any other purpose, would also be an asset. Thus, where a building is used to promote art, charity, religion or any object of general public utility, neither, it is a residential or commercial use of the building nor it is being used as a guest house or farm house, such building would be an asset as it is being used "otherwise". Similarly, a building used as a social club or welfare centre or health centre would also be an asset. Thus, a building used for any purpose is an "asset". However it can be subject to exclusions.

Land appurtenant to the house:

"land appurtenant to the house" is also being treated as asset to avoid any controversy in the matter. The expression "land appurtenant thereto" has not been defined in the Act. It must, therefore, be understood in its popular and non-technical sense of "relating to", usually enjoyed or occupied with a house. The words "land appurtenant to" in the context of house property means the lands belonging to house property or the lands necessary or connected with the enjoyment of the house [ITO *v.* Goverdhan Dass and Sons (1987) 20 ITD 681 (Amr.)].

Thus, the appurtenant land in respect of a residential building may be in the form of a compound and playground, courtyard and backyard, kitchen-garden, cattle-shed, motor-garage, etc., forming part of the building.

In respect of a non-residential building, the appurtenant lands may be in the form of car-parking space, connecting roads between different departments of the factory area, drying grounds and play-grounds, forming part of the building.

Where the land, contiguous to the building, can be used for purpose other than enjoyment of the building, the whole of the land may not be treated as land "appurtenant thereto". For example, where a building has got 10 acres of adjoining land, the entire adjoining land may not be treated as "lands appurtenant to the building". The tax authorities have got jurisdiction to determine the extent of land appurtenant to the building taking into account a variety of circumstances that may be relevant to determine whether the land contiguous to the building should be treated as "land appurtenant thereto". Some of the relevant tests have been cited in [CIT *v.* Ziabunisa Begum (1985) 151ITR 321 (AP)] as follows:

(i) If the building together with the land is treated as an indivisible unit and enjoyed as such by the persons enjoying the building, it is an indication that the entire land is appurtenant to the building.

(ii) I If the building has extensive lands appurtenant thereto, and even if the building and the land have been treated as one single unit and enjoyed as such by the occupiers, an enquiry could be made to find out whether any part of the land contiguous to the building can be put to independent use without causing any determent to the effective and proper enjoyment of the building as such.

Such an enquiry should be conducted not based on any artificial considerations but from the point of view of the persons occupying the building, that is, the number of persons of different branches of families, residing in the building, the requirement of the persons occupying the building consistent with their social standing, etc. If any surplus is arrived at on such enquiry, the extent of such surplus land may not qualify to be treated as land appurtenant to the building.

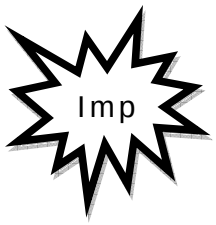
(iii) If there is any evidence to indicate that any portion of the land contiguous to the building was put to use other than the enjoyment of the building, such land does not qualify to be treated as land appurtenant to the building. For instance, the land used by the occupants for commercial, agricultural and horticultural purpose, although forming part of the land adjacent to building, does not qualify to be treated as land appurtenant to the building.

(iv) If the owner or occupant is deriving any income from the land which is not liable to be assessed as income from the house property under Sec. 22 of the Income-tax Act, then the extent of such land does not qualify to be treated as lands appurtenant to the building.

(v) Any material pointing to the attempted use of the building for purpose other than the effective and proper enjoyment of the house would also afford a safe guide to determine the extent of surplus land not qualifying to be treated as land appurtenant to the building.

The above tests are only illustrative and not exhaustive. Thus, whether or not, the land contiguous to the building, is land appurtenant thereto, is a question of facts.

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. No where 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.

Houses excluded from the purview of chargeability:

(1) Residential house allotted by a company to a whole-time employee, drawing a gross annual salary of less than Rs 5,00,000:

The exclusion applies only to a company assessee, provided the following conditions are satisfied:

(i) The house is allotted by the company to its employee/officer/director who is in the whole-time employment. Thus, no exclusion applies where the employee is a part-time employee or where the alloottee is not an employee.

The whole-time employee may be a permanent employee or temporary employee. For example, Mr J is appointed by a company in leave vacancy for 3 years as a whole-time employee. The condition is satisfied even though he is not a permanent employee,

(ii) The annual gross salary of the employee/ officer/ director should be less than Rs 5,00,000. Thus, if the annual gross salary is Rs 5,00,000 or more, the exclusion is gone. The term "gross salary" has not been defined in the Act. It may be construed as per its dictionary meaning. "Salary" refers to a fixed compensation paid to a person for regular work or service. Accordingly, salary would include all cash allowances but not perquisites. The limit of Rs 5 lakh is applicable from the assessment year 1999-2000.

(iii) The house is allotted exclusively for residential use. Thus, where the house is allotted partly for residential purposes and partly as a showroom to display company's products or as a godown to store company's products, the exclusion does not apply.

(2) Any house for residential or commercial purposes, held as stock-in-trade:

Any house for residential or commercial purposes which forms part of stock-in-trade is excluded from the purview of "assets". Thus, construction companies/concerns/real estate dealers, holding residential houses as stock-in-trade are not liable to wealth tax. Similarly, where shops, godowns, warehouses, office premises, factory premises, etc., are held as stock-in-trade, all of them are excluded from the purview of the assets. Like-wise, constructing guest houses and selling them at profit will take them out from the ambit of wealth-tax laws. If guest house is used.for entertaining customers, it is an asset.

(3) Any house occupied by the assessee for any business or profession carried on by him*:*

From the assessment year 1997-1998 and subsequent years, any house which is occupied by the assessee for the purposes of any business or profession carried on by him, has been excluded from the purview of "assets". Accordingly, commercial building or any other building, occupied by the assessee for the purposes of business or profession, carried on by him, is not an asset. Thus, a nursing home building owned and occupied by the owner for treating the patients, is not an asset. Similarly, the studio owned and occupied by a photographer is excluded from the purview of assets. Office building owned and occupied by a chartered accountant for his practice is not liable to wealth tax. Factory building, office premises, showroom, godown and shop, etc., owned and occupied by the company assessee for its business would not be an asset. Where a welfare building, like guest house, club house, school building and temple, etc., is owned by the assessee and used for the purposes of business, its exclusion from wealth tax would be doubtful. The narrow view may be that "occupancy" would mean personal and physical occupation by the owner himself for the purposes of business. Hence, exclusion would not apply. The broader view may be that "occupancy" by the agents is 'occupancy' by the principal. Accordingly, the occupancy of the welfare building by the employees/agents, etc., would be regarded as occupancy by the owner. Hence, the exclusion would apply-Where an assessee is engaged in the business of constructing building and let them on hire for business purposes, he is not entitleci to claim the exclusion in respect of such buildings under this clause as he has not occupied them for his own business.

Where the assessee has occupied only a part of the premises for his business or profession, the exclusion would apply to that part only. The balance part of the premises which is not occupied for the purposes of business or profession would be an asset and liable to wealth tax. For example, Dr D owns a house. One-third portion is used as a "clinic" for practice and two-thirds portion is used as residence. Clinic portion of the house is not an asset.

Similarly, where a businessman uses the ground floor of the building for his business purposes and the first floor is occupied for residential purposes, the ground floor of the building is not an asset. The residential portion is an asset.

Where a building, owned by a partner, is occupied by the firm for the purposes of its business, the partner would be entitled to claim the exclusion of such building. Partnership business is nothing but the business carried on by every partner, acting for all the partners. The building used by the firm would he treated as used by the partner for the business carried on by him. Majority of the High Court opinions support this view [Addl. CIT *v.* N. Vaidayanathan (1989) 180 ITR198 (Mad.). Also see: CIT *v.* P.M. Thomas (1990) 181ITO 247 (Ker.); CIT *v.* Syed Anwar Hussien (1990) 180 ITR 749 (Pat.); CIT *v.* Rasiklal Balabhai (1979) 119 ITR 303 (Guj.)]' However, the Karnataka High Court has dissented from this view [CIT r. K.N. Guruswami, (1984) 148 ITR34(Kar.)].

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)

(4) Residential property let out for 300 days or more during the previous year:

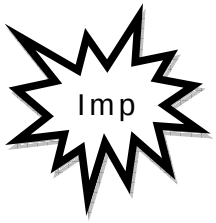
Where, a residential property is let out for a minimum period of 300 days during the previous year, it is excluded from the purview of "assets". It is operative from the assessment year 1999-2000 and subsequent years.

Where a residential property is let out for mixed purposes, that is, residential and commercial, the portion let out for residential purposes would not be treated an asset. Where a residential building consists of several units, some of them remain let out for 300 or more days and some are laying vacant or let out for less than 300 days, it appears that exclusion would apply for units which remained let out for 300 or more days.

Where a commercial property is let out for residential purposes for 300 or more days during the previous year, it appears that exclusion would not apply as it is not a residential property.

Similarly, where a residential property is let out for 300 or more days for commercial purposes, exclusion would not apply.

(5) Commercial complexes/establishment:



Any property in the nature of commercial establishment or complexes is excluded from the purview of "assets". The exclusion is applicable from the assessment year 1999-2000 and subsequent years. The terms "commercial establishment" and "commercial complexes" have not been defined. 'Commercial establishment' would refer to a place where products are sold/exchanged or a profit-making establishment. Thus, where a place is let out to a trader, the place is used for a commercial establishment, that is, to carry on any trade or business. Thus, it should be excluded.

"Commercial complex" is a large building or group of buildings with common facilities like banks, post office, telecommunication, security, parking spaces, storage, etc. Such complexes are built by the builders to let them on hire under lease or tenancy. Thus, exclusion would apply when such complexes are in use as such. Exclusion would not apply to commercial complexes remaining vacant.

Thus, commercial establishment complex held as investment would be chargeable to wealth tax. The shops, offices, factory buildings situated in commercial complex/commercial establishment are excluded from the purview of assets, provided they are let out.

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Motor cars :

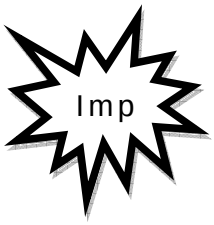
Motor cars are "assets". "Motor car" means any motor vehicle other than a transport vehicle, omnibus, road roller, tractor, motor cycle or invalid carriage [Sec. 2(26) of the Motor Vehicle Act, 1988]. "Transport vehicle" means a public service vehicle, private service vehicle, bus of an educational institution or a goods carriage [Sec. 2(47) of the Motor Vehicle Act, 1988]. Transport vehicle is not a motor car. "Invalid carriage" means a motor vehicle specially designed and constructed, and not merely adapted for the use of a person suffering from some physical defect or disability and used solely by or for such a person [Sec. 2(18) of the Motor Vehicle Act, 1S'88]. "Invalid carriage" is not a motor car.

Motor car held as stock-in-trade or used in a hiring business excluded from chargeability: Two exclusions have been provided in respect of motor cars.

(1) ***Motor cars held as stock-in-trade:*** Where the assessee holds motor cars as stock-in-trade, the motor cars are excluded from the purview of "assets". Thus, automobile dealers/manufacturers are not assessable on the value of motor cars, held as stock-in-trade. No time-limit is provided to hold them as stock-in-trade.

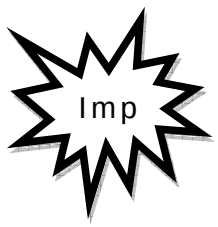
(2) ***Motor cars held as taxies:*** Where the assessee holds the motor cars to be used in a business of running them on hire, such motor cars are not "assets".

Unregistered motorcars



Motor car purchased by an assessee but not registered under Motor Vehicle Act legally belongs to the assessee as the ownership of moveable property passes under the Sale of Goods Act and not under Motor Vehicle Act. Where a motor car of an assessee is stolen before valuation date but theft is not certified by the police authorities till valuation date, the stolen motor car still belongs to the assessee. It is to be included in his net wealth.

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.

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Hours of video access Granted	5 Hrs	100 Hrs	75 Hrs
Membership commence (May 2011 Exam)	16th May	16th May	16th May
Fair Usage of Hours for attending all lectures for given subject once. *(approximately in this many hours once all lectures can be attended, some extra time is given considering revision of any chapters that may be required. Particularly for DT if students attend basic topics of IPCC lectures also when we post from time to time then students will have to buy more hours at additional cost.)*	5 Hrs	100 Hrs	65 Hrs
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Membership expiry for May 2011 exam (Respective hours or this date whichever is earlier.)	No	18th May	18th May
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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 location of assets and debts is of prime importance for computation of taxable net wealth and incidence of tax. The location of assets or debts is essentially a question of fact and should be decided in the light of evidence. The following instruction have been issued by the Department in this connection for general guidance:

	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.

DEEMED ASSETS - SEC 4 CLUBBING

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.

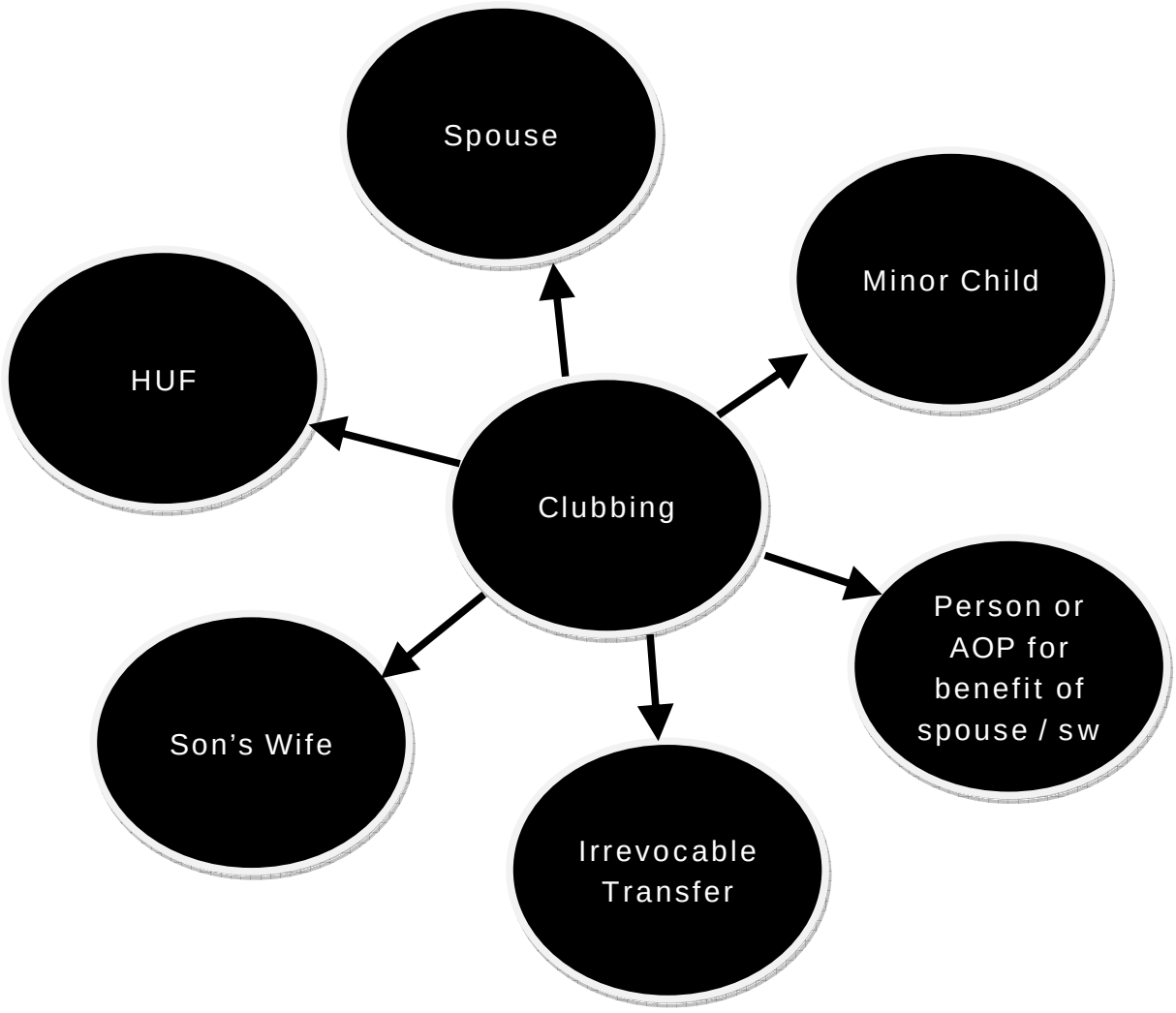
Where any such assets are once included in the net wealth of either parent, any such assets shall not be included in the net wealth of the other parent in any succeeding year unless the Assessing Officer is satisfied, after giving that parent an opportunity of being heard, that it is necessary so to 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

The word "spouse" means lawfully-wedded husband and wife and not the relationship of concubine. The word "wife" or "spouse" does not include a female with whom the assessee has an illicit connection for however long a period.

The "spouse" does not include a prospective wife or prospective husband: For example, M was engaged to K. He settled jewellery/motor car/cash, etc., on a trust with a direction that the said assets would be given to K at the time of her marriage with him. However, the trustees delivered the said assets to K, 20 days prior to her marriage with M. The Assessing Officer included the said assets in the net wealth of M on the ground that the trustees were not empowered to deliver the said assets to K prior lo her marriage with M. Hence, the

transfer should be deemed to have taken place at the time of her marriage with M when the relation of the spouse was there. The action of the Assessing Officer is not justified. It is not relevant to consider that there was violation of the terms of the trust deed. Even if the delivery of the said assets is against the terms of the trust deeds, it is not possible to ignore the factum of delivery before her marriage with M. The value of the assets transferred is not assessable in the net wealth of the transferor. It is taxable as the wealth of the transferee-spouse [CWT *v.* M. K. Ananthkumar (1986) 157ITR 598 (Mad.)],

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)

Payement of "meher"

Any transfer of an asset in discharge of legal obligation is for adequate consideration. Thus, payment of "Meher" to the wife by the husband during the life-time is not a transfer without "adequate consideration" [Ghiasuddin Babu Khan *v.* CIT (1985) 153 ITR 707 (AP)(F.B.)]. Therefore, the property purchased out of such *meher* cannot be included in the hands of the husband under Sec. 4(l)(a)(i) [CWT *v.* Nawab Fazalyar Jung (1993) 66 Taxman 168 (AP)].

Asset transferred in connection with divorce

Transfer by one spouse to another under an agreement to live apart (DIVORCE) not covered by clubbing provisions: Any transfer effected either by the husband to the wife or vice-versa under an agreement to live apart does not fall within the purview of the deeming provision. Accordingly, the transferred asset is to be excluded from the net wealth of the transferor.

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 us 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, form 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.

Accreation 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 ineludible 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) it 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.

Minor converting property

If a minor child of the converting member or donor member also gets a share in the partition of converted property or gifted property the share of the property received by the minor child is not to be included in the net wealth of the converting member/donor member such property held by the minor is to be clubbed with the net wealth of that parent whose wealth is greater provided the marriage of the parents subsists on the valuation date if the marriage of the parents does not subsist such asset is to be included in the net wealth of that parent who maintains the child.

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.

Where R transfers a motor car to S for 6 years, the transfer is revocable even if the car is wholly used for the benefit of S. The motor car so held by S is to be included in the net wealth of R. If the transfer is for a period exceeding 6 years or for the life-time of the transferee, the transfer may still be revocable if the transferor derives any benefit or exercises control over the income or the asset.

Computation of the period of irrevocability:

The minimum period or irrevocability, that is, 6 years and one day would be counted from, the date of the execution of the deed. If the deed is irrevocable originally for a period of 6 years or less and is made irrevocable for a period of 6 years and one day by executing another extension deed, such transfer cannot be treated an "irrevocable" eventhough the extension deed is executed before the expiry of the original deed.

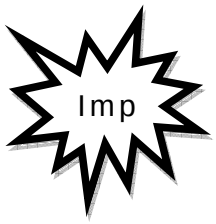
Sec.4 (5A) gifts by book entries

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

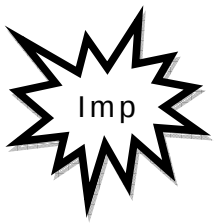


A Person:

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.

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.

Charitable or religious purpose:

The expression "charitable purpose" has not been defined in the Act. It is said to mean relief of the poor, educational and medical relief or the advancement of any other object of general public utility. The relief to poor does not necessarily mean giving them free doles or alms, it may take some other shape, e.g. seeking better reward for labour. Raising of moral, intellectual, economic, social and political conditions of people in general is an object of general public utility. 'Public religious purpose' means any purpose related to the advancement, support or propagation of religion. Property dedicated to an idol to which public have free access is a public religious trust and is entitled to exemption.

The charitable or religious purpose should be confined to India. If the charitable or religious purpose for which the property is held lies outside India, the right to exemption is lost. Thus, if a Muslim in India settles certain property on trust and directs the trustees to spend the income for the benefit of Mecca and Medina, no exemption can be claimed in respect of such properties. The exemption is to be denied completely even if some objects of the charitable trust confine outside India [CWT v. Trustees of the Nizam's Religious Endowment Trust (1977) 108 ITR 229 (AP)].

Sec.5 (ii): coparcenercy interest in huf	
	Interest of the assessee in coparcenercy property of an HUF is exempt. The exemption avoids double taxation of the same property once in the hands of the coparcener and then in the hands of Hindu undivided family.
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 (26th Amendment) Act. 1971 is exempt.

One Official Residence of Ex-Indian Ruler [(Sec. 5(iii)]

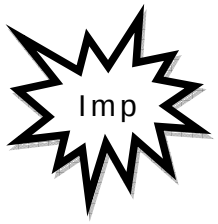
Any one building which is in the occupation of ex-Indian ruler and which has been declared by the Central Government as his official residence, is exempt from wealth tax. If the ruler ceases to occupy the building, notified by the Central Government as his official residence, the Ruler is not entitled to exemption in respect of such building.

If a ruler has more than one official residence, the exemption is available only in respect of one such residence, as is declared to be his official residence by the Central Government. The choice of such official residence to be exempted from wealth tax left to ruler.

The exemption applies only to building or part of the building which has been declared by the Central Government as official residence of the ex-ruler and which is in his occupation, therefore, the building let put to tenants is not entitled to the exemption as it is not in the occupation of ex-rulers [Mohammedan Khan and others v. CIT (1997) 224 ITR 672 (SC)].

The expression 'ruler' means the Prince, Chief or other person who, at any time before the commencement of the Constitution (Twenty-sixth Amendment) Act 1971) was recognised by the President as the ruler of Indian State, or any person who at any time before such commencement was recognised by the President as successor of such ruler.

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. Where such recognition does not exist, the Central Board of Direct Taxes is empowered to accord such recognition but it should be obtained by the ex-ruler at the time of his first assessment under this Act. If the Board recognises the jewellery in the possession of an ex-ruler at the time of his assessment as his "heirloom jewellery", it will be exempt from wealth tax.

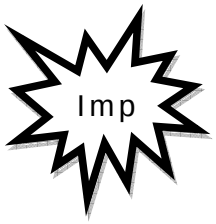


Heirloom jewellery of ex-rular 5(iv)

The exemption is available if the following conditions are also satisfied by an ex-ruler:
(i) The jewellery is permanently kept in India and is not removed outside India except for a purpose and period approved by the Board.
(ii) The reasonable steps are taken for keeping the jewellery substantially in its original shape,
(iii) The reasonable facilities are allowed to any office of the government authorised by the Board in this behalf to examine jewellery as and when necessary.
If any of the conditions is not satisfied, the Board is empowered to withdraw the recognition retrospectively from 9 September 1972. The Board has to record the reasons for such withdrawal. If the Board withdraws the recognition retrospectively, wealth tax becomes payable by the ex-ruler for all the assessment years for which the jewellery was exempted on account of the recognition. In such a case, the back assessment years have to be rectified. For this purpose, the fair market value of the jewellery on the date of the withdrawal of the recognition is deemed to be the market value on each valuation date relevant to back assessment years. But the aggregate amount of wealth tax in respect of jewellery for all the back assessment years cannot exceed 50% of its fair market value on the valuation date relevant for the assessment year in which the recognition is withdrawn.

Sec.5 (v): for person of indian origin or a citizen of india

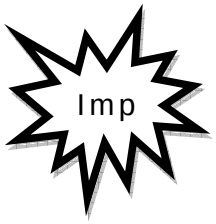
If any person of Indian origin or a citizen of India who was ordinarily residing in a foreign country, leaves such country and returns to India with an intention of permanently residing in India then he will enjoy exemption on the following assets for the next 7 successive Asst. Years after his return.



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. *(1 sq meter = 10.794 feets)* 
	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).
	The Act has not defined "house". The word "house" would include any building irrespective of its use, that is to say, it may be used for business purpose or as a residence or as a school and it should not be restricted to a dwelling house. Thus, where the assessee lets out a part of the house as a godown for business purposes and remaining part for residence, he is entitled to the exemption for the entire house, comprising residential unit and godown which constituted one building [CWT v. Mahal Chand Pandia (1996) 219 ITR 733 (Guw.)].

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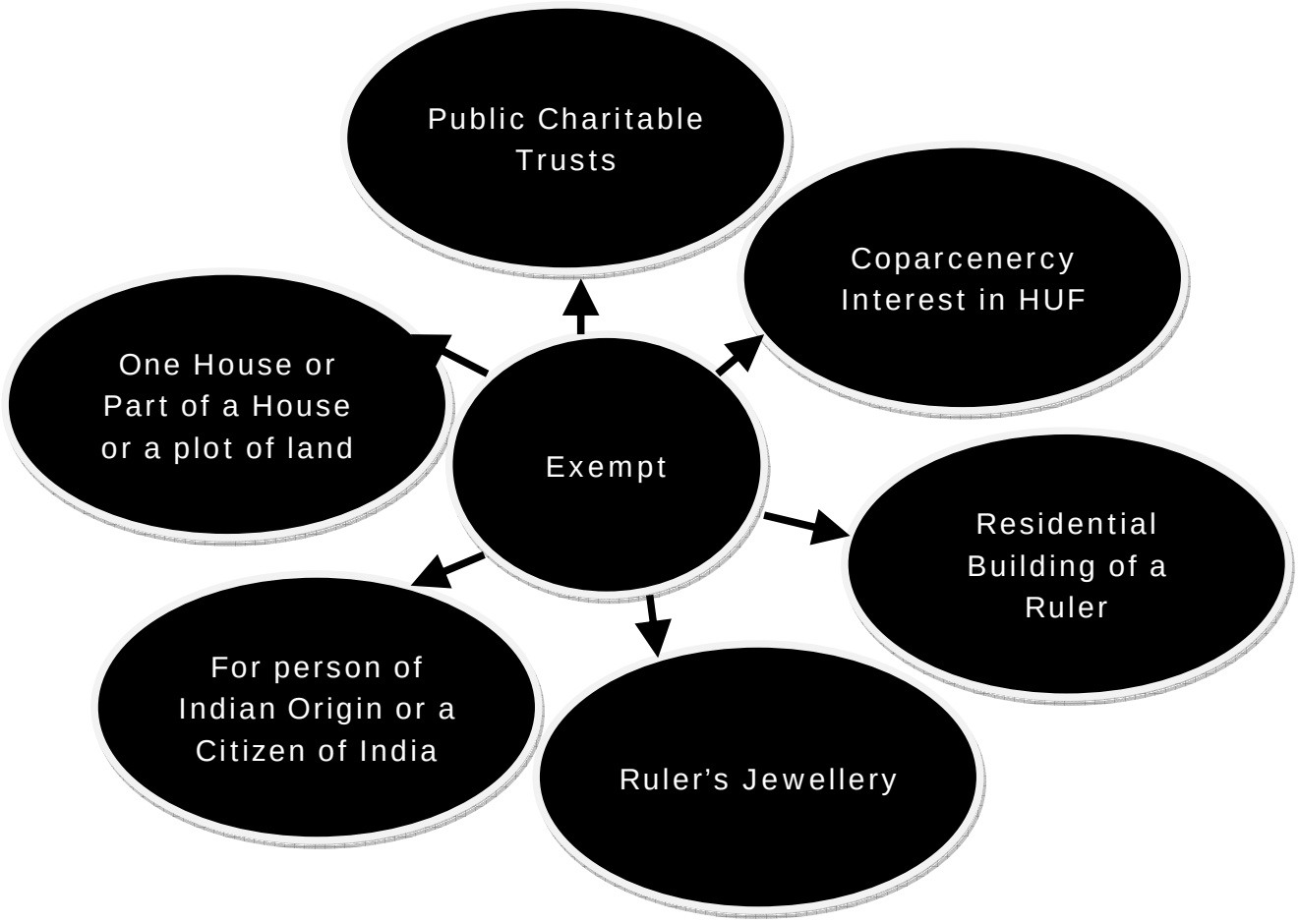
Public Charitable Trusts
Coparcenercy Interest in HUF
One House or Part of a House or a plot of land
Exempt
Residential Building of a Ruler
For person of Indian Origin or a Citizen of India
Ruler's Jewellery

DEBT OWED

Net wealth = total assets – allowable debts

Format of computation

Particulars	Asset Value	Debt	Net
1 Jew	12	10	2
2			
3			
4			
Total	XX	XX	XX

Deduction of Debts Owed by the Assessee on **Valuation Date and** which have been Incurred in relation to Chargeable Assets: The next step in computing the net wealth is to deduct the value of all debts owed by the assessee on valuation date and which have been incurred in relation to the chargeable assets

The deduction of such debts is allowed from the aggregate value of the chargeable assets, wherever located, belonging or deemed belonging to the assessee on the valuation date.

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

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)

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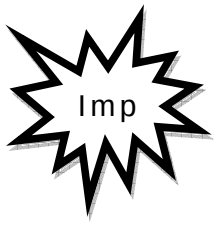
Family settlement



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)

GENERAL PRINCIPAL OF DEBT OWED

It should be a debt.

The expression "debt" signifies a sum of money which is now payable or will become payable in future by reason of present obligation (Keshoram Industries & Cotton Mills Ltd *v.* CWT (1996) 59 ITR 67 (SC). For example, a loan is taken on 15 June 2008, repayable after 3 years. On valuation date 31 March 2009, it is debt because an obligation to pay has been incurred on or before valuation date though the debt is payable after the valuation date.

Debt to be owed by the assessee.

It should be debt owed by the assessee, that is, it should be enforceable against the assessee. If the debt is not enforceable against the assessee, no deduction can be allowed in respect of such debts. Take an example. Mr J owns a residential house. Mrs J borrows Rs 50,000 from her relatives to renovate/repair the house. Mr J cannot claim the deduction of Rs 50,000 because the debts is not enforceable against him. Similarly, where Mrs J purchases a motor car out of borrowed money in the name of her husband, J cannot claim the deducti. 'ii of such debt in computing his net wealth.

Debt to be outstanding on valuation date.

The debt, owed by the assessee, should be outstanding on valuation date. If it has been paid on or before valuation date, no deduction is allowed for such debts.

Purpose ot the debt.

The debt, owed by the assessee and outstanding on valuation date, should be incui red in relation to the chargeable assets which have been included in the net wealth of the assessee. Thus, each and every kind of debt, not relating to chargeable assets, is not deductible. For example, a loan taken to purchase shares or loan taken to acquire plant or machinery is not to be deducted, as the shares and plant and machinery are not "assets" under Sec. 2(ea). Similarly where a loan is taken to acquire an exempted asset under Sec. 5, it is not deductible. For example, loan is taken on the security of jewellery. The loan is applied to acquire residential house which is exempt under Sec. 5(vi). Such loan is not to be deducted in computing net wealth because it is applied to acquire an exempted asset. It cannot be deducted on the ground that it has been taken on the security of jewellery which is an asset under Sec. 2(ea). Where a loan is taken to purchase a motor car or jewellery or a residential house, such debt is deductible as the said properties are "assets". Where a loan is taken on the security of the residential house to meet the marriage expenses or to meet the medical expenses of the assessee, such debt cannot be deducted because the purpose of the borrowing is not to acquire any chargeable asset.

If a loan is taken on the security of jewellery to purchase a motor car for personal use, such loan is to be deducted as it is incurred in relation to chargeable assets.

Deduction of debt vs. Value of assets.

Where a debt is incurred in relation to the chargeable asset and the debt is outstanding on the valuation date, such debt is deductible in computing the net wealth. There is no nexus between the value of the assets and the amount of the debt to be deducted. The value of the asset is to be determined under Schedule III which at times may be less than the amount of debt incurred in

relation to be said chargeable asset. Such debt has to be deducted in full. Take an example: Mr J borrows Rs 2,00,000 to purchase a motor car. The motor car is valued under Rule 20/21 at the market value on the valuation date. The market value is Rs 1,50,000. In computing net wealth the deduction of outstanding debt together with accrued interest, on valuation date is deducted. Thus, if the amount of outstanding debt plus accrued interest is Rs 2,50,000 deduction is allowed for such debt though the value of asset to be included in net wealth is Rs 1,50,000.

Location of debt.

Debt is to be deducted if it is owed by the assessee on valuation date and it is incurred to acquire chargeable asset. For example, loan is taken outside India to acquire taxable asset in India; such loan is deductible in computing net wealth in India.

Time-barred debt.

A time-barred debt is not enforceable against the debtor, Therefore, the debtor cannot claim it as a deduction even if the debt has been incurred in relation to the chargeable asset. However, if the debtor does not take shelter under the law of limitation and agrees to pay a time-barred debt, he can claim deduction in respect of such debt. The rule of "no consideration, no contract" under Sec. 25 for the Indian Contract Act, does not apply to such a case.

Debt payable by instalments.

Where a debt relating to chargeable asset, is payable by instalments, the discounted net value of the outstanding instalments, falling due after valuation date, is to be deducted. Thus, the deduction is not to be allowed for gross amount of future instalments but present values of future instalment.

Accrued interest.

Where a debt is incurred relating to chargeable assets, the outstanding interest on the debt till valuation date is also to be deducted even if the assessee follows cash system of accounting.

Current year wealth-tax liability.

Current year wealth-tax liability is a debt relating to chargeable asset. It is also owed by the assessee on valuation date but it is not a debt "incurred" by him. The word 'incurred' means voluntarily incurred. Wealth tax is a tax imposed on the assessee by the statute. Hence, current year wealth-tax liability is not to be deducted in computing net wealth (Circular No. 663 Dt. 28.09.1993).

Transferee's debt [Sec. 4(3)(a)].

Any debt incurred by the transferee relating to deemed assets under Sec. 4 neither can be allowed to the transferor nor to the transferee. The transferor cannot be allowed the deduction because the debt is not owed by him. The debt is owed by the transferee but no deduction can be allowed to him because the deemed asset is not taxable in the hands of transferee. Deemed asset is included in the net wealth of the transferor.

Advance for sale of property is a debt.

Where an assessee agrees to sell a property, receives part consideration and gives possession of the property, the property is still owned by the assessee, since he continues to have title over the same and has to be included in the wealth of the assessee notwithstanding the deeming provision of

presuming sale for purposes of computation of income from property and capital gains. The question that arose in CWT v. Bajoria Properties Pvt. Ltd. [2002] 258 ITR 29 (Cal) was whether the amount received as part consideration for the agreement of sale could be treated as debt in relation to property, so as to require deduction of the same as a liability incurred in relation to the included wealth in computation of taxable wealth. The High Court pointed out that the payment received would be a charge on the property within the meaning of section 55 of the Transfer of Property Act, so that it has necessarily to be treated as debt incurred in relation to that asset and allowed as a deduction.

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SOME ILLUSTRATIVE CASES OF ASSET

Particulars of assets	*Whether asset on valuation date*
1. Farm house situated within 25 km from Delhi Cantonment Board.	Yes
2. Farm house situated within 25.01 km from Delhi Municipal Corporation but within 1 km from Gurgaon Municipality.	Yes
3. Farm house under construction on land situated within 8.01 km from Kolkata Municipal Corporation.	Farm house not an asset as it is under construction. Land is not an asset as it is not urban land.
4. A residential house allotted by a foreign company in India to its resident manager, whose annual gross salary is Rs 4,99,999.	No
5. A residential house allotted by a firm in India to its accountant whose annual gross salary is Rs 4,99,999.	Yes However, firm is not an assessee.
6. A residential house allotted by a private company in India to its part-time permanent accountant whose annual gross salary is Rs 2,00,000.	Yes
7. A residential house allotted by a public company in India to its whole-time director, whose net annual salary after deducting contributions to provident fund (Rs 75,000) is Rs 4,24,999.	No
8. Motor car used for transporting employees.	Yes
9. Motor truck owned by an Indian company, used for transporting its raw material and finished products.	No
10. A residential house under construction on a land purchased in Surat on 15 July 2006 but completed on 25 August 2007.	Urban land is an asset but incomplete house is not an asset.
11. Guest house held as stock-in-trade for the last 5 years.	No
12. Factory building/godown and office building occupied by the assessee for his business purpose.	No
13. Godown building let out on rent.	No
14. Residential house held as stock-in-trade.	No
15. Urban land held as stock-in-trade since 31 March 1997.	Yes
16. Commercial complex let out on rent.	No
17. Residential house let out on rent for 299 days.	Yes
18. Aircraft used by the company for its senior executive.	No
19. 10 kg of gold, held bv an individual.	Yes

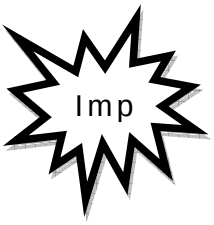
20. 10 kg of gold held bv Krishna Jewellers.	No
21. Gold/silver utensil, held by an HUF.	Yes
22 Gold, silver utensil held by a jeweller.	No
23. Urban land on which building is constructed without the approval of the competent authority.	Yes
24. Agriculture land in Delhi on which construction is not permissible.	No
25. Urban land purchased on 1 March 2005 for constructing factory, lying vacant on 31 March 2007.	Yes
26. Building site purchased in 1996 within the jurisdiction of a municipality having a population of 9,999. Construction on land is permissible. However, it is lying vacant.	No
27. Opening cash book balance of J on 31 March 2007 is Rs 5,25,000. However, he has deposited Rs 4,75,000 into bank before close of banking hours.	No Cash balance not exceeding Rs 50,000
28. Closing cash book balance of J Ltd. on 31 March 2007 is Rs 15,00,000. A customer has paid Rs 35,000 cash on 31 March 2007 after the closing balance and it is recorded in cash book on 1 April 2007.	Unrecorded cash of Rs 35,000 is an asset.

VALUATION OF ASSETS

(Part B schedule III)

Valuation of immovable property being Building or LA

	Actual Rent Received (6 months, say)	X
	Actual Rent Receivable (12 months)	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.	
	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. 2,4)	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. (Note 4)

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

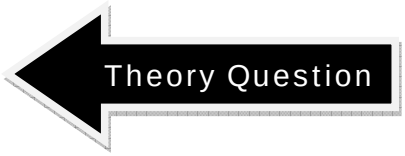
1) The property is constructed on land obtained on lease from the Government or a Local/Housing Authority
2) The Government /authority is entitled to recover a specified part of the unearned increase in value of the land, at the time of transfer of the property.

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.

Rule 8. -- Rule 3 not to apply in certain cases (NOTE 4)



(a) where, having regard to the facts and circumstances of the case, the Assessing Officer, with the previous approval of the Deputy Commissioner, is of opinion that it is not practicable to apply the provisions of the said rule to such a case ; or

(b) where the difference between the unbuilt area and the specified area exceeds twenty per cent. of the aggregate area ; or

(c) where the property is constructed on leasehold land and the lease expires within a period not exceeding fifteen years from the relevant valuation date and the deed of lease does not give an option to the lessee for the renewal of the lease

and in any case referred to in clause (a) or clause (b) or clause (c), the value of the property shall be determined in the manner laid down in rule 20 i.e. FMV is to be adopted.

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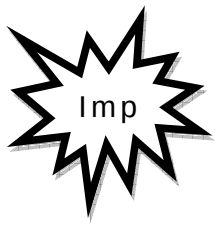
(Part D schedule III)

ASSETS OF BUSINESS (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:

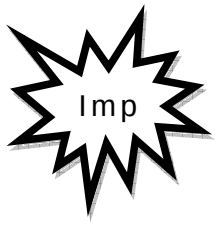
Assets	**Value to be taken**
Depreciable assets	Written down value
Non-depreciable assets (other than stock-in-trade)	Book value
Closing stock	Value adopted for the purpose of income tax.

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.

(Part E schedule III)

INTEREST IN FIRM OR AOP (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.

(Part F schedule III)

VALUATION OF LIFE INTEREST (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.

APPENDIX (See rule 17)

1 / (P + D) - 1

Age nearer birthday	Premium for unit sum assured	Value of life interest of rupee 1 per annum at 6 % rate of interest
(1)	(2)	(3)
0	0.02906	10.100
1	0.01590	11.999
2	0.01295	12.517
3	0.01162	12.765
4	0.01095	12.893
5	0.01065	12.951
6	0.01058	12.965
7	0.01063	12.955
8	0.01076	12.930
9	0.01095	12.893
10	0.01117	12.850
11	0.01142	12.803
12	0.01169	12.751
13	0.01197	12.699
14	0.01226	12.644
15	0.01257	12.587
16	0.01286	12.534
17	0.01319	12.473
18	0.01350	12.417
19	0.01387	12.351
20	0.01431	12.273
21	0.01469	12.207
22	0.01512	12.132
23	0.01556	12.057
24	0.01606	11.972
25	0.01656	11.888

26	0.01706	11.806
27	0.01762	11.715
28	0.01825	11.614
29	0.01894	11.505
30	0.01962	11.399
31	0.02037	11.285
32	0.02112	11.173
33	0.02194	11.053
34	0.02281	10.927
35	0.02369	10.804
36	0.02462	10.675
37	0.02562	10.541
38	0.02669	10.400
39	0.02787	10.249
40	0.02912	10.093
41	0.03044	9.932
42	0.03181	9.771
43	0.03325	9.607
44	0.03475	9.441
45	0.03637	9.267
46	0.03806	9.092
47	0.03987	8.911
48	0.04181	8.724
49	0.04387	8.533
50	0.04612	8.333
51	0.04850	8.130
52	0.05100	7.926
53	0.05362	7.722
54	0.05637	7.518
55	0.05931	7.310
56	0.06244	7.099
57	0.06575	6.888
58	0.06925	6.676
59	0.07294	6.464
60	0.07681	6.255
61	0.08167	6.008
62	0.08589	5.806
63	0.09025	5.610
64	0.09475	5.419
65	0.09938	5.234
66	0.10415	5.054
67	0.10907	4.879
68	0.11414	4.709
69	0.11938	4.543

70	0.12483	4.380
71	0.13054	4.220
72	0.13652	4.062
73	0.14278	3.907
74	0.14936	3.753
75	0.15627	3.602
76	0.16356	3.453
77	0.17125	3.305
78	0.17937	3.160
79	0.18796	3.016
80	0.19706	2.875

(Part G schedule III)

VALUATION OF JEWELLERY (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

Theory Question

	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.

RULE 19 ADJUSTMENT FOR SUBSEQUENT 4 A.Y.

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:

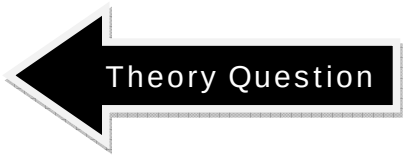
Theory Question

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

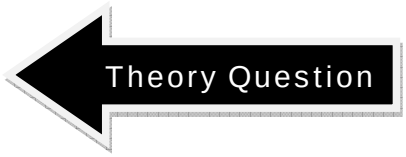
The Chief Commissioner or Director-General shall maintain a register to be called the Register of Valuers in which shall be entered the names and addresses of persons registered as valuers. Any person who possesses the qualifications prescribed in this behalf may apply to the Chief Commissioner or Director-General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

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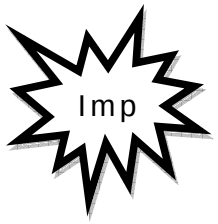
(Part H schedule III)

RESIDUARY RULES (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.

Concept of price and open market:

The expression "the price it would fetch" means the gross price as paid by the purchaser and not the amount which the seller would ultimately receive after deduction of incidental expenses in effecting the sale, for example, advertising, commission, legal fees, etc.

The expression "open market" means a market to which everybody has free access to come in and make an offer. A black market is not an 'open market' and the prices prevalent in such market cannot be taken into account.

Price controlled by law:

Where prices are controlled under any law in respect of some properties, the prices fixed by the legislature should be taken into account. Both the purchaser and the seller are equally bound by the law of the land.

Procedure to be followed:

Valuation is an art and not an exact science. Mathematical certainty is not demanded, nor indeed, is it possible. While estimating the price which an asset would fetch if sold in the open market on the valuation date, the Assessing Officer is required to estimate the price that a willing buyer would pay. The power conferred on the Assessing Officer is a judicial power and has to be exercised judiciously and not in arbitrary manner according to whims and surmises. He should not over-value an asset and must take into account all the relevant factors while estimating the price. He is bound to consider the value declared by the assessee and if he rejects it, he has to give reasons and background for his conclusions. The opinion of the Assessing Officer is neither sacred nor binding. It is open to review in appeal by the Commissioner (Appeals) (under Sec. 23) and thereafter by the Tribunal (under Sec. 24).

PART - B

BUSINESS INCOME

BUSINESS OR PROFESSION

Profits and gains of business or profession are required to be computed in accordance with the method of accounting regularly followed by the assessee [Sec. 145], However, some outlays are allowed to be deducted on actual payment basis even if the assessee follows mercantile system of accounting [Sec. 43B]. In certain cases, scheme of presumptive computation has been devised to dispense with the requirements of compulsory audit and maintenance of accounts Thus, if the assessee follows cash system of accounting, profits be computed on receipts basis, while in mercantile system, it should be computed on accrual basis.

Revenue computation normally does not allow capital outlays. However, some special provisions have been enacted to amortise capital outlays to arrive at taxable profits [Sec. 35ABB, 35D, etc.]. Scheme of depreciation also helps to amortise capital cost of the assets used for the purpose of business profession [Sec. 32].

Certain deeming provisions and some deemed incomes also play, their defined role to swell the gamut of taxable profits [Sec. 41 and Sec. 68 to 69D].

Special provisions have been enacted to regulate certain deductions in the computation of taxable profits [Sec. 30 to 35, Sec. 36, Sec. 40 and Sec. 40A]. It is impossible to legislate for each and every item of business expenditure. Hence, an assessee is allowed to claim residuary deductions under the umbrella of commercial expediency under Sec. 37(1).

The scheme of computation of taxable profits and gains of business or profession is proposed to be discussed in this chapter.

Profits of each business need not be computed separately.

If one and the same business is carried on at a number of places, there is only one business. Net profits of the business have to be ascertained by aggregating the profits earned in all the branches and deducting them from all the allowable expenses. If more than one business is carried on by the assessee, profits of each business must be computed separately [South India *v.* CIT 3 ITR 11].

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.

Systematic and Organised Activity.

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 [Barandra Prashad Ray *v.* ITD (1981) 129 ITR 295 (SC)].
The expression "business" though extensively used, is a word of indefinite import. In taxing statues it is used in the sense of an occupation or profession, which occupies time, attention and labour of a person, normally with the object of making a profit [State of Andhra Pradesh *v.* H. Abdul Bakshi and Bros. (1964) 15 STC 644(SC)]. To regard an activity as business, there must be a course of dealings, either actually continued or contemplated to be continued with a profit motive, and not for sport as a pleasure [CVT V.K. Vijay Kumar (2000) 243 ITR 271 (Mad.)].

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 literal 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 if 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)

Profits Motive not Essential.

Though the element of profit is generally present in "business" but the motive of making profit or actual earning or profit is not an essential ingredient of business. For instance, mutual concerns and societies carry on business though not with a profit motive. Business includes Trade, Commerce. Trade implies buying goods and selling them to make profit. If such transactions are done on a large scale, it is called commerce. Nobody can define the volume of business, which would convert a trade into commerce. But everybody understands the distinction between the two with sufficient vagueness [Sri Gajalakshmi Ginning Factory Ltd. v. CIT (1952) 22 ITR 502 (Mad.)].

"Business" is not merely confined to purchase and sale of articles or goods. It may consist of rendering services to others, i.e. communication service (i.e. telephone, telegraph, etc.) or transport (i.e. railways, bus, and aeroplane, etc.). There is no anti-thesis between service and business. Business includes Manufacture. Manufacture involves the bringing into existence of a new product, which may have a different physical or chemical composition and is understood differently in common and

commercial parlance [CIT v. Best Chem and Limestone Industries Pvt. Ltd. (1994) 210 ITR 883 (Raj)]. "Manufacture" implies a change but every change is not "manufacture".
It is only when the change, or a series of changes take the commodity to the point where commercially it can no longer be regarded as the original commodity but instead it is recognised as a new and distinct article, having its own name, identity character and end use [CIT v. Oceanic products Exporting Co. (1996) 219 ITR 293 (Ker.); Assistant CIT v. Soni Photo Films P. Ltd. (2000) 245 ITR (AT) II (Del.) (AT)].
The principles are clear, but difficulties arise in their application in individual cases. There might be borderline cases where either conclusion with equal justification may be reached [CIT *v.* Kanam latex Industries (P) Ltd. (1993) 203 ITR 542 (Ker.)].

Intention to resell

When the purchase is made solely with an intention to resell at a profit and purchaser has no intention of holding the property for himself, the transaction is an adventure in the nature of trade. Where the purchase of any article is made without an intention to sell at a profit, a resale under changed circumstances is only a realisation of capital investment and does not stamp the transaction with a business character.

Transaction relating to business

If a transaction is related to the business which is normally carried on by an assessee, though not directly part of it, it may be inferred that the transaction is an adventure in the nature of trade. For example, Mr X is a cotton merchant. During a crisis in the cotton market, he is appointed under the power of attorney to wind up the affairs of a cotton firm and to dispose of the cotton bales and distribute the sale proceeds. The commission that he receives is taxable as business profits,

The quantity of the commodity purchased

Where the transaction is unrelated to business, which is normally carried on by an assessee, the quantity purchased and sold may throw some light on the nature of the transaction. If the quantity purchased is quite large which cannot be consumed by an assessee and his family in a reasonable time, and it does not give him any pride or possession, such transaction may be inferred as an adventure in the nature of trade.

Where the purchased property undergoes alteration and then sold

Where a commodity is purchased, altered, repaired or converted into a different property and then sold, it may be readily inferred that the transaction is an adventure in the nature of trade.

number of operations

If the operations are repeated, the transaction may be regarded as an adventure in the nature of trade. For instance, Mr S, a partner in the firm of ship brokers, entered into contracts for the purchase of ships in his own name and thereafter turned over those contracts to the client of his firm; profits from such contracts are assessable as income from business.

Other considerations

The nature of the commodity, the subsequent dealings of the assessee, the nature of the organisation employed by the assessee and the manner of disposal may be such that the transaction mav be stamped with the character of a trading venture.

Concern in the nature of a trade

A concern in the nature of trade, commerce, or manufacture also falls within the definition of "business". A concern in the nature of trade implies that it has an adequate degree of business organisation for the purpose of carrying on an undertaking. The size of organisation must necessarily depend upon the character of the concern itself.

Land ventures

Developing land and selling it in bits: where a person acquires land with a view to selling it later after developing it, he is carrying on an activity to be described as a business venture. Where the person goes further and develops the land into plots, develops the area, and deals with the land as stock-in-trade, he is carrying on business and making profits [Raja J. Rameshwar Rao *v.* CIT (1961) 42 ITR179 (SC)].

If a person invests money in land intending to hold it, enjoys its income for sometime, and then sells it at a profit, it would be a clear case of capital accretion and not profit derived from an adventure in the nature of trade [G. Venkataswami Naidu & Co. *v.* CIT (1959) 35 ITR 594 (SC)]. Where the assessee company purchased large areas of land and buildings from the government with borrowed funds, interest on which was much higher than the income from the said properties, and sold part of the said properties within a short time of their purchase, it was held that the purchase and sale of properties was an adventure in the nature of trade and was in the course of a profit-making scheme [Khan Bahadur, Ahmed Alladin & sons *v.* CIT 60 ITR 573 (SC)]. Thus, where initial intention is to make profit by resale, transaction is a business venture.

Shares dealings

The surplus realised on sale of shares would be capital if the assessee is an ordinary investor realising his holdings but it would be revenue, if he deals with them as an adventure in the nature of trade [Raja Bahadur Kamakhya Narian Singh *v.* CIT (1970) 77 ITR 253 (SC)].

Bullion dealings

Where the assessee purchased silver bar at the beginning of the war and not with an intention to make investments but in expectation of rise in the price of silver and sold them when the war had come to an end, the profit from the sale of gold and silver was held to be a revenue receipt [Tribhuvandas Vallabhodas *v.* CIT (1960) 61ITR 518 (Bom.)].

Decrees/claims acquired in money lending business

Purchase of money-decrees and realisation of monev therefrom by a money-lender, is an adventure in the nature of trade, since money decree is not an asset which one would acquire for keeping it for his employment [Rukmam Co. (P) Ltd. *v.* CIT (1964) 92 ITR 599 (Mad.)].

Purchase of a claim, pending arbitration

Where the assessee took over claims from the party against a company in respect of which arbitration suit was pending, and on settlement of the claim made a profit, the profit was held assessable as

income accruing from an adventure in the nature of trade [CIT *v.* Himalayan Files & Marbles (P) Ltd. (1991) 188 ITR 293 (Bom.)].

Leasehold dealings

Dealings in real property, activity of taking a property on lease, setting up a market thereon and letting out the shops and stalls in the market as a part of trading operations would fit within the meaning "business" [S. G. Mercantile Co. (P) Ltd. *v.* CIT 83 ITR 700 (SC)].

Forest leasing

Leasing out of forest to contractors and recovering royalty from them can be in the nature of business activity under Sec. 28 [CIT *v.* Khairagarh Timber Traders (1982) 137 ITR 346 (MP)].

Stock broker

A stock-broker is not engaged in the practice of profession. The real job of the stock-broker is to make arrangement for sale of the share or securities to others. Such activity clearly fills within the expression "business" and not " profession" [CIT *v.* Lallubhai Nagardes & Sons. (1993) 204 ITR 93 (Bom.)].

Scope of : 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)

Capital Receipts not Chargeable.

Capital receipts are outside the purview of this clause unless specifically required to be included by the statutes. Take an example. The supplier of bottles received compensation from an American company for destroying empty bottles of Coca-cola and Fanta as the Government refused permission for bottling agreement. The A.O. did not tax the amount of compensation. The CIT revised the Order under Sec. 263 and taxed it. Held, the empty bottle being a capital asset, the compensation received for their distruction was a capital receipt [CIT *v.* Soft Beverages P.Ltd. (2001) 249 ITR 552 (Mad.)].

Chargeability of Revenue Receipts.

In order to be chargeable, the receipts must be of revenue nature either by way of sales or consultancy fees or in some other form. Receipts should be a part of consideration for goods or services. It should not be a capital receipt or a returnable deposit. Thus, where a manufacturer of soft drinks receives deposits from customers for safe return of empty bottles, such deposits cannot give rise to business income because such deposits are returnable after the bottles have been returned. Such deposits are not part of sales consideration [CIT *v.* Madurai Soft Drinks (P) Ltd. (2000) 241 ITR (Mad.)].

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PROFESSION AND VOCATION

Meaning of profession

A vocation, as normally understood, is a calling in which a person passes his life. It may even be stated to a way of living or a sphere of activity for which one has a special fitness, though it is not necessary that the activity should be indulged in for the purposes of livelihood [K. Ramaswami Gounder *v.* CIT (1987) 163 ITR 94 (Mad.)]. Social work and preaching religion may amount to vocation. Teaching is a vocation if not a profession, a teaching of vendents even as a matter of religion amounts to carrying on a vocation [P. Krishna Mohan *v.* CIT (1959) 35 ITR 48 (SC)]. Profession vs. Occupation. Profession has to be distinguished from occupation, which tantamount to "business", viz., an occupation which substantially is the arrangement for sale of goods.

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 entailed 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 Dhwani". 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.

Distinction between Business, Profession is of no Importance.

Distinction between business, profession and vocation is of no importance in the computation of taxable income. What does not amount to "profession" may amount to "business", and what does not amount to "business" may amount to vocation. The Act treats them on an equal footing and the charging provisions for computing taxable income are the same for all of them.

BUSINESS OR HOUSE PROPERTY

Standard / municipal rent vs. Actual rent

In CIT v. Sarabhai (P.) Ltd. [2009] 176 Taxman 6 (Guj.), there was no fixation of standard rent by any competent Court under the rent control legislation and, thus, annual letting value was finally determined on basis of actual rent received by assessees and not on basis of gross rental value determined by Small Causes Court for municipal tax purpose. The Gujarat High Court held that the assessment of a property for municipal taxation purpose by a local authority would stand on altogether different aspects and, thus, municipal valuation is also irrelevant. Even it was found that standard rent fixed under Rent Control Legislation would lack any significance since there is a fetter or restriction over the enforceable right with the landlord to recover the rent exceeding the standard rent. However, only in case the standard rent exceeds the actual rent, shall it provide any significance since higher of the two would be the key.

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.

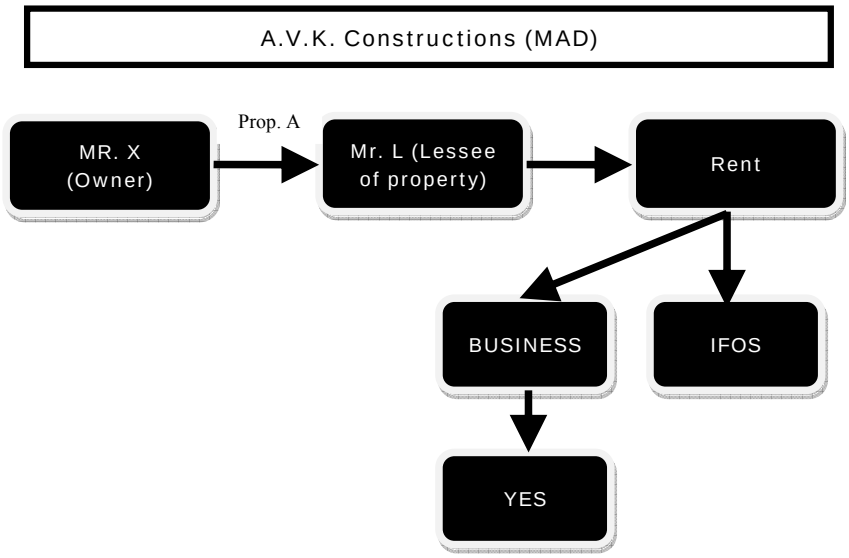
Company was formed for developing landed properties and markets. Income from letting of stalls and shops in market was income from house property. The character of that income was not altered because it was received by a company formed with the object of developing and setting up markets. Nor because 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)

Income from sub-letting

Income from sub-lease is also income from investment, where the assessee is content to derive rental income. But then, the further question is, where it could not be assessed as business income, whether it would be income from property or income from other sources. Income from the property put up on leased land would be assessable as property income. Definition of owner under section 27 of the Income-tax Act extends the meaning of ownership to lease, but excludes monthly tenancy and lease for a period less than 12 years vide section 27(iiib) read with section 269UA(f). Though the computation provision under section 24 for property does not recognise deduction for lease rent, the

annual value of the property in the hands of such lessee cannot ignore the over-riding claim of lessor, since the lease rent payable gets diverted at source. At any rate, the lessee is not the full owner, so that the lessor and the lessee can only be assessed on their respective income.

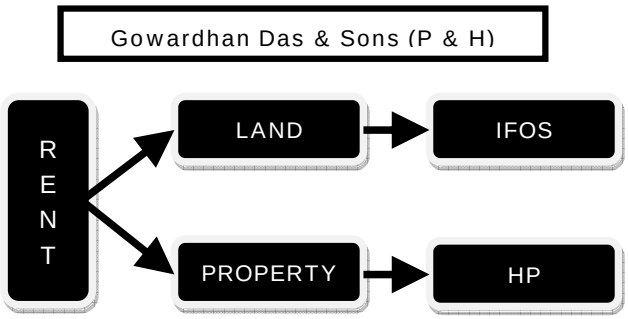


An issue that came up for consideration was whether income from sub-lease could be treated as income from property. It was held in CIT v. A.V.K. Constructions P. Ltd. [2007] 292 ITR 512 (Mad), that the assessee cannot be treated as the owner, since sub-lease was on monthly payment of rent for period, which could be extended only for two more years. The issue, however, related to the assessment of sub-lease income in the hands of the assessee-company as lessor. On the finding that the lease itself was not for period of twelve years, the High Court had little difficulty in coming to the conclusion that the income cannot be assessed as property income. But the finding of the Assessing Officer that was approved by the Tribunal was that its income should be assessed as business income, while the correct inference would have been that it should be assessable as income from other sources, but that was not the point which was urged by the Revenue.

Where bare property is let out, such rent would be income from property. Where certain amenities are also provided against a composite receipt, it may be possible to dissect the composite receipt as between amounts relatable to property and amenities. The amount relating to the latter part may well be taxable under business or other sources, while the part relating to property is taxable only as property income as was held in Shambhu Investment P. Ltd. v. CIT [2003] 263 ITR 143 (SC). But where the provision of various amenities and services is predominant, the entire receipt may well be assessable as business income as in the case of commercial complexes, where it is not unusual for the service element to predominate. The High Court in A. R. Complex v. ITO [2007] 292 ITR 615 (Mad) remanded the case to be decided on the inference, that it is a service-cum-lease agreement, so that bifurcation is necessary as between rental receipts and service charges, with latter to be assessed under "Other sources" following its own earlier decision in CIT v. Chennai Properties and Investments Ltd. [2004] 266 ITR 685 (Mad). The remand order may well be vulnerable, if the service element represented the dominant part. It appears that the assessee wanted it to be treated as business income, only on the ground that it is exploiting a commercial asset and that at any rate, the fact that it was earning income from a commercial complex was itself enough justification for treating it as business income, while the Revenue would take the view that the entire amount would be property income, since no material was allegedly placed before the authorities. Provisions for common reception, telephone booth and generator were all that were noticed for urging the claim that the entire income was from business. It is under these circumstances, that bifurcation of amount as ordered by the High Court became unavoidable.

Treatment of income from land

House property has been defined under section 22 to include land appurtenant thereto. But where such land is put to use, not as part of the building to which it is contiguous, the income from such land could not be assessed as income from property. It could be assessed only under the head "Other sources" as was pointed out in Gowardhan Das and Sons v. CIT [2007] 288 ITR 481 (P&H). In coming to the conclusion, the High Court reviewed various dictionaries and law lexicons besides the view taken by the Madras High Court in M. Ramalakshmi Reddi v. CIT [1998] 232 ITR 281.

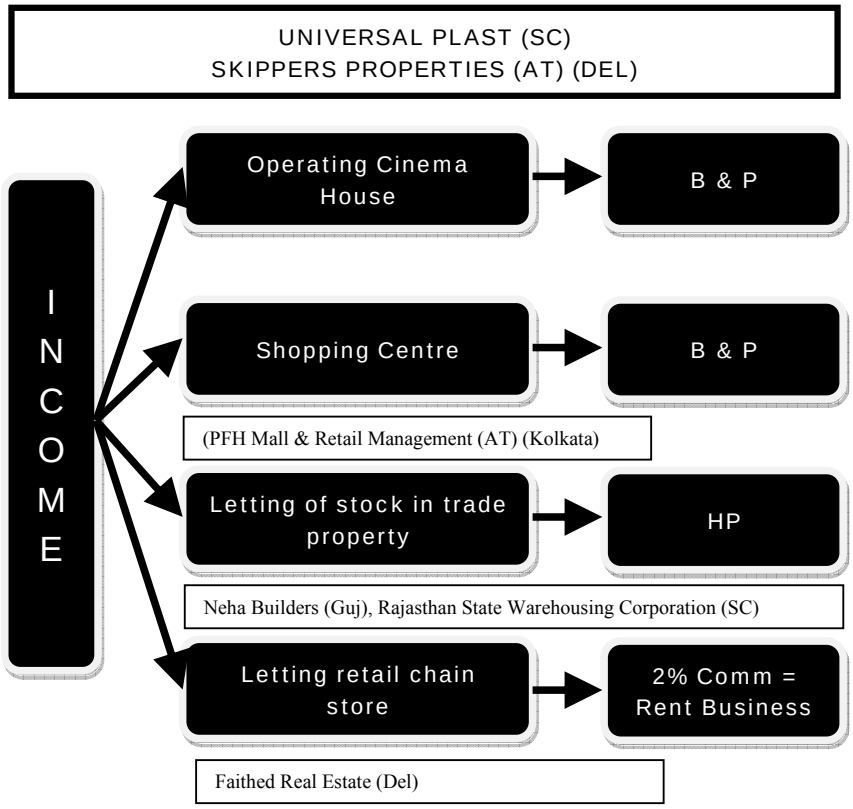


Lease rent is income from property

Where assessee received lease rent, such rent could be assessable as only income from the property as was held in Keyaram Hotels P. Ltd. v. Asst. CIT [2008] 300 ITR 118 (Mad). Rent from hotel, which was used for business, does not mean that the rental income could be business income. There was no commercial exploitation of the property by the assessee company. In coming to the conclusion that the income was assessable as property income, the High Court followed its own decision in CIT v. Chennai Properties and Investments Ltd. [2004] 266 ITR 685 (Mad).

Letting of cinema house / operating cinema house

Universal Plast Ltd. v. CIT [1999] 237 ITR 454 the Supreme Court laid down that : (1) no precise test can be laid down to ascertain whether income (referred to by whatever nomenclature, lease amount, rents, licence fee) received by an assessee from leasing or letting out of assets would fall under the head "Profits and gains of business or profession" ; (2) it is a mixed question of law and fact and has to be determined from the point of view of a businessman in that business on the facts and in the circumstances of each case, including true interpretation of the agreement under which the assets are let out ; (3) where all the assets of the business are let out, the period for which the assets are let out is a relevant factor to find out whether the intention of the assessee is to go out of business altogether or to come back and restart the same ; (4) if only a few of the business assets are let out temporarily while the assessee is carrying out his other business activities then it is a case of exploiting the business assets otherwise than employing them for his own use for making profit for that business ; but if the business never started or has started but ceased with no intention to be resumed, the assets also will cease to be business assets and the transaction will only be exploitation of property by an owner thereof, but not exploitation of business assets. In the instant case all the assets of the business owned by the assessee had been leased out. The period for which the assets were let out was a relevant factor. The period of lease was short. After leasing out the property the assessee had come back to its business and had restarted the same. Hence the income was assessable as business income. Universal Plast Ltd. v. CIT [1999] 237 ITR 454 (SC) applied. [2008] 298 ITR (A.T.) 0394- Income-tax Officer v. Skipper Properties P. Ltd. (Income-tax Appellate Tribunal--Delhi)



Operating shopping centre

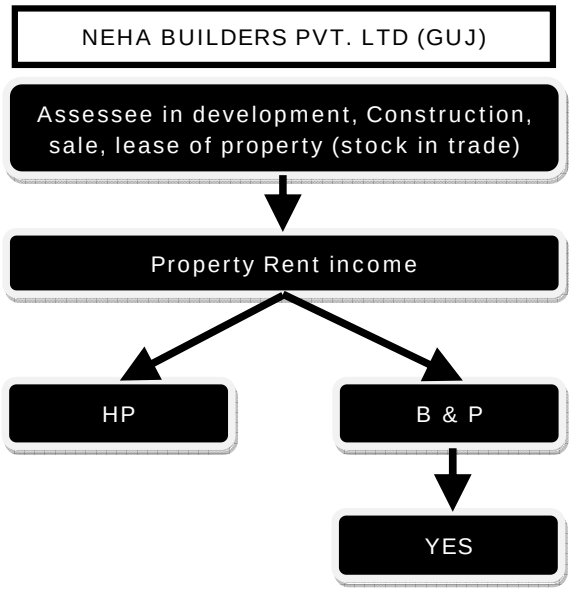
The issue whether income from a shopping centre could be treated as income from property was considered by the Tribunal in PFH Mall and Retail Management Ltd. v. ITO [2008] 298 ITR (AT) 371 (Kolkata) in the context of an appeal against the revisional order of Commissioner under section 263 favouring the view that it should have been assessed as income from property. The Tribunal found that the assessee was providing various services and facilities for the occupants by way of security system, cleaning and maintenance, lighting, lifts, escalators and elevators, management of parking space, provision for fire extinguishment, diesel generators and insurance of property, besides telephone and fax lines, computers and internet lines and similar other amenities. It is in this context

that the income from shopping malls or business centre, it was held, would be rightly assessable as business income.

In ITO v. Skipper Properties P. Ltd. [2008] 298 ITR (AT) 394 (Delhi), the income from lease of a theatre for a short period was claimed to be business income, because of the short period of lease with the assessee resuming possession of the theatre as its business shortly thereafter, so that it was held to be business income by the Tribunal following the decision of the Supreme Court in Universal Plast Ltd. v. CIT [1999] 237 ITR 454 and other precedents on the subject.

Letting of property held as stock in trade – business income

The question of classification of income as between different heads of income is one of the perennial sources of dispute, since the income under one head may be different from the income computed under a different head. One such dispute came up in CIT v. Neha Builders P. Ltd. [2008] 296 ITR 661 (Guj) in respect of income from letting out property in the case of an assessee, who is engaged in the business of development, construction, sale and lease of immovable property. In other words, the property was his stock-in-trade. The High Court overruling the decision of the Tribunal held that, since the property was stock-in-trade, the income from that part of property which was let out by the assessee, should be income from business. Since the property was stock-in-trade, the High Court ruled that "the Tribunal, in our considered opinion, was absolutely unjustified in comparing the rental income with the dividend income on the shares or interest income on the deposits. Even otherwise, the question was not raised before the subordinate Tribunals and, all of a sudden, the Tribunal started applying the analogy". The Tribunal's reference to the case of dividend from shares held as stock-in-trade was not based upon analogy but on adoption of the principle decided by the Supreme Court in CIT v. Rajendra Prasad Moody [1978] 115 ITR 519.



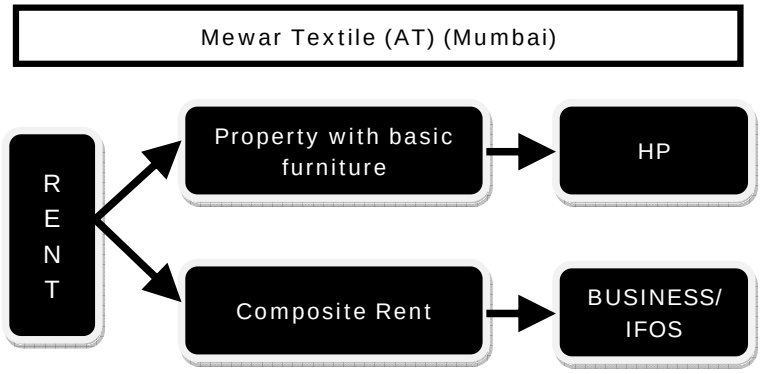
Where the assessee gets mere rent from the property, such income is assessable only as income from property, because of the schedular system of taxation and in the larger context of the meaning of business for classification as between heads of income. The High Court decision that it forms part of the assessee's business income in the wider sense cannot be faulted, but it is not so for computation of taxable income of the year. When interest on securities was a separate head of income, such income was found assessable under this head, even where securities were held as stock-in-trade in United Commercial Bank Ltd. v. CIT [1957] 32 ITR 688 (SC) and CIT v. Cocanada Radhaswami Bank Ltd. [1965] 57 ITR 306 (SC), though it was conceded that for purposes of set off of carried forward loss against such income, it was business income, since this rigid classification was applicable only for assessing the income of the year and not for set off purposes.

In a number of decisions on computation of income from property, it has been held that irrespective of the fact, whether the property was managed as part of the assessee's business or otherwise, the rental income is assessable only as income from property as held in Rajasthan State Warehousing Corporation v. CIT [2000] 242 ITR 450 (SC), where the property was merely let out on hire. Even where it is let out along with amenities for a consolidated amount, such amount could be split up as

between income from property and other sources as held in Shambhu Investment P. Ltd. v. CIT [2003] 263 ITR 143 (SC), so that the decision of the Tribunal accords with law and should not have been taken up by the Revenue to the High Court in the facts of the case and in the light of its own stand in other cases based upon its interpretation accepted by the courts.

Letting to group company

Where the assessee was letting out furnished accommodation to be used by its group companies on long term basis without any service, the income therefrom is assessable as income from property as was held by the Tribunal in Marwar Textiles (Agency) P. Ltd. v. ITO [2008] 307 ITR (AT) 19 (Mumbai) following, inter alia, the decision of the Supreme Court in Shambhu Investment P. Ltd. v. CIT [2003] 263 ITR 143. The claim that the accommodation was for running a business centre, was found to be factually incorrect and, therefore, it was not treated as business income.



263 ITR 0143- SHAMBHU INVESTMENT P. LTD. VS. CIT (SC)

The issue, whether a property can be exploited in a manner that its income may fall either wholly or partly under any other head arises from time to time. Where a service element is predominant with consideration being a lump sum one, income has sometimes been treated as business income, as for example in the case of a cold storage, or a fully equipped cinema theatre. There are instances, where the courts approved splitting up of the consideration as between property income and other sources. Where the element of hire rental is considered more important, the entire income may well be assessable as property income but the borderlines have been too thin and quite often the inference has not merely been one on the facts but one of perception.

In this case, the assessee had let out some portion of commercial space for use as table space with all facilities like security, power, water and other common amenities. The Assessing Officer had accepted the assessee's claim to treat the receipt as business income, often found to be of greater advantage to the taxpayer, because of the deduction for depreciation. The Commissioner of Income-tax acting under section 263 remanded the matter for fresh consideration. But his order was taken up in appeal to the Tribunal. The Tribunal found fault with the order of the Commissioner of Income-tax on the ground that there was no case for presuming that the order of the Assessing Officer was in any manner adverse to revenue. The court, after elaborate review of the case law, found that the agreement was one of tenancy and that the assessment of the income as business income was not correct on the basis of the finding that the primary intention to let out the premises was to get rent.

Question

The assessee owned an immovable property. It occupied a portion of the property and let out the rest to be used as table space to occupants, with furniture and fixtures and lights and air-conditioners. The assessee provided services like watch and ward staff, electricity and water and other common amenities. The monthly rent payable was inclusive of all charges. The assessee had also recovered by way of security from the occupants a sum of Rs. 4,25,000. The officer is of the opinion that income

from the property was assessable in the hands of assessee as income from house property. You are required to answer whether view of the officer is justified or not.

Answer

Merely because the landlord provides certain amenities like air-conditioning, telephone, water coolers, canteen services, furniture and fixtures, income from property does not cease to be such income assessable as property income. The decision of the Tribunal favoured bifurcation of the receipt as between rent taxable as income from property and service charge taxable as income from business. But the High Court held that it should not be so bifurcated in CIT v. Sarabhai Pvt. Ltd. [2003] 263 ITR 197 (Guj) after review of case law on the subject, where amenities were ordinarily required to be met by the tenant, the cost of the amenities should be taken as the tenant's burden so as to reduce the same from the rental receipts to arrive at annual value, so that the net annual value should be assessable as income from property. The other view is to treat it as business income, where the service element is predominant. But in most of these cases, what is considered a better solution is to split up the consideration and to treat such split parts under the respective heads.

In case of [2003] 263 ITR 0143- SHAMBHU INVESTMENT P. LTD. VS. CIT (SC), the assessee had let out some portion of commercial space for use as table space with all facilities like security, power, water and other common amenities. The Assessing Officer had accepted the assessee's claim to treat the receipt as business income, often found to be of greater advantage to the taxpayer, because of the deduction for depreciation. The Commissioner of Income-tax acting under section 263 remanded the matter for fresh consideration. But his order was taken up in appeal to the Tribunal. The Tribunal found fault with the order of the Commissioner of Income-tax on the ground that there was no case for presuming that the order of the Assessing Officer was in any manner adverse to revenue. The court, after elaborate review of the case law, found that the agreement was one of tenancy and that the assessment of the income as business income was not correct on the basis of the finding that the primary intention to let out the premises was to get rent. Thus in view [2003] 263 ITR 0143- SHAMBHU INVESTMENT P. LTD. VS. CIT (SC), the income shall be assessable under the head house property.

265 ITR 0379- ACIT VS. SAPTARSHI SERVICES LTD. (GUJ)

The controversy as to whether income from a business centre should be treated as business or property income was resolved with reference to the facts in Asst. CIT v. Saptarshi Services Ltd. [2004] 265 ITR 379 (Guj), where it was found after review of the case law on the subject, that the income of a sub-lessee developing the property as a business centre and providing various services like provision of lift, services as those of receptionist besides secretarial services, data processing, conference room, etc. with many facilities, has necessarily to be assessed as business income. Special leave against this decision has also since been refused by the Supreme Court [2003] 264 ITR (St.) 36.

266 ITR 0685- COMMISSINER OF INCOME-TAX VS. CHENNAI PROPERTIES AND INVESTMENTS LTD. (MAD)

Section 22 of the Income-tax Act, 1961, does not refer to "house property" despite its caption. The language employed in the section shows that the income referred to therein is not necessarily income from houses. It is income from property "consisting of any building or lands appurtenant thereto of which the assessee is the owner". The word "building" is not confined in its scope only to dwelling

houses. The word "house" in association with other words also has many other meanings. But, a commercial building is not regarded as a house. That, however, would not take the income from such buildings out of the ambit of section 22. Though it is not clear from the context why the Act describes income from property as income from house property, the substantive provision of law which creates the charge and obligates the person who receives such income to have it assessed under that head does not confine its application only to house property, but extends to all buildings whether such building is used as a dwelling house or for other purposes.
The assessee-company owned two buildings. The Assessing Officer declined to assess that rental income under the head "Income from business" and assessed the same under the head "Income from property". Held that, it was clear that the assessee, as owner of the building, was only exploiting the property as owner by leasing out the same and realising income by way of rent. Such rental income was liable to be assessed under the head "Income from house property".

266 ITR 0106- SRI HANUMAN SUGAR AND INDUSTRIES LTD. VS. CIT (CAL)

Income from lease of property should ordinarily be property income. Where it is a composite lease of factory, it would be assessable as income from other sources. But in cases, where the business is merely suspended with the lease agreement itself providing an option to the assessee-company to determine the lease before the expiry of the period of lease, it could well be assessable as business income as held in Sri Hanuman Sugar and Industries Ltd. v. CIT [2004] 266 ITR 106 (Cal). This decision rendered after review of case law indicates that in such cases, what is relevant is the inference on the facts as to whether the assessee still carried on business, though temporarily suspended or whether the assessee had chosen finally to be content with the reward for the lease till such time as it is in a position to revive. The decision follows the principles well-established on the subject. Merely because what is let out is a commercial property, the lease income therefrom does not become business income. This proposition was reiterated without any precedents obviously because the proposition does not admit of any controversy in CIT v. Gambhir Mal Pandey P. Ltd. [2004] 266 ITR 274 (Raj).

277 ITR 0088- COMMISSIONER OF INCOME-TAX VS. SMT. SURESHINI MITTAL (ALLAHABAD HIGH COURT)

In CIT v. Smt. Sureshini Mittal [2005] 277 ITR 88 (All), the firm was deriving only rental income, but because hiring was of a cinema hall along with machinery, it was assessed as business income in the hands of the firm. The income even in the hands of a partner, who took over the business, was also returned as business income and it was found assessable as business income, because the agreement was a composite one for the theatre as well as the machinery with lease rent being in the nature of tenancy agreement terminable at three months' notice. The Tribunal upheld the claim of the assessee and the High Court endorsed the same. The claim of the Department in the context of the lease agreement covering equipment, furniture, etc. before the High Court, that it should be assessed as property income is not understandable. If it were not assessable as business income, the more appropriate head of income is "Other sources" in such cases.

Lease income should ordinarily be assessable under "other sources". But, where the amount received is a composite lease rent for property together with machinery in a lease of a theatre by a partnership firm, it could be business income, because the objective of the partnership was not only to hire

theatre, but also do business in partnership for exhibition of motion picture. This aspect of the decision is non-controversial, because the very definition of partnership under section 4 of the Indian Partnership Act, 1932 is that "it is the relationship between the persons who have agreed to share the profits of a business carried on by all or any of them acting for all".

271 ITR 0079- COMMISSIONER OF INCOME-TAX VS. T.V. SUNDARAM IYENGAR AND SONS LTD. (MADRAS HIGH COURT)

Where a property is used for assessee's business, there is no doubt that the income from such property, whether notional or otherwise, would be assessed only as business income and not as property income. It is on this reasoning, that where the assessee derives income from letting out property for its own employees or directors, such income has been understood as being assessable as business income as was done by the Full Bench of the Delhi High Court in CIT v. Modi Industries Ltd. [1994] 210 ITR 1. Where the assessee's property was being used by employees of a sister concern, a different inference would follow in that, such income could be assessed only as income from property, as held in CIT v. T. V. Sundaram Iyengar and Sons Ltd. [2004] 271 ITR 79 (Mad) distinguishing Modi Industries' case.

283 ITR 0162- COMMISSIONER OF INCOME-TAX VS. KOHINOOR TOBACCO PRODUCTS P. LTD. (MADHYA PRADESH HIGH COURT)

There is a mistaken view that income from commercial property should be assessable as business income and that income from residential properties alone should be assessable as income from property. Such a view was taken in CIT v. Kohinoor Tobacco Products P. Ltd. [2006] 283 ITR 162 (MP), where it was held that temporary letting out of property used normally for business, which was not intended to be closed down, will be assessable as business income. An assessee may have let out on hire properties as its business. But that does not mean that such income can be assessed as business income. This decision would need review, since even income from property held as stock-in-trade in real estate business pending sale of such property was held to be assessable as property income in CIT v. Chugandas and Co. [1965] 55 ITR 17 (SC).

BENEFIT OR PERQUISITE OF BUSINESS

250 ITR 0667- BOEING VS. COMMISSIONER OF INCOME-TAX (MADRAS HIGH COURT)

Where a dealer gets an incentive from manufacturer as incentive for additional effort, such gift being a benefit convertible into money, will it be business income taxable under the law? It was this issue which arose in Boeing v. CIT [2001] 250 ITR 667 (Mad), where it was answered that the income in kind, which was an Ambassador car in this case, was clearly income from business received as an incentive by way of additional reward for services. In the present case, the assessee was carrying on business and the profits and gains were subjected to tax. The amount was received from a manufacturer by way of incentive for achieving the target. The receipt was clearly a trading receipt.

Question

The assessee a dealer in cloth received Rs. 50,000 as cash equivalent of value of an ambassador car as a gift from a company under a gift scheme formulated in the company's centenary year for having purchased suiting worth more than Rs. 8 lakhs from the company. The assessee contended that the receipt was not income, but was a gift, and that the receipt was of a casual and non-recurring nature. The assessee's contention was rejected by the Income-tax Officer. You are required to state the correct tax treatment of of the said gift.

Answer

The incentive scheme was formulated by the manufacturer in connection with its centenary year. There would have been no occasion for the assessee to receive this amount had it not been a dealer for the manufacturer and had it not put in additional efforts. According to section 28(iv) of the Income-tax Act, 1961, the value of any benefit or perquisite, whether convertible into money or not, arising from the business or the exercise of a profession shall be treated as income chargeable to income-tax under the head "Profits and gains of business or profession". The amount received by the assessee was clearly a benefit which was convertible into money arising from its business and clearly constituted the profits and gains of business. Therefore, the value of the ambassador car received by the assessee as incentive for additional effort was not a casual and non-recurring receipt and was taxable.

262 ITR 0393- CIT VS. G.S.R. KRISHNAMURTHY (MAD)

The assessee was a film artiste. The Assessee's children received gifts from producers. Since there was ordinarily no reason why producers should have given gifts to the actor's children, the Assessing Officer assumed that these gifts were actually additional remuneration paid to the actor for his services over and above what was stipulated in the agreements. It would appear that this was a prima facie inference, which could have reasonably been drawn by the Assessing Officer. The assessee's case was that the assessee had accounted for the amount receivable by him as per contracts between himself and the producers. Gifts were given by cheques to the donees and gift-tax had been paid by the donors (producers), who had made the gifts. They have not claimed it as their cost of production, which they should have otherwise done. The Income-tax Department also did not question the gift, when they had made gift-tax assessments on the donors. It is in this context that the Tribunal found that the taxation of this amount in the hands of the assessee could not be justified. This case illustrates the principle that what is apparent is real. But in such cases, the burden of proof is on the

Revenue to show that what is apparent is not real on investigation as by examining the producers and the assessee himself, as to the circumstances in which the gifts were given to the children. Mere disbelief on the part of the Revenue as in this case, without any effort even without making the gift-tax assessments protective and by not making any enquiry in the assessments of the producers or by calling them as witnesses, was bound to fail. The Revenue has the duty to enquire into such cases and come to a right conclusion. Making an addition without such enquiry is probably a glaring instance of breach of such duty, since the prima facie inference in this case was a pointer to the need for such enquiry.

Question

The assessee was a film actor as also a film distributor. During the previous year he had entered into an agreement with producers of films and had received remuneration for acting in those films which were duly accounted for by him as also by the producers. The assessee's children had received gifts from those producers. The Assessing Officer took the view that there was a pattern of the assessee's children receiving gifts from the producers. He treated the amounts gifted to the children as additional remuneration of the assessee. The assessee is of the opinion that amounts gifted to the children by the producers were not to be treated as the assessee's income. You are required to discuss the correct position of law.

Answer

In case of [2003] 262 ITR 0393- Commissioner of Income-tax vs. G.S.R. Krishnamurthy (Madras High Court) the Tribunal had noted that the donors/producers had stated that the amounts in question were gifts and not part of the remuneration of the assessee. The donors did not claim as deduction, the gifts made to the assessee's children as business expenditure but suffered gift-tax on these gifts. The Department did not allow the gifted amounts as cost of production in the hands of the producers. The gifts made by the producers to the children of the assessee could not be construed as consideration received by the assessee for the professional service rendered by him.

263 ITR 0001- CIT VS. DINERS BUSINESS SERVICES PVT. LTD. (BOM)

The assessee had let out a portion of its commercial premises in Bombay and Hyderabad to its sister concern for which the assessee received non-interest bearing security deposit of Rs. 48,51,000 for the Bombay property and Rs. 4,50,000 for the Hyderabad property. The assessee also received annual rent for both the properties from the concern. The Assessing Officer held that the arrangement was a collusive arrangement between the two sister concerns and that the assessee had received lesser rent vis-a-vis the market rent from the concern. Consequently, the Assessing Officer held that 60 per cent. of the amount should be taxed as value of the benefit which accrued to the assessee. Accordingly, the Assessing Officer made an addition to the income of the assessee on this ground under section 28(iv). Held that the market rent determined by the Assessing Officer was arbitrary and found that the Assessing Officer had determined the market rent without discounting the amenities and facilities which existed in so-called comparable premises. Thus officer was not justified in making the addition under section 28(iv).

Question

The company X had let out a portion of its commercial premises in Bombay and Hyderabad to its sister concern for which the assessee received non-interest bearing security deposit. The assessee also received annual rent for both the properties from the concern. The Assessing Officer held that the arrangement was a collusive arrangement between the two sister concerns and that the assessee had received lesser rent vis-a-vis the market rent from the concern. Thus reasonable amount in opinion of the officer was chargeable to tax by virtue of 28(iv). You are required to answer whether

he is justified in so doing.

Answer

The facts of this case is similar to [2003] 263 ITR 0001- CIT VS. DINERS BUSINESS SERVICES PVT. LTD. (BOM) where the Commissioner (Appeals) had found that the market rent determined by the Assessing Officer was arbitrary and found that the Assessing Officer had determined the market rent without discounting the amenities and facilities which existed in so-called comparable premises. This finding had been confirmed by the Tribunal. This finding was a finding of fact. Thus the officer was not justified in for additions made by the Assessing Officer under section 28(iv).

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PRE-COMMENCEMENT INCOME / EXPENSES

Set up of business

A business is nothing more than a continuous course of activities and for commencement of business all the activities which go to make up the business need not be started simultaneously. As soon as an activity which is the essential activity in the course of carrying on the business is started, the business must be said to have commenced. A finding regarding the date when a business was set up is a finding of fact. Under section 3 of the Income-tax Act, 1961, it is the "setting up" of the business and not the "commencement" of the business that is to be considered. A business is commenced as soon as an essential activity of that business is started. Thus, a business commences with the first purchase of stock-in-trade, and the date when the first sale is made is immaterial. Similarly, a manufacturer has to undertake several activities in order to bring to produce finished goods and he commences his business as soon as he undertakes the first of such activities. CIT v. Saurashtra Cement and Chemical Industries Ltd. [1973] 91 ITR 170 (Guj) followed.

In CIT v. ESPN Software India (P.) Ltd. [2009] 184 Taxman 452 (Delhi), the assessee-company was incorporated on 1-8-1995. On 15-8-1995, it had acquired a licence from its parent company to sub-licence 'ESPN' services for distribution of programmes in India via cable television system. By virtue of licence, the assessee entered into an agreement on 1-10-1995 with a company and appointed it as its sole distributor for distribution of ESPN programmes in India.

Test of Commencement of Business

(1) Essential business activity started
(2) Date of purchase of VSAT system
(3) 1st purchase of stock in trade
(4) Trial run successfully done
(5) Hired office, visited customers, participating in fair.

The Delhi High Court read that it is well-settled that business is nothing more than a continuous course of activities, and for commencement of business all the activities, which go to make up the business, need not be started simultaneously and as soon as an activity, which is the essential activity in the course of carrying on the business, is started, the business must be said to have commenced. The Court then held that in this case the assessee was ready to commence its business on 15-8-1995, when it acquired license to distribute in India through cable television systems, Satellite Master Antenna Systems and DTH, etc. By virtue of the license, it could discharge one of its objects as set

out in the Memorandum of Association of the company. That was the activity, which was first in point of time and which must necessarily precede all other activities and on that activity being done, the business of the assessee would be deemed to have been set up.

Section 284(75) of the Direct Taxes Code also so defines 'date of setting up of business' as the date on which it is ready to commence its commercial operations.

Following the Supreme Court decision in Sarabhai Management Corpn. Ltd. v. CIT [1976] 102 ITR 25, the Calcutta High Court in Tetron Commercial Ltd. v. CIT [2003] 261 ITR 422/133 Taxman 781 held that the business commences on the first step for commencement of the business if undertaken. The Delhi High Court in CIT v. Hughes Escorts Communications [2007] 165 Taxman 318 held that in the case of a company incorporated for carrying on the business of setting up satellite business communication systems its business would be set up on the date on which it placed the order for purchase of VSAT equipment and, thus, any expenditure incurred thereafter be considered as revenue expenditure.

Pre-operative interest incomes

In Indian Oil Panipat Power Consortium Ltd. v. ITO [2009] 181 Taxman 249 (Delhi), the assessee joint venture company was to put up a power project. Funds such as share capital and additional share capital were raised for purchase of land and development of infrastructure, but due to legal entanglements with respect to title of land, they were temporarily put in fixed deposit with bank and interest was earned thereon. Whereas it claimed that said interest was capital receipt and, therefore, should be set off against pre-operative expenses, the Assessing Officer treated the interest as 'income from other sources'.

Between the two decisions of the Apex Court in CIT v. Bokaro Steel Ltd. [1999] 236 ITR 315/102 Taxman 94 and Tuticorin Alkali Chemicals & Fertilizers Ltd. v. CIT [1997] 227 ITR 172/93 Taxman 502 relied upon by either side, the Delhi High Court found Bokaro Steel Ltd.'s case (supra) most appropriate to the situation as it found that the funds held with the assessee were not surplus funds but funds which were inducted into the joint venture company by the joint venture partners, primarily to purchase land and to develop infrastructure. Further, taking a clue from section 3 of the Act, the Court held that the previous year shall be the period beginning with the date of setting up of the business so that any income earned during setting up stage must be offset against pre-operative costs.



Interest Income	Treatment
Share capital kept in Bank for asset acquire (Indian oil panipat power (Del))	Reduce cost
Interest income on surplus funds (Bokaro steel (SC))	IFOS
Interest paid (Challapali Sugar (SC))	Add to cost

Interest paid during the pre-commencement period would be required to be capitalised as decided in Challapalli Sugars Ltd. v. CIT [1975] 98 ITR 167 (SC). The rationale of this decision in converse facts would require that interest receipt should be an abatement of capital cost, a view not followed in Tuticorin Alkali Chemicals and Fertilizers Ltd. v. CIT [1997] 227 ITR 172 (SC). But all the same,

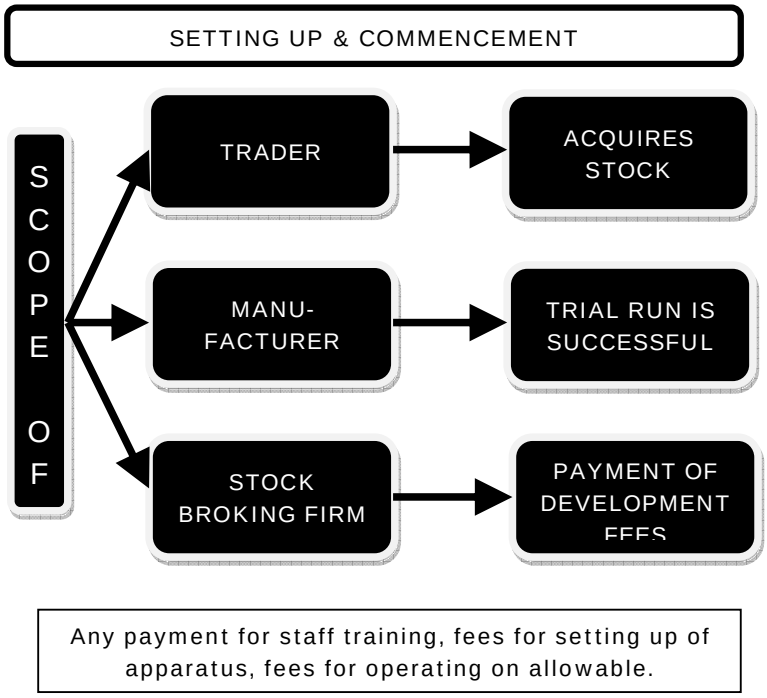
a series of decisions thereafter would favour a different view as in CIT v. Bokaro Steel Ltd. [1999] 236 ITR 315 (SC) ; CIT v. Karnataka Power Corporation [2001] 247 ITR 268 (SC) and Bongaigaon Refinary and Petrochemicals Ltd. v. CIT [2001] 251 ITR 329 (SC). A limited claim for adjustment of interest paid against the interest received was recognised in CIT v. VGR Foundations [2008] 298 ITR 132 (Mad), wherein the later decisions of the Supreme Court have been preferred to the decision in Tuticorin Alkali Chemicals and Fertilizers Ltd.'s case (supra). The further claim that the surplus, if any, of interest receipts over interest payment should be treated as abatement of capital cost did not arise in this case.

Interest income earned before the commencement of business should ordinarily be assessable under the head "Other sources". It may be capitalised, if such interest has nexus with the setting up of a plant. If it does not have such nexus, it may well be assessable as income taxable during the year. In Central Travancore Specialists Hospital Ltd. v. Asst. CIT [2008] 302 ITR (AT) 131 (Cochin), it was found that in the facts of the assessee's case, there was no nexus for such interest with the setting up of the plant and that the interest was from surplus funds which were kept with the bank to earn interest. Notwithstanding the possible difference between the decision in CIT v. Bokaro Steel Ltd. [1999] 236 ITR 315 (SC) and in some other cases, it was felt that the facts of the case warranted the application of the principle in Tuticorin Alkali Chemicals and Fertilizers Ltd. v. CIT [1997] 227 ITR 172 (SC), so that the Tribunal upheld the order of the authorities that such interest income was taxable.

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 ones 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



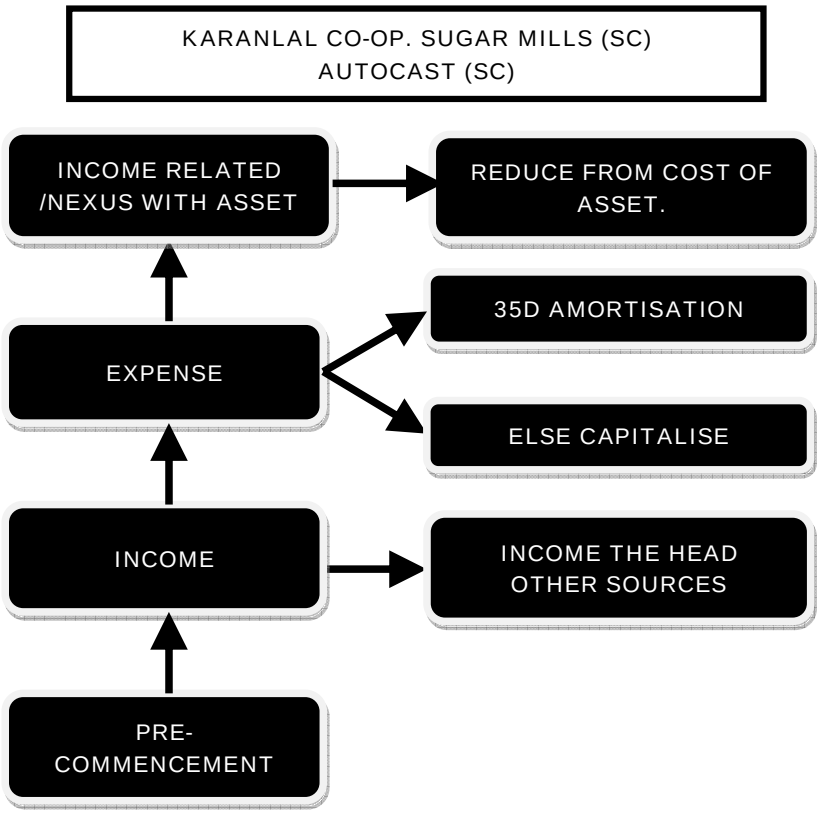
admissible, the assessee suffering both ways.

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.

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 Russel 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.

Receipts prior to Setting up Business.

A business must be carried on before there can be any profits and gains. Any receipt, received before the business is carried on, is not a business receipt and if any expenditure is incurred before the business has started, it is also not a business expense. Where the assessee received grants-in-aid before it started business, it could not be treated a business receipt [CIT *v.* State Trading Corporation of India Ltd. (1973) 92 ITR 294 (Del.)].

Similarly, where an assessee is awarded the work of erecting and commissioning plant and machinery to a contractor before the commencement of the business and for speedy execution of the work and he is allowed accommodation for his workers on the site, also allowed to use certain plant and machinery of the assessee and is also given advances for this purpose, the receipts from the contractor on account of rent and royalty are not assessable as business income but should be reduced from the capital cost of the machinery to be erected [CIT *v.* Bokaro 236 ITR 315 (SC)].

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.

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.)

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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

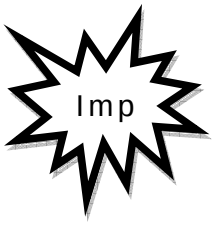
(iii) Income derived by a trade, professional or similar association from **specific services** performed for its members;

(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.

(vii) any sum, whether received or receivable, in cash or kind, on account of any capital asset (other than land or goodwill or financial instrument) being demolished, destroyed, discarded or transferred, if the whole of the expenditure on such capital asset has been allowed as a deduction under section 35AD.

Receipts, which are Associated with Ascertainable Liability, cannot be Treated as Trading Receipt.

Hence, such receipts are not liable to be taxed. For example, a sugar manufacturer collected a sum of Rs 40,50,570 from the buyers in excess of the price fixed for sale of levy sugar. The amount was kept in a suspense account and was liable to be refunded if the assessee failed in getting the relief that it has sought in the writ petition before the High Court. The Assessing Officer treated the receipt as trading receipt and taxed it. In an appeal, it was held that the receipt of the amount was associated with the liability to refund and the amount of liability was ascertainable and quantified. It cannot be treated as a trading receipt. Accordingly, it cannot be taxed [CIT *v.* South India Sugar Ltd. (2001) 248 ITR 92 (Mad.)].

Tax Collection.

When an assessee collects sales tax, excise duty, such tax collections are part of trading receipts. The assessee is allowed deduction when such tax, or duty is paid in accordance with the provisions of Sec. 43B.

Receipt may be in Cash or Kind.

Receipts may be in money or money's worth, in cash or in kind. When a company sells its trading asset for fully paid shares in another company, the profit of the transaction is assessable although no cash passes [British South Africa Co. *v.* CIT 19 ITR 17].

Voluntary Payments.

All revenue receipts arising from business or the exercise of profession or vocation are chargeable under this section. Voluntary payments by persons who are under no obligations to pay anything at all would be income receipts in the hands of the receiver if those are received in the course of business or in the exercise of profession. Thus, an amount paid to the lawyer by a person who was not a client who had benefited by his professional services to another [Re Susil Sen 91 ITR 261] or a voluntary payment made to an actress by a producer of film who had engaged her services [Laxmi Rajam *v.* CIT 140 ITR 340] or bonus voluntarily paid by textile society to a textile businessman [Nabadwip *v.* CIT 44 ITR 591] or tips given to a taxi driver [Calvert *v.* Wainwright 16 ITR Supply. 54] are taxable under this clause.

Ownership of Business not essential for Chargeability.

A person carrying on the business profession is assessable on business profits. Normally, this right is vested with the owner of business and so he would be assessable on business profits. It is not necessary that the owner of the business should carry on the business personally. The business may be carried on by a manager, servant or agent.

However, in a few cases, the right to carry on the business may not vest with its owner eventhough the profits may accrue to him. In such cases, the Revenue would charge the person who is vested with the right to carry on the business. Thus, promoters are assessable on pre-incorporation profits and not the company even though it might have ratified all pre-incorporation deals and accepted pre-incorporation profits [CIT *v.* City Mills distributors (P) Ltd. (1996) 219 ITR 1 (SC)].

Where a guardian of a minor has the right to carry on business, he is to be assessed on such profits. Similarly, where the court takes away the right of the owner to carry on his business and appoints somebody else to carry on the business, the person appointed by the court is assessable on business profits. The owner is not assessable as he is not carrying on the business [Saifuddin Alimohamed *v.* CIT (1954) 25 ITR 237 (Bom.)].

Business to have been Carried On during the Accounting Year.

For chargeability of business profits, it is necessary that the business should have been carried on by the assessee at any time during the accounting year. It is not necessary that business should have been carried on throughout the previous year [CIT *v.* Express Newspapers 53 ITR 250 (SC)] or in the assessment year [Re Kamdar 14 ITR 10].

If the business in discontinued before the commencement of the accounting year, the profits of the business received in the accounting year cannot be taxed because the source of income does not exist in the accounting year [Baroda Trades *v.* CIT 57 ITR 490].

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).

BUSINESS LOSS

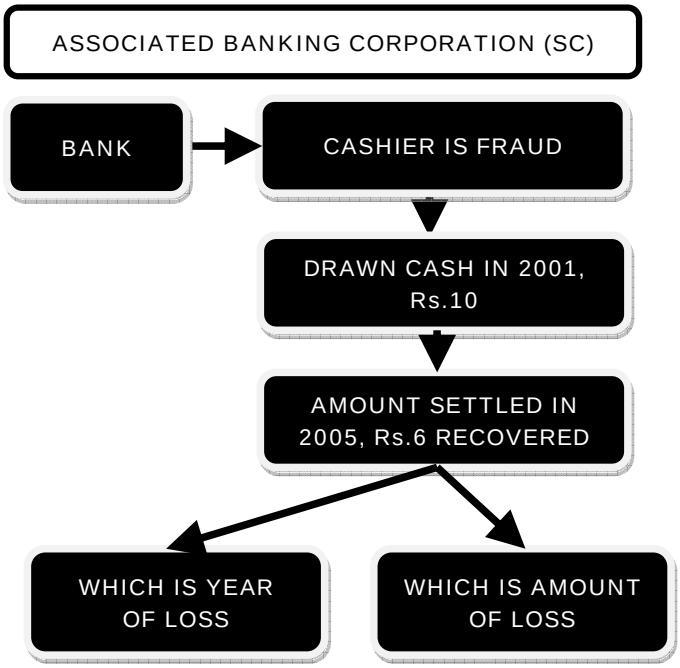
Profits should be understood as Including Losses also

Profits and gains represent "plus income", whereas losses represents "minus income". Both positive and negative profits are of revenue character. Both must be taken into account in computing taxable income of an assessee [CIT *v.* Harprasad & Co. Pvt. Ltd (1975) 99 ITR 118 (SC)].

Allowance for Business Losses

Business losses, though fall outside the purview of Sec. 30 to 43D, may be allowed under this section on the basis of ordinary commercial principles provided following conditions are satisfied:
(i) Losses are not of capital nature [Mandani *v.* CIT 161 ITR 165 (SC)]. (ii) They are not merely connected with the trade but are incidental to the trade itself [CIT *v.* Textile 135 ITR 200, CIT Sedhu 212 ITR 92)]. (iii) There is no provision, direct or indirect, against such deduction. These principles were affirmed by Supreme court in Badri Das Daga *v.* CIT (1958) 34 ITR 10 and CIT *v.* Nainital Bank Ltd. 55 ITR 707.

If there is a direct and proximate nexus between the business operation and the loss, such loss is deductible because without business operation and without doing all that is incidental to it, no profit can be earned. It is in this scene that such a loss is considered as trading loss from commercial standard and becomes deductible from the total income [Ram Chandar Shiv Narain *v.* CIT (1978)111ITR 263 (SC)].



The loss to be allowed in the year when it comes to knowledge of the assessee.
Deduction must be allowed in the year of settlement.
Amount lost is the amount of deduction.

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).

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

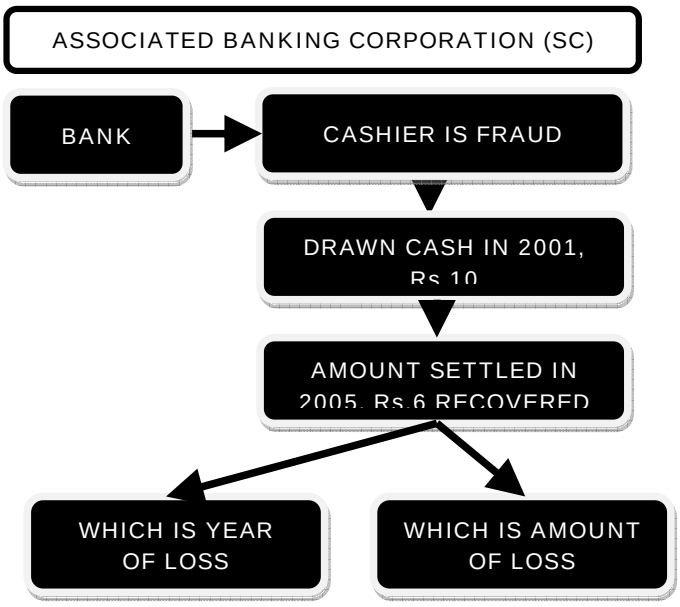
In order that a loss may be deductible it must be a loss in the business of the assessee and not payment relating to the business of somebody else which under the provisions of the Act is deemed to be and becomes the liability of the assessee. Thus, where an agent of a non-resident paid the tax liability 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 of stock-in-trade:

A loss of stock-in-trade occasioned by enemy action or by ravages of white ants or by fire or by negligence or fraud of employees or by natural causes or loss of stock-in-trade in transit is deductible as a trading loss. If the assessee, for reasons beyond his control, cannot prove the exact amount of stock-in-trade destroyed, the loss may be estimated from such materials as are available.
Any compensation received in lieu of loss of stock-in-trade is a trading receipt [CIT *v.* S.N.A. S.A. Annamalai Chettiar (1972) 86ITR 607 (SC)]. For example, an assessee mortgaged his stock-in-trade to secure loan. The stock-in-trade was damaged in the custody of bank. The assessee was awarded compensation by the bank for the damage caused to the stock-in-trade. The compensation is taxable as the income of the previous year in which it is received [Ramesh Narain Saxena and others *v.* CIT (1996) 220 ITR 19 (SC)].

Loss through embezzlement by employee or agent:

A business is normally carried through employees and agents. Human nature being what it is, it is impossible to rule out the possibility of an employee taking advantage of his position and misappropriating the funds of his employer. An amount embezzled by the assessee's employee or agent is deductible in computing business profits. Loss caused by embezzlement is allowable as a deduction not necessarily in the year, in which the embezzlement takes place, but when there is no reasonable chance of obtaining restitution and the amount is found to be irrecoverable [Associated Banking Corporation of India Ltd. *v.* CIT (1965) 56 ITR 1 (SC)].



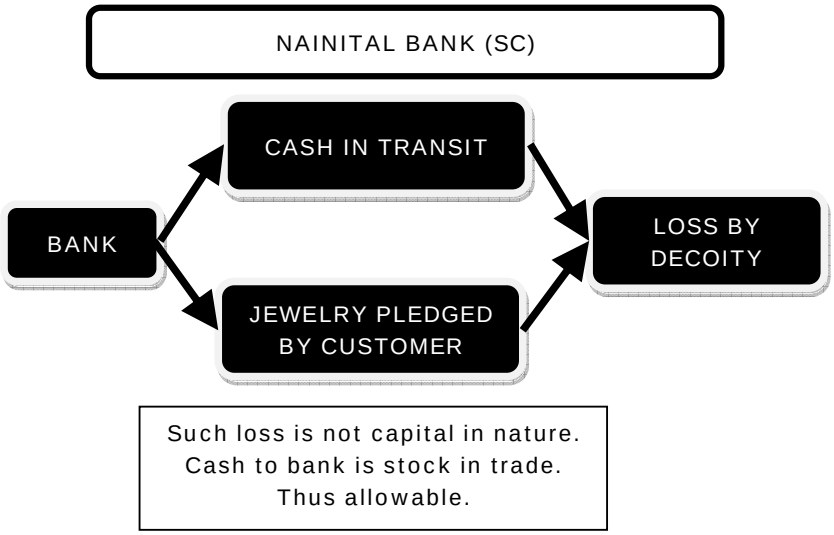
The loss to be allowed in the year when it comes to knowledge of the assessee.
Deduction must be allowed in the year of settlement.
Amount lost is the amount of deduction.

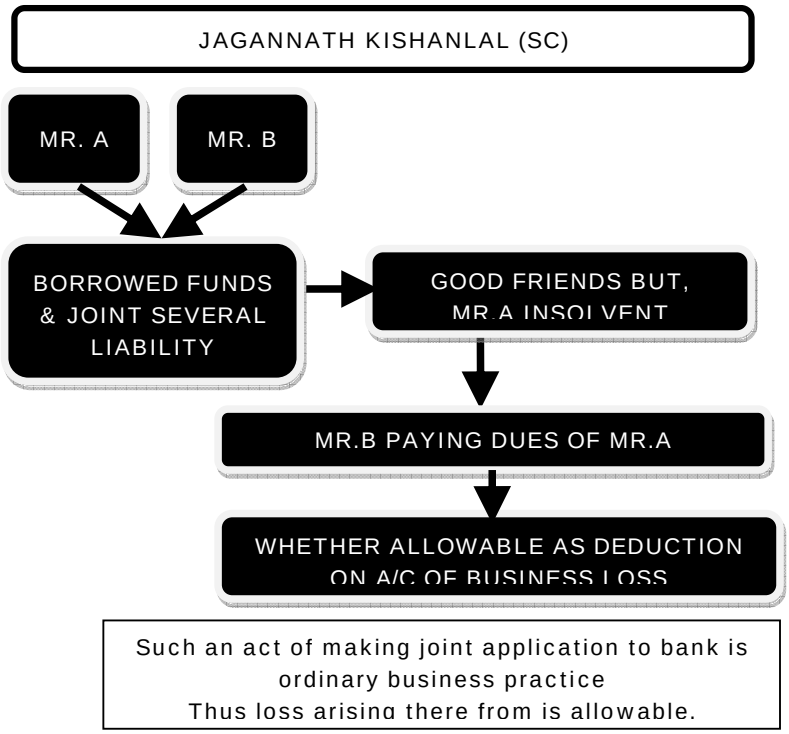
Loss on account of non-recovery of advance, made during the course of business:

Where the assessee makes an advance during the course of the business and such advance is not recovered, the loss arising on account of non-recovery of such advance is allowable as a trading loss.
The assessee carried *on* the business of film distribution. He purchased distribution rights of a film for Rs 7,50,000. On the request of the producer, the assessee advanced Rs 1,10,000 as a loan to him for completion of the film. The picture failed at the box-office and the producer could not repay the loan amount. Non-recovery of advance is allowable as a trading loss. The advance was made during the course of business for completion of the film, failing which the assessee would have lost Rs 7,50,000 [CIT *v.* Cresent Films (P) Ltd. (2001) 248 ITR 670 (Mad.)].

Loss by robbery or theft:

If the loss of cash by theft or robbery is incidental to the operations of the business such loss is deductible in computing taxable profits of business or profession. For instance, when an employee who is entrusted with funds for purpose of distribution amongst sugar cane growers in accordance with statutory rules, is robbed of them on the way, the loss is deductible [Motipur Sugar Factory Ltd. *v.* CIT (1955) 28 ITR 128 (Pat.)]. If stolen moneys which are allowed as a deduction in any year are subsequently recovered, such receipts are taxable as the income of the previous year in which stolen moneys are received [Sec. 41(1)]. Similarly, when an assessee or his employee carrying cash to bank is robbed on the way such loss is an allowable deduction.





Likewise, the loss of cash in the robbery committed at night in the bank premises is an allowable deduction as a bank is under statutory obligation to maintain a certain amount of cash at the close of the business everyday [CIT *v.* Nainital Bank Ltd. (1965) 55 ITR 707 (SC)]. Similarly, keeping cash is found inevitable to carry on business operations on the next day, loss of cash due to theft or burglary in factory premises during or after working hours is deductible [CIT *v.* Surya Sugar Mills (P)ltd. (1968) 70 ITR 109 (All.)]. Also, see Ramachandar Shivanarayan *v.* CIT (1978) 111 ITR 263 (SC)].

Loss incurred as surety:

When a trader stands surety for the debt of another and such guarantee is not for the purpose of the trade, any payment made as a result of such guarantee cannot be deducted as a business loss. For instance, when money is borrowed jointly by two or more persons, and one of them has to pay the creditor on the failure of the other party to repay, the payer cannot deduct the money so paid as trading loss. But where the finding is that there is mutuality and custom to borrow money on joint promotes for carrying on business, such loss is deductible as trading loss [CIT *v.* Jagannath Kishanlal (1961) 41 ITR 360 (SC)].

Loss of security deposit

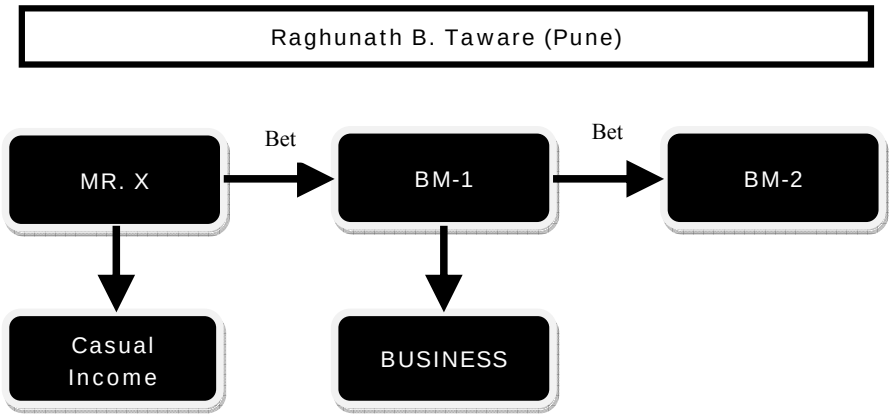
Loss arising from forfeiture of security deposit as a result of non-performance of a trading contract is deductible as a trading loss [Narandas Mathuradas & Co. *v.* CIT (1959) 35 ITR 461 (Bom.)]. On the other hand, profit arising from the forfeiture of security deposits during the course of business dealings is revenue receipt and is included in total income [Atlas Cycle Industries Ltd. *v.* CIT (1982) 133 ITR 231 (P&H)].

Chit fund loss

The deduction of chit fund loss is judicially controversial. One view is that where an assessee subscribes to a chit and bids the chit after paying a few instalments, the difference of chit fund amount and the price paid for the bid is deductible as business loss [CIT *v.* Kovue Textiles and Co. Ltd. (1982) 136 ITR 61 (AP)]. The other view is that the discount incurred in obtaining the chit is not deductible because of mutuality among contributors and participators. Once the principle of mutuality is established, the surplus is not chargeable to tax as no one can make profits out of himself. Hence, the contributions to chit fund cannot be treated as revenue expenditure. Similarly, the receipt from the fund cannot be treated as business activity. The transaction does not give rise to any income assessable to income tax nor any revenue loss, hence, no deduction can be allowed [Soda Silicate and Chemical Works *v.* CIT (1989) 179 ITR 588 (P&H)].

Bookmaker hedge with bookmaker

A bookmaker is allowed to make a hedge bet with another bookmaker only to the extent of the total amount of bets accepted by him on a particular horse at the time of such lay over. The assessee, an individual, ran the business of booking races. He also bet on horse races in order to minimize probable losses. Such winnings were popularly called as "tote winnings". In the opinion of the Assessing Officer, the tote winnings were covered under section 56(2)(ib) of the Income-tax Act, 1961, and the assessee was to be taxed at a flat rate as provided under section 115BB. The Commissioner (Appeals) held that the winnings were not assessable under section 115BB. On appeal to the Tribunal Held, that the total amount received by the assessee from the bets laid over by the assessee with another bookmaker could not be treated as the winnings from horse race as commonly perceived in the case of a punter. It was an integral part of the assessee's business activity as a bookmaker provided the total amount of such hedge betting did not exceed the total amount of the bets accepted by him on a particular horse at the time of such hedging. It was thus to be treated as part and parcel of the assessee's business receipts or payments as a bookmaker. It could not be assessed at the maximum marginal rate specified under section 115BB.



Income from winnings from races including horse races is taxable under the head "Other sources" along with income from lotteries, etc. under section 2(24)(ix) read with section 56(2)(ib) of the Act. The bookmakers indulged in the business of booking races and also bet on horse races by way of hedging to minimise probable losses with such winnings known as "tote winnings". The Assessing Officer assessed the income from booking as business and tote winnings as covered under section 56(2)(ib) to be taxable at the then prevailing flat. It was decided by the Tribunal in Asst. CIT v. Raghunath B. Taware [2008] 302 ITR (AT) 136 (Pune) holding that tote winnings are commonly perceived as part of the business of a punter. It is an integral part of the assessee's business activity as a bookmaker with such bets made by him treated as hedge betting. The entire income is, therefore, assessable as normal business income.

EXCHANGE PROFIT / LOSS

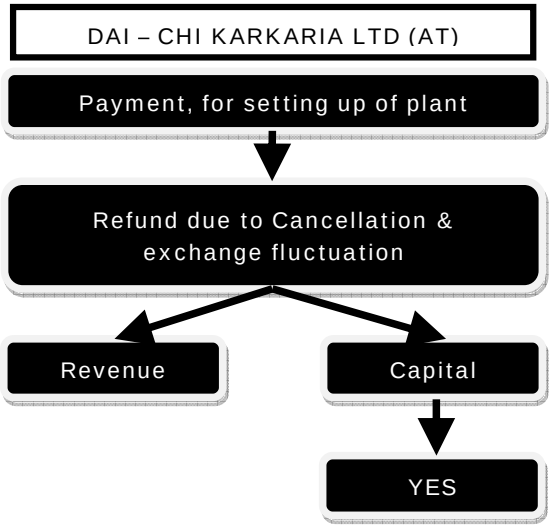
The exchange loss as a result of fluctuations in the rate of exchange of foreign currencies, held as stock-in-trade, is allowable deduction [CIT *v.* Bank of India (1996) 218 ITR 371 (Bom.)].

Foreign Currency Profits / losses.

When profit or loss arises to an assessee on account of appreciation in the value of foreign currency on conversion into another currency, such profit or loss would ordinarily be a trading profit if the foreign currency is held by the assessee on revenue account or as trading asset or as part of circulating capital embarked in the business. But, if, on the other hand, the foreign currency is held as a capital asset or as fixed capital such profit or loss would be of capital nature [Sutlej Cotton Mills Ltd. *v.* CIT (1997) 116 ITR 1(SC)]. For example, where foreign exchange earned overseas by the assessee is retained by offshore for payment of capital goods, any surplus arising on repatriation of such foreign exchange will be a capital receipt [CIT *v.* Tata Locomotive and Engineering Co. Ltd. (1966) ITR405(SC)].

Loss incidental to business - forex loss on advance repayment

In Loksons (P.) Ltd. v. Asstt. CIT [2010] 187 Taxman 55 (Bom.) the assessee incurred foreign exchange loss on refund of trading advance in view of order cancellation due to change in the Government policy. The Bombay High Court held that excess payment in that case would meet the commercial expediency factor, as a good businessman will always maintain certain amount of credibility and specially so in a foreign market. The Court held that such loss would qualify as business loss.



When the co-venturers had undertaken a contract for prospecting mineral oil, but each independently taking its own risk, the loss suffered on account of foreign currency transactions was found admissible. These were not independent foreign currency transactions, but loss, booked in conversion of expenditure in foreign currency into rupee expenditure at the prevailing exchange rate on the stipulated date, which was different from the rate at which the actual expenditure was incurred. Such loss was found admissible in CIT v. Enron Oil and Gas India Ltd. [2008] 305 ITR 75 (SC), while affirming the decision of the Uttarakhand High Court in CIT v. Enron Oil and Gas India Ltd. [2008] 305 ITR 68 (Uttarakhand). From the facts, it is clear that it was not a case of foreign exchange loss in the sense that it was not loss suffered in foreign exchange held by the assessee, but only on conversion of different expenditures to uniform rate. Incidentally, it also observed that it was a case of production sharing with each co-venturer taking its own risk, so that there was justification for independent assessment on the reasoning of the Supreme Court, that there were "independent accounting regimes".

Treatment of exchange profit under section 10A

Where the assessee books a sale on the basis of a prevailing rate of exchange on which an invoice is raised, but receives a different sum in Indian rupees as sale proceeds, the excess or the shortfall is not an exchange loss or profit in the sense that it is a result of sale of such exchange held by the assessee.

It is only sale proceeds. It does not have a different character from the export turnover and it is also part of export profits. In coming to the conclusion, the Tribunal in Renaissance Jewellery P. Ltd. v. ITO [2007] 289 ITR (AT) 65 (Mum) followed a number of decisions of the Tribunal itself in Smt. Sujatha Grover v. Deputy CIT [2002] 74 TTJ 347 (Delhi) and in Priyanka Gems v. Asst. CIT [2005] 94 TTJ 557 (Ahd) apart from the three other unreported decisions. There is also a decision of the High Court in CIT v. Rane (Madras) Ltd. [1999] 238 ITR 377 (Mad), where even a forward contract in foreign exchange, which had nexus with the export of goods could be treated as relating to the activity eligible for deduction in the context of sections 80E and 80-I. The same reasoning should apply for section 80HHC as well. That the profit on account of foreign exchange gain was directly referable to the articles and things exported by the assessee. Such profits were therefore of the same nature as the sale proceeds. The assessee was entitled to exemption under section 10A in respect of such profits.

P/L 1-4 to 31-3			
Particulars	Amount	Particulars	Amount
For ex loss (trading advance allowable)	12	Export Export (For ex-Income) (Forex is part of export)	3456

1.	Loksons (P.) Ltd. (Bom.)
2.	Enron Oil and Gas India Ltd. (SC)
3.	Renaissance Jewellery P. Ltd. (Mum)
4.	Sujatha Grover (Delhi)
5.	Priyanka Gems (Ahd.)
6.	Rane (Madras) Ltd. (Madras)

Forex fluctuation loss

The Supreme Court in CIT v. Woodward Governor India (P.) Ltd. [2009] 179 Taxman 327 held that the unrealized loss due to foreign exchange fluctuation in foreign currency transaction on revenue items on the last date of the accounting year is an admissible deduction under section 37(1) so much so that the liability incurred in this regard would constitute an ascertained liability and not a contingent liability. The Apex Court held that the method of accounting undertaken by the assessee continuously and the follow up of Accounting Standards is supreme so that anyone not adhering to the accounting consistency and Accounting Standards would be deprived of such deduction of forex fluctuation loss.

The Apex Court further held that the following factors count in order to judge if an expenditure is deductible :

(i) whether the system of accounting followed by the assessee is mercantile system, which brings into debit the expenditure amount for which a legal liability has been incurred before it is actually disbursed and brings into credit what is due, immediately it becomes due before it is actually received;

(ii) whether the same system has been followed by the assessee from the very beginning and if there has been a change in the system, whether the change was bona fide;

(iii) whether the assessee has given the same treatment to losses claimed to have accrued to it and to the gains that may accrue to it;

(iv) whether the assessee has been consistent and definite in making entries in the account books in respect of losses and gains;

(v) whether the method adopted bsy the assessee for making entries in the books, both in respect of losses and gains as per nationally accepted Accounting Standards;

(vi) whether the system adopted by the assessee is fair and reasonable or is adopted only with a view to reduce the incidence of taxation.

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).

Loss in illegal business:

The losses which have actually been incurred in carrying on a particular illegal business must be deducted in computing taxable profit of that business. Thus, a smuggler of gold or currency is entitled to claim the loss arising from the confiscation of gold or currency [CIT *v.* Piara Singh (1980) 124 ITR 40 (SC)].

The Explanation to Sec. 37(1) inserted retrospectively from the commencement of the Act is confined only to disallowance of an expenditure for prohibited purposes. It does not apply to "Loss" which is different from "an expenditure". [Dr. T.A. Qureshi v. CIT (2006) 157 Taxman 514 (S.C.)]

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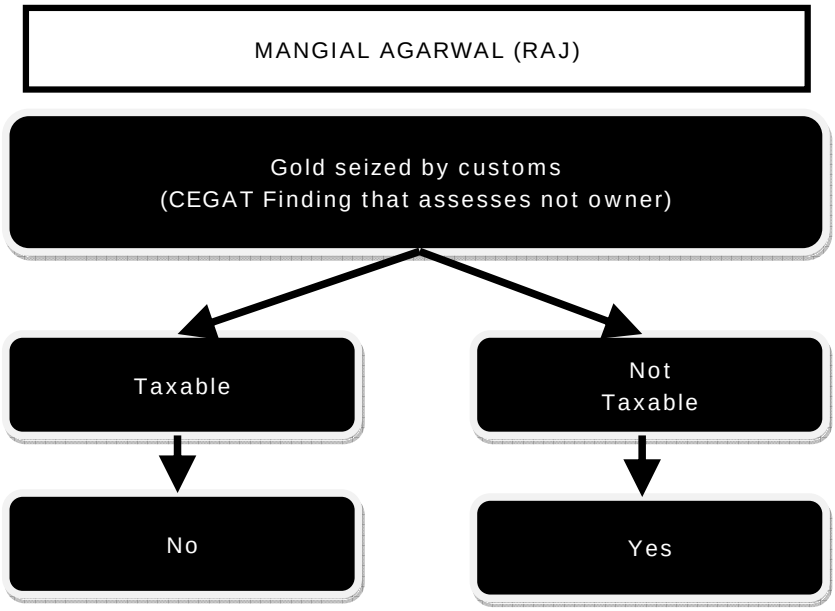
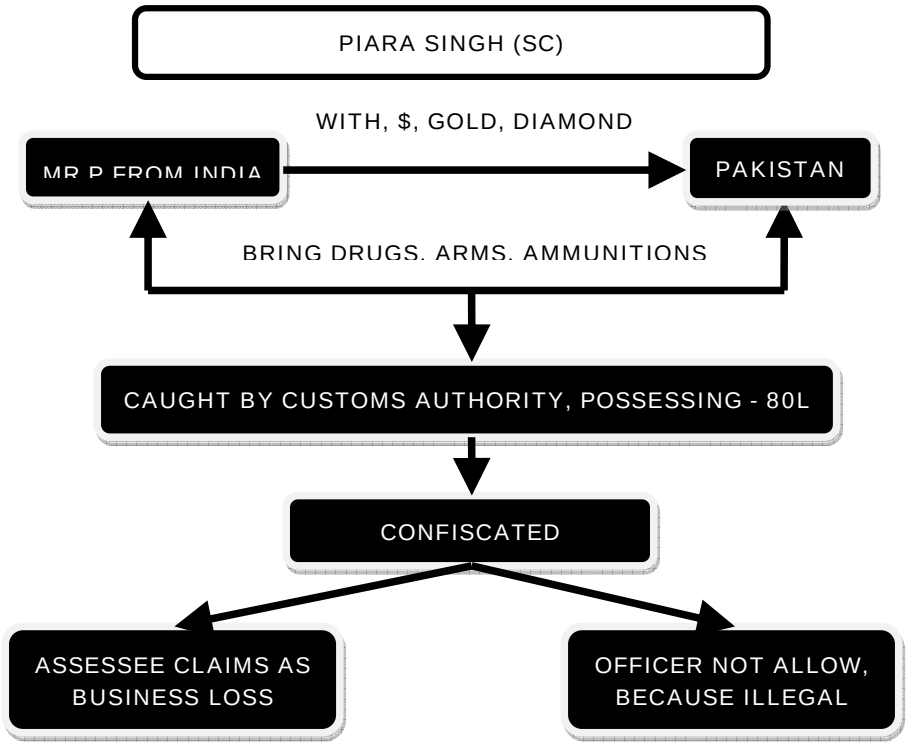
If the business is illegal, neither the profits earned nor the losses incurred would be enforceable in law. But, that does not take the profits out of the taxing statute. Similarly, the taint of illegality of the business cannot detract from the losses being taken into account for computation of the amount which can be subjected to tax as "profits".



Expenditure, which would constitute offence is specifically disallowed under the Explanation to section 37(1). Losses suffered on infringement of any law is being disallowed except in rare cases, where such violation is innocent and the amount payable is compensatory in character. But where the assessee is carrying on illegal business, there is no bar for deduction of loss or expenses as decided in CIT v. S. C. Kothari [1971] 82 ITR 794 (SC) and CIT v. Piara Singh [1980] 124 ITR 40 (SC). Where gold is carried by professional carrier from whom it is confiscated, such loss has been allowed in the latter case. It is this law, which was followed in CIT v. Hiranand [2005] 272 ITR 626 (Raj), where the Tribunal found that the assessee was carrying on illegal business of smuggling, notwithstanding his claim to the contrary, as evident from the previous convictions and incarceration. It was in this context that the loss on account of confiscation of gold was a loss, which had to be allowed. The question of allowing the loss arose because the confiscated gold was treated as an unexplained asset, the source of which was treated unexplained, because the assessee claimed that the confiscated gold did not belong to him. The amount treated as income now stood cancelled by the loss. Such decisions bring out the anomaly of our laws.



SPECULATIVE BUSINESS

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 merchanting 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)

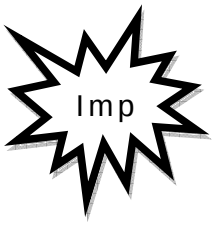
Concept of Delivery

Under Sales of Goods Act, delivery can be made either by physical delivery of the commodity directly to the purchaser or to the carrier for him or by transferring the documents of title to the commodity. Thus, actual delivery is not the essence to make a transaction non-speculative. Delivery also takes within its ambit delivery to the carrier or transfer of title deeds to the purchaser.

J contracted to purchase a tanker of groundnut oil. The seller dispatched the oil by Railway and sent the invoice along with Railway Receipt (RR). After obtaining the RR, J sold the consignment to R by endorsing the RR. The sale to R was concluded at a lesser rate than the rate of purchase. Thus, J suffered loss and claimed its set off against other business profits. The ITO disallowed the set off

treating the loss as speculative because J did not settle the transaction by actual delivery. Held that the transaction is not speculative because the expression "otherwise by actual delivery or transfer of commodity" in Sec. 43(5) take within its ambit these two modes of delivery, that is, delivery to the carrier or transferring the documents of title to the commodity. Accordingly, the transaction is not of speculative nature. The loss is business loss, allowed to be set off [CIT *v.* Lakshminaravan Trading Co. (1996) 219 1TR 90 (AP)].

Hedging Transactions not to be Treated Speculative Transactions.



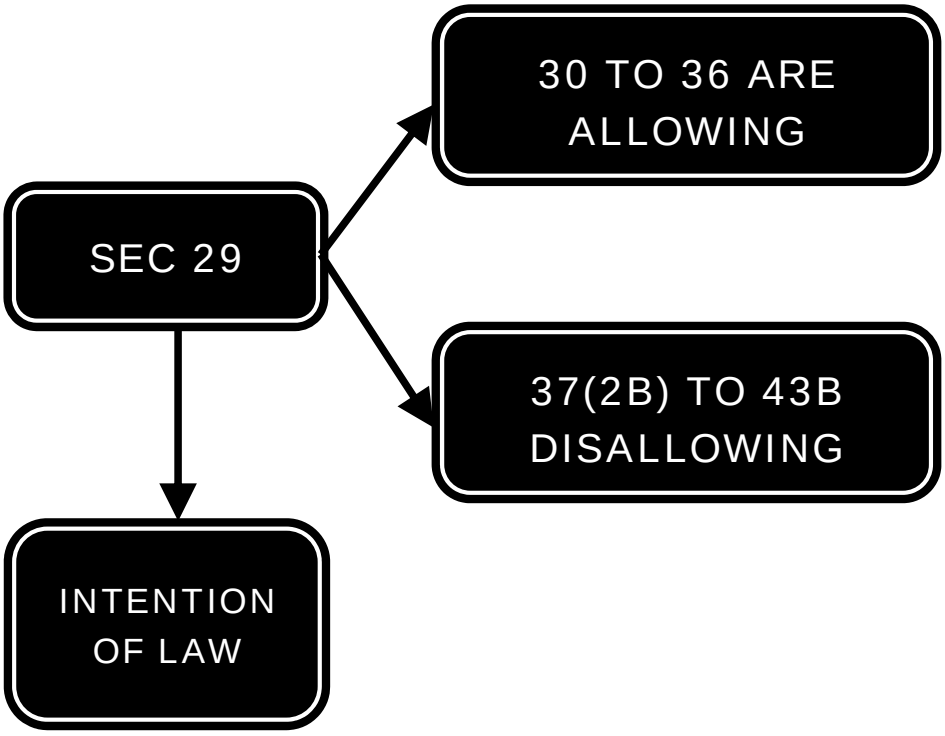
Hedging transactions are not deemed to be speculative transactions. Such transactions are entered into by manufacturers and merchants in the course of business to guard against loss through future price fluctuations. A hedging loss is treated as business loss and is allowed to be set off against business profits. Likewise, hedging profit is treated as business profits.

R, an exporter of castor oil contracted to supply 100 tonnes of caster oil to J of Japan @ Rs 1,650 per tonne. The delivery was to be effected after 2 months. To guard against the loss on account of price fluctuations in the market, R concluded a deal in the forward market to purchase about 4000 tonnes of castor seeds which is roughly equivalent to 100 tonnes of castor oil. The course of prices in the forward market generally follows the same trend as in the ready market. If the prices of castor oil in the ready market goes up bv the time of actual delivery, R would suffer a loss because he would buy at a higher rate and supplv at lower rate as contracted 2 months before. But the prices of castor seeds would also go up in the forward market. He would realise a corresponding profit in his dealings in the forward market. The transaction in the forward market would be settled by realising the difference of prices. It would not be treated as speculative transaction because it was entered to hedge/insure the possible future loss on account of price fluctuation. Thus, R would set off the loss in export business against the profit of hedging business.

SEC. 29 INCOME, 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



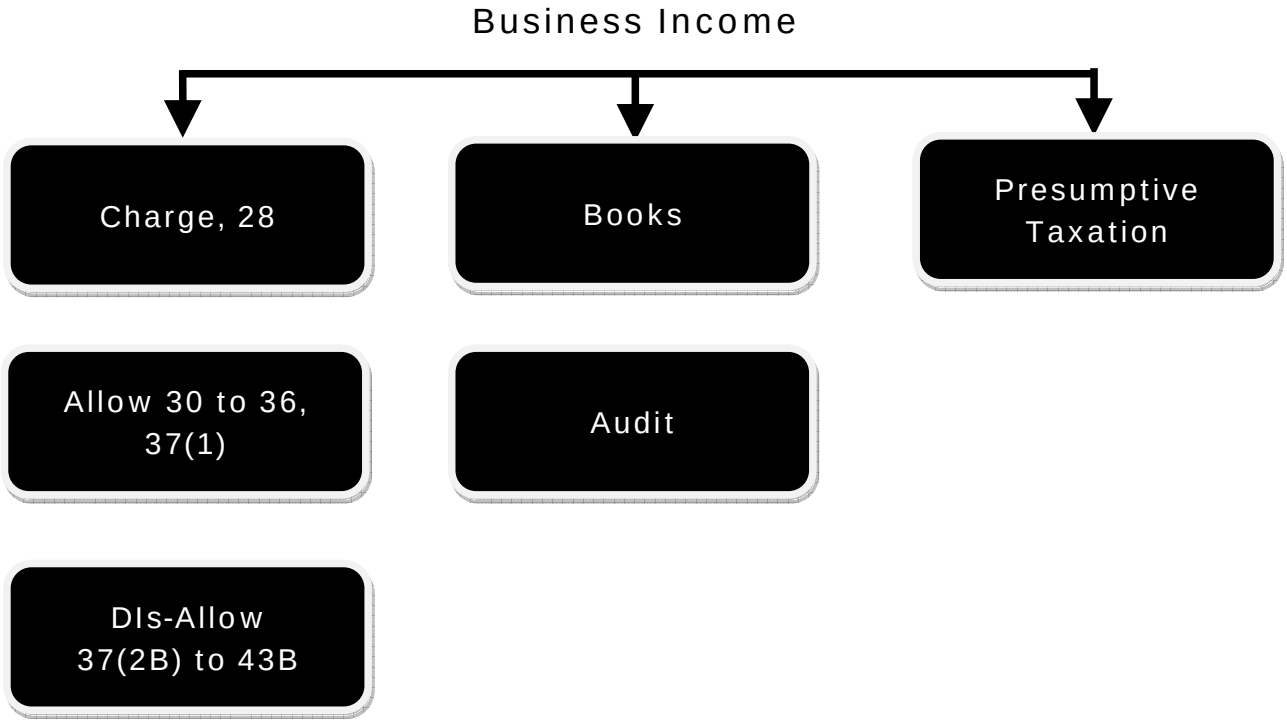
For allowing deductions under sections 30 to 36, it is immaterial whether the expenditure is capital or revenue in nature. Section 37(1) being a residual provision, it cannot be taken aid of unless and until it is established that none of the provisions of section 30 to 36 are applicable to a given case. 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

Enquiry to be held about Justification for Deduction

In order to determine whether a particular item (not covered by Sec. 30 to 37) may or may not be deducted from profits under this section, one should first ascertain whether its deduction is expressly prohibited under any of the sections, and if not, whether it is of such nature that its deduction mad be allowed on ordinary commercial principle in computing taxable profits.

Burden of Proof

Where an assessee seeks to deduct from his business profits certain items under this section, the onus of proving that such deductions are permissible, falls on him [CIT *v.* Calcutta Agency 19 ITR 191 (SC)].


Business Income
Charge, 28
Books
Presumptive Taxation
Allow 30 to 36, 37(1)
Audit
DIs-Allow 37(2B) to 43B

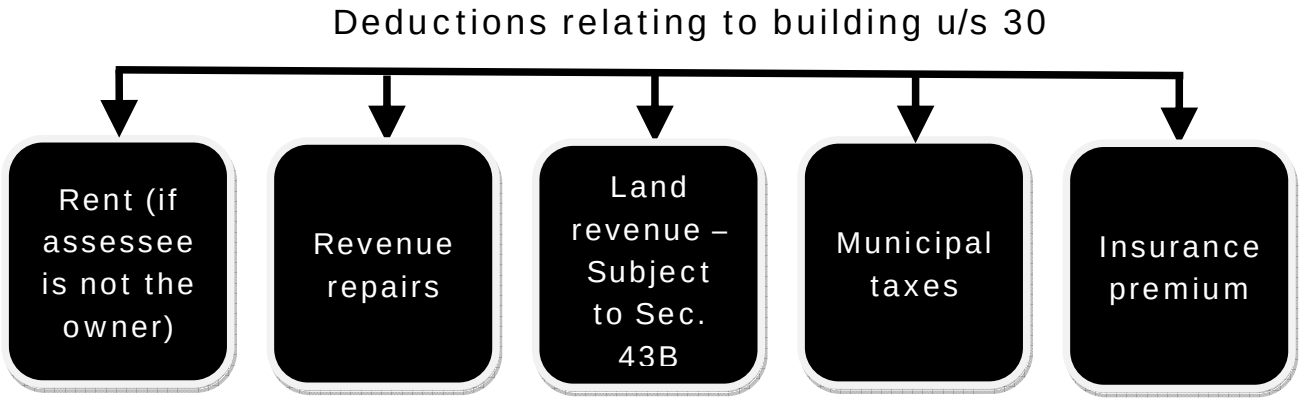
SEC.30: RENT, RATES, REPAIRS AND INSURANCE FOR BUILDINGS

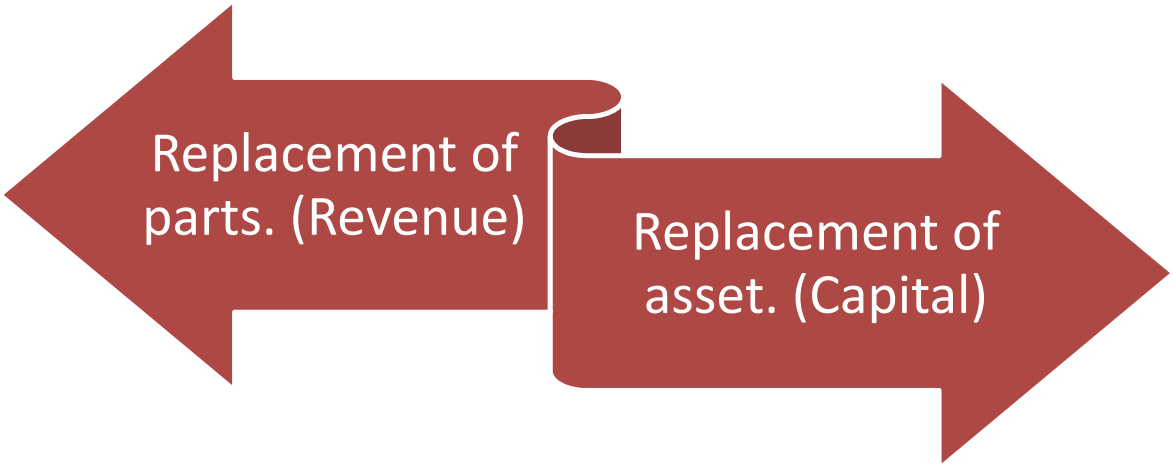
In respect of rent, rates, taxes, repairs and insurance for premises, used for the purposes of the business or profession, the following deductions shall be allowed.

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.

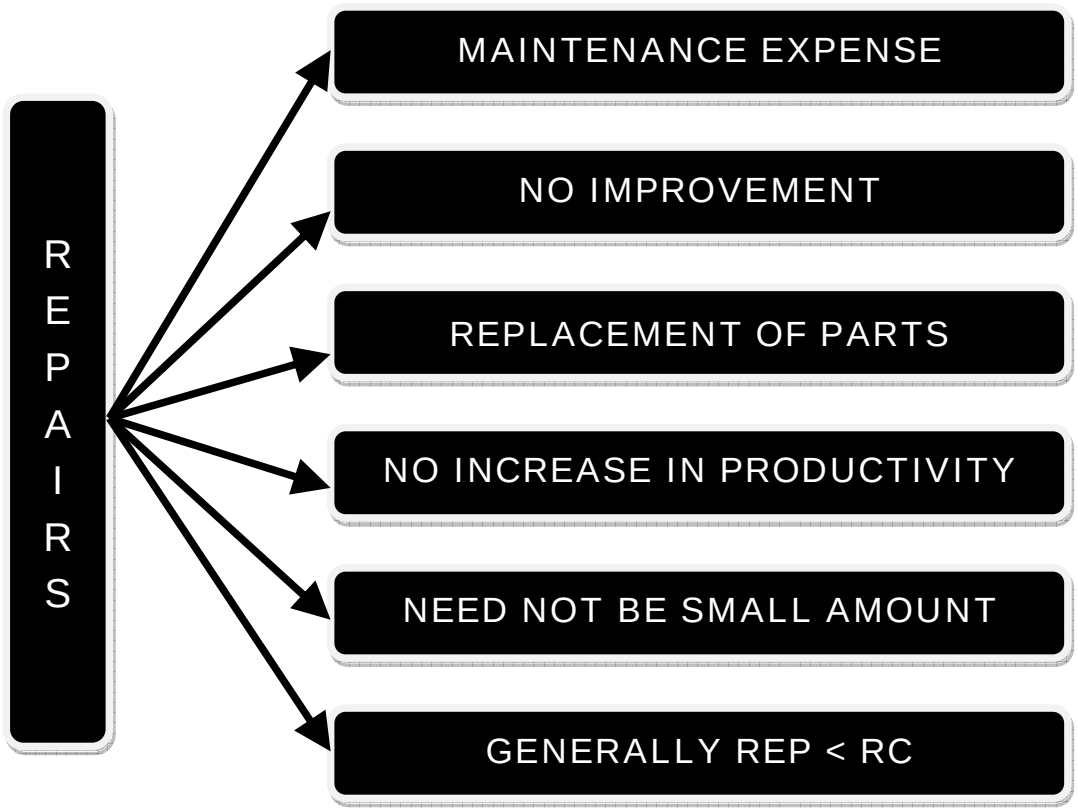
Today such capital expenditure will be governed by explanation 1 to section 32 .Where the business or profession of the assessee is carried on in a building not owned by him but in respect of which the assessee holds a lease or other right of occupancy and any capital expenditure is incurred by the assessee 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.)



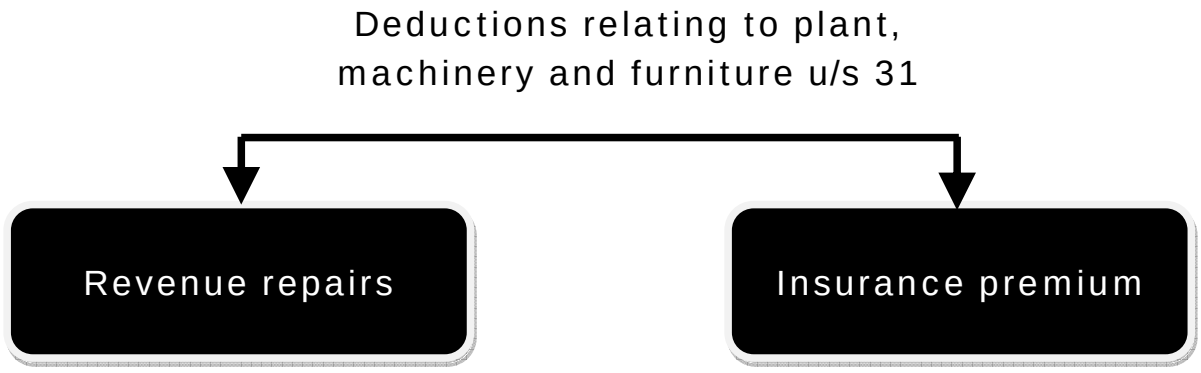
The respondent-firm owing several collieries carried on business in coal. One of the collieries was requisitioned for military use and occupied for thirteen years. During that period the respondent continued carrying on its business in coal working the other collieries and also incurred expenditure on 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)

Manner of computation / Adjustments		Rs.
Net profit as per Profit and Loss account		108
Add:		
Repair Expense capital in nature, debited to profit and loss account		2
Premises (Capitalised in books)		--
		106

SEC.31: REPAIRS AND INSURANCE OF P/M 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.



Savings	Replacement	Status
80%	20%	Repair
60%	40%	Repair
40%	60%	Major Replacement (Repair expense)
20%	80%	Repairs
1% (salvage)	99%	Replacement of asset

Business premises hired by the assessee:

Where premises are taken on rent by an assessee, rent paid for the premises is an allowable deduction if the premises are used for business. The word "paid" means actually paid or incurred according to the method of accounting adopted by an assessee [Sec. 43(2)]. Where the assessee maintains the accounts on mercantile basis, "paid" will signify the accounting year in which the liability to pay the rent was first accrued. In other words, the rent payable for a previous year is allowable on due basis even when not actually paid.

Rent of guest house:

The rent paid for a guest house, used for the purposes of business is fully allowable under this section.

Chargeability of rent in the hands of receiver not a condition for deduction:

Rent payable for the business premises is deductible even though the recipient of the rent may not be assessable on such rent.

Sub-letting of business premises vs. Deduction of rent:

Where a part of the business premises are sub-let, the rent from sub-letting would be set off against the amount of rent payable. Thus, net rent payable would be deducted.

Premium paid for lease of business premises:

Premium *(salami* or *pugri)* paid for obtaining lease or for a renewal of lease cannot be equated with rent. Such premium is a capital expense and cannot be deducted.

Payment of rent arrears of the previous tenant:

If a tax-paver takes business premises on lease for carrying on a business and agrees to pay arrears of rent of the previous occupier, whether voluntarily or under legal obligation, such arrears or rent cannot be deducted under this section because it is not the rent payable for the period during which the premises are used for the purposes of the business [C1T *v.* Maharajadhiraj Rameshwar Singh of Darbhanga (1933) 1ITR 94 (PC)].

Rent paid for unexpired lease period in respect of premises not used for business:

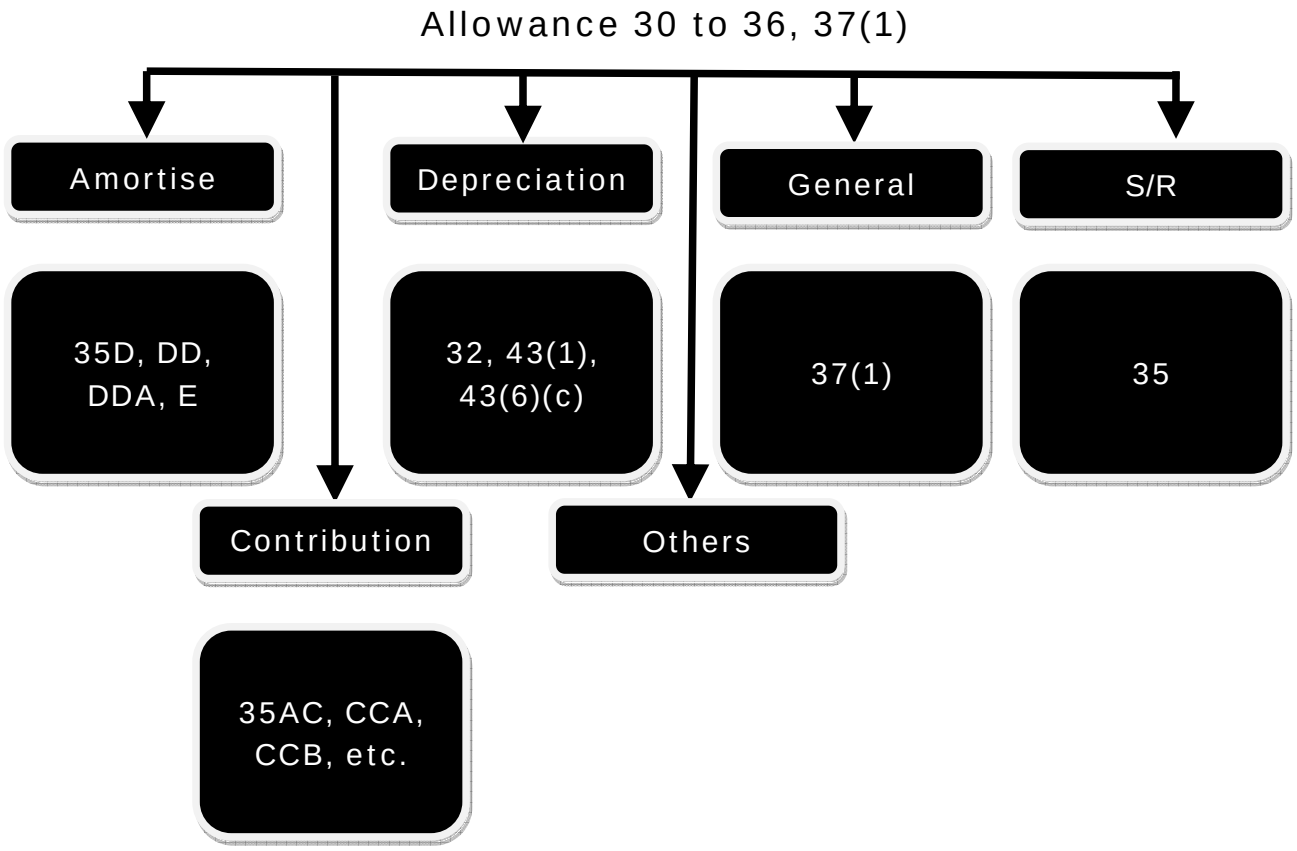
If the business premises have been taken on a long-term lease which is still subsisting but the business ceases to be carried on in those premises and it is carried on elsewhere, the rent paid for the premises under the old lease cannot be deducted under this clause. It can be claimed under "general deductions" (under Sec. 37) if it can be proved that the liability could not be terminated when the business came to an end [Pohoomal Bros. *v.* CIT (1958) 34 ITR 64 (Bom.)].

Rent of the business premises, partly occupied by the assessee/employee:

Where part of the business premises taken on rent is used by an assessee as his dwelling house, a proportionate deduction on account of rent in respect of the portion so occupied is to be disallowed (Sec. 38). But if such premises are occupied by the employees of the business, the rent of the premises so occupied is an allowable deduction under this clause or in any case under "general deduction" (under Sec. 37).

Notional rent of the premises owned by the assessee not to be deducted:

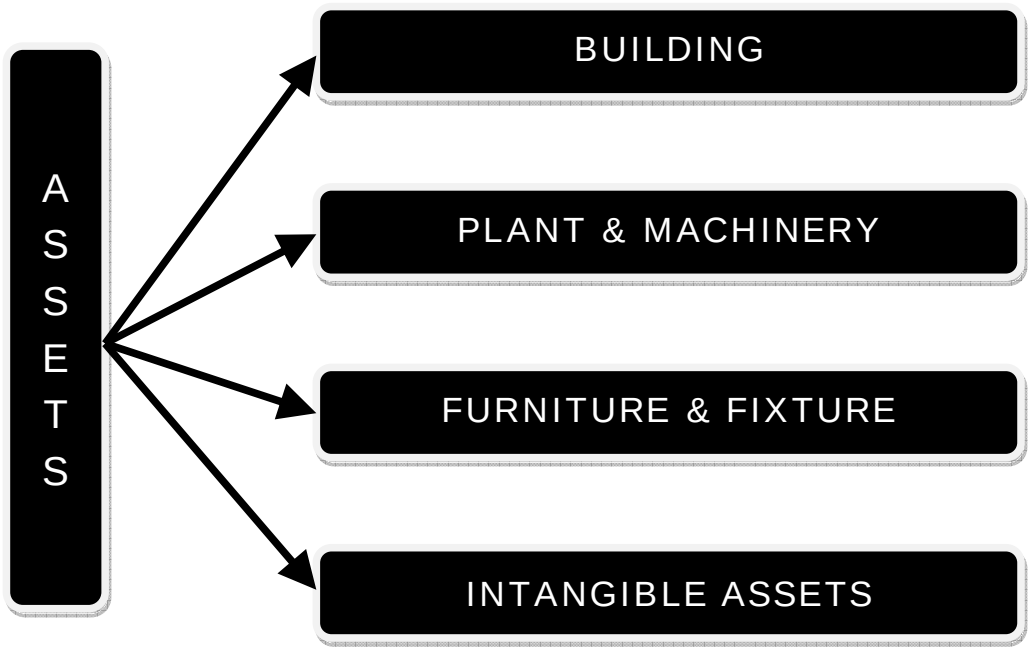
It business premises are owned by a tax-payer, no deduction is allowed on account of notional rent. In such event, the annual value of business premises is not assessable under Sec. 22. (ii) Repairs: Expenditure on repairs is incurred to preserve and maintain an existing asset. The objective of repairs is neither to bring a new asset into existence nor to obtain any fresh advantage. Repairs restore what has been lost by wav of wear and tear [New Shorrock Spinning & Manufacturing Company Ltd. *v.* CIT (1956) 30 ITR (Bom.)].



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.



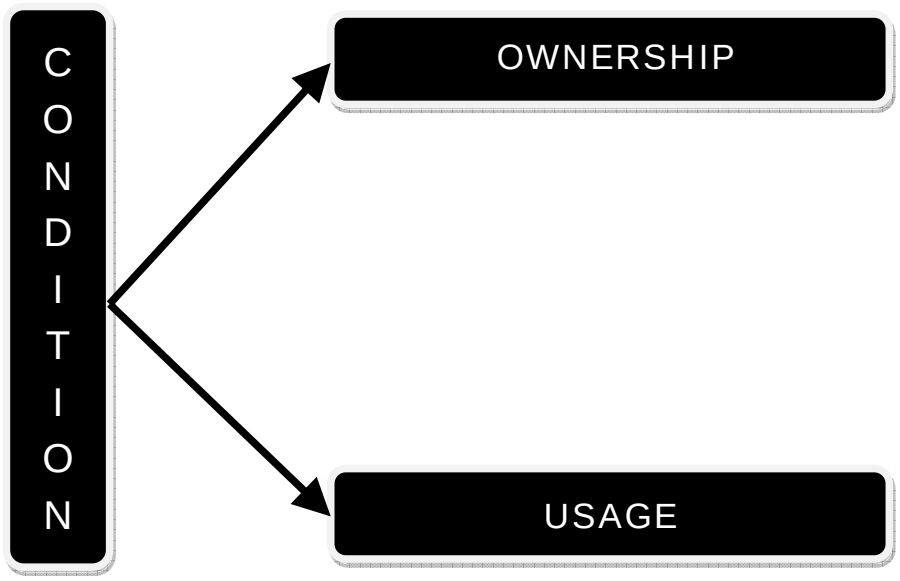
Depreciation-accounting aspects

Depreciation is an important component while drawing up the profit and loss account and balance-sheet of both corporate and non-corporate enterprises. As per the provisions of the Companies Act,. 1956, every company has to draw up its profit and loss account and balance-sheet in such a manner that they disclose the profit or loss and the assets and liabilities in a true and fair manner. The Companies Act, 1956 contains comprehensive provisions for the provision of depreciation and Schedule XIV to the Companies Act contains an elaborate classification of assets along with prescribed rates of depreciation. The management of every company has to necessarily provide for depreciation at a rate not less than a rate prescribed in Schedule XIV. However they are free to provide for depreciation at a higher rate, if in the opinion of the management it is necessary to do so.

Depreciation under the Income-tax Act, 1961

Depreciation is now mandatorily to be allowed under the Income-tax Act for the purpose of computing income under the head "Profits and gains of business or profession". Under the Companies Act, 1956 depreciation is to be charged to the profit and loss accounts in accordance with the rates mentioned in Schedule XIV. The main objective of providing for depreciation as per the provisions of the Companies Act is to prepare the profit and loss account and balance-sheet in a true and fair manner. While the rates mentioned in Schedule XIV are minimum rates, the management is free to provide for higher rates of depreciation in respect of various assets if it feels necessary to do

so. The rates of depreciation under the Income-tax Act are mentioned in Appendix I to the Income-tax Rules, 1962.



Depreciation is mandatory

The Finance Act, 2001 added Explanation 5 to section 32(1) with effect from the assessment year 2002-03. This Explanation provides that the provisions of sub-section (1) of section 32 shall apply whether or not the assessee has claimed the depreciation. This Explanation is a statutory recognition of the principle enshrined in Accounting Standard-6 which provides that depreciation is a charge on the profits. Further, the correct income from "profits and gains of business or profession", cannot be computed unless depreciation is deducted.

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)

Scope of Building:

"Buildings" include roads, bridges, culverts, wells and tube-wells. The buildings may be factory buildings or non-factory buildings, that is, building used for office, storage, employees' quarters or welfare of employees, e.g., workers' canteen or sports pavilion, etc. Building include a part of a building.

Building constructed on leasehold land is eligible for depreciation even if the building may be handed over to the lessor after the expiry of lease. It is not necessary that building should have a roof for claiming depreciation. A large stadium or an open swimming pool would be a building as it is a permanent structure and designed for a useful purpose. It would quality for depreciation,

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)

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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 livestockor 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)

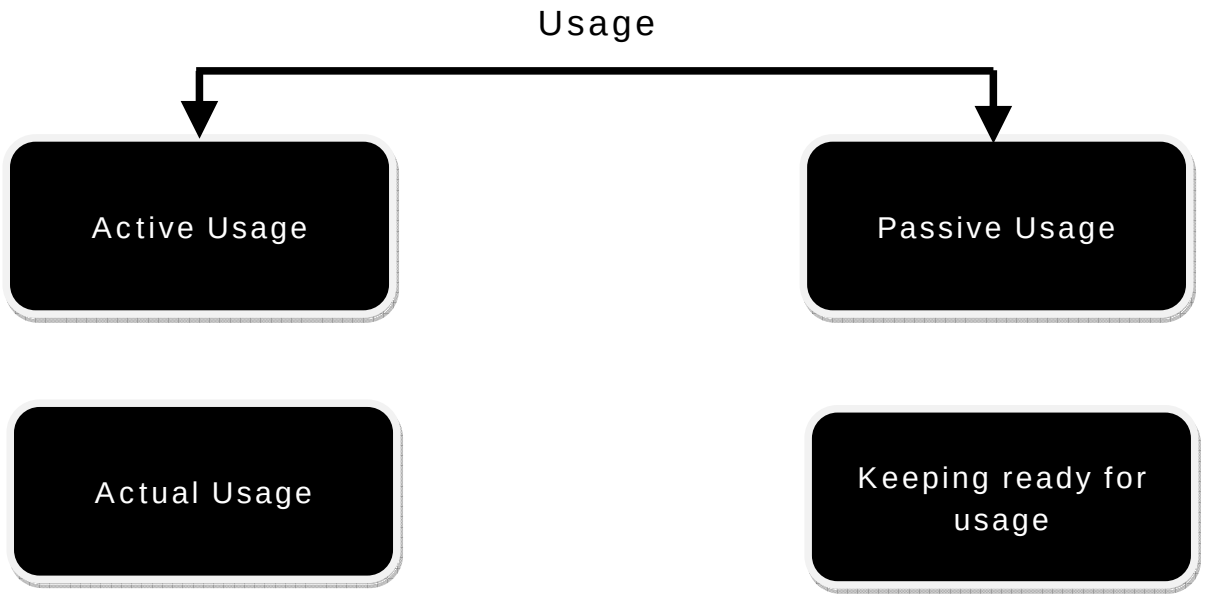
The concept of plant cannot be limited to actual installation of machinery which produces goods by itself. Anything which is used for the purpose of business including any installation which facilitates the production or increases the efficiency of the business will be plant [CIT *v.* Electronic Research Industries Pvt. Ltd. (1991) ITR 20 (Kar.)]. Poles, cables, conductors and switch boards for distribution of electricity were held to be plants [CIT *v.* Indian Turpentine and Resin Co. Ltd. (1970) 75 ITR 533 (All.)]. In a hotel, light fittings, ceiling and pedestal fans, water pipe fittings, sanitary and pipeline fittings were held to be plants [CIT *v.* Taj Mahal Hotel (1971) 82 ITR 44 (SC)]. Safe deposit vault; air-conditioning equipment installed in a safe deposit vault by a bank [CIT *v.* Central Bank of India (1976) 103 ITR 196 (Bom.)]. Cylinders used for storing oxygen gas by an oxygen manufacturing company [CIT *v.* National Air Products (1980) 126 ITR 196 (Del.)] internal telephone system [CIT *v.* Mohan Meakin Breweries Ltd. (1980) 122 ITR 203 (H.P.)] have been held as "plant". Data processing machinery was held to be plant [CIT *v.* I.B.M. World Trade Corporation (1981) 130 ITR 739 (Bom.)].

A theatre building or hotel building cannot be treated as "plant" [CIT *v.* Anand Theatre (2000) 244 ITR 192 (SC). The word "plant" is given an inclusive meaning under Sec. 43(3) which nowhere includes buildings. The Rules prescribe different rates of depreciation for different assets and it is against the legislative intent to treat building as a plant.

Furniture & fixtures:

There is no definition of the word "furniture" in the Act. All articles of convenience or decoration, used for the purpose of furnishing a dwelling place or a place of business or an office, are articles of furniture.

Meaning of "used for the purpose of business or profession"



The machinery and plant must be such as were used, in whatever sense that word is taken, at least for a part of the accounting year. If the machinery and plant have not at all been used at any time during the accounting year, no allowance can be claimed in respect of them. The other words 'used for the purposes of the business' are 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)

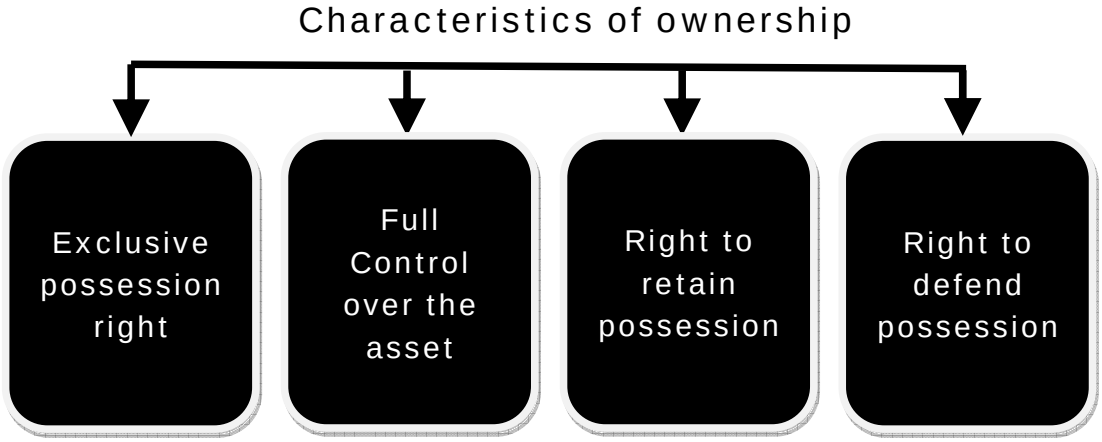
The assessee-company which owned two cotton ginning and pressing factories and two other concerns, owning in all four presses, entered into a pooling agreement. As the agreement clearly provided that, although two out of the four presses which were directly in the pooling arrangement were to remain idle 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

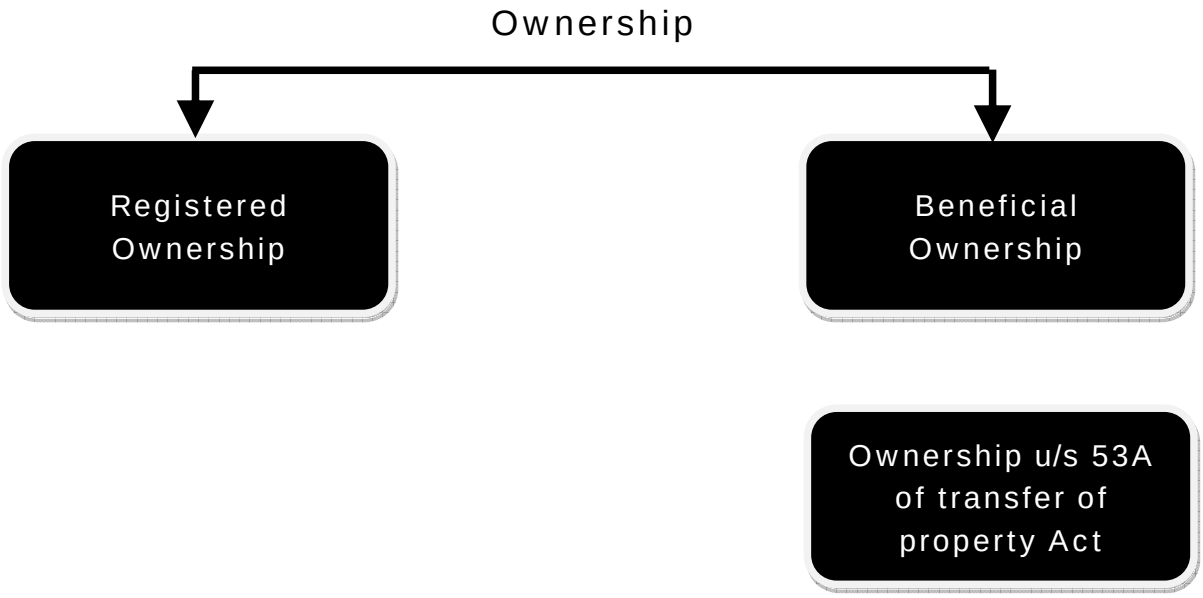


The assessee was a private limited company. During the year the assessee had purchased for the use of its staff seven low income group houses from the Housing Board. The assessee had made part payment and was in turn given allotment of the houses followed by delivery of possession by the Housing Board. The actual deed of conveyance was not yet executed by the Housing Board in favour of the assessee. The assessee made a claim under section 32 of the Act in respect of depreciation of buildings used for the purpose of the business of the assessee. Finding of fact arrived at in the case at hand was that though a document of title was not executed by the Housing Board in favour of the assessee, the houses were allotted to the assessee by the Housing Board, part payment received and possession delivered so as to confer dominion over the property on the assessee where after the assessee had in its own right allotted the quarters to the staff and they were being actually used by the staff of the assessee. The assessee was entitled to depreciation in respect of the seven houses in respect of which the assessee had not obtained a deed of conveyance from the vendor although it had taken possession and made 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)

It is now well settled law that depreciation is to be allowed to the one who has invested in the capital asset and is utilizing the capital asset. Further, there are several judicial decisions to support the view that registration of a vehicle in own name is not necessary for claiming depreciation. In the case of lease transactions it is not necessary that the commercial assets should be put to use and worked by the owner himself. Even if a licensee or a hirer works the assets, depreciation is allowable to the lessor- *CIT* v. *Sarveshwar Nath Nigam* [1963] 48 ITR 853 (Punj).



2(11) "block of assets" means

A group of assets falling within a class of assets comprising, Tangible assets, being buildings, machinery, plant or furniture, or Intangible assets, being know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, in respect of which the same percentage of depreciation is prescribed.

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 ==	X
	However, that the amount of such decrease does not exceed the written down value.		

	Written Down Value		X
Less	Depreciation for the year		X
	Closing Written Down Value		X

Meaning of "moneys payable''

It includes any insurance, salvage or compensation moneys payable in respect there of 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

Normal Depreciation					
	Block 1 Building	Block 2 Furniture	Block 3 Plant	Block 4 Plant	Block 5 Intangible Assets
Rate of Depreciation	10%	10%	15%	60%	25%
Opening WDV	30,00,000	5,75,000	18,75,000	15,00,000	75,000 (Patents)
Add:					
Assets acquired during the year (Additions during the year)	7,00,000	-	5,80,000 (used for <180 days)	-	1,50,000 (Technical know how)
	37,00,000	5,75,000	24,55,000	15,00,000	2,25,000
Less:					
Assets sold during the year	-	47,500	1,25,000	-	-
WDV before depreciation	37,00,000	5,27,500	23,30,000	15,00,000	2,25,000
Less:					
Depreciation for the year	3,70,000	52,750	3,06,000 (17,50,000 @ 15% + 5,80,000 @ 15% * 50%)	90,000	56,250

Interest on capital borrowed for the purposes of business

Under section 36(1)(iii), interest on capital borrowed for the purposes of business is allowed as a deduction. The Finance Act, 2003 has inserted a proviso to section 36(1)(iii) with effect from the assessment year 2004-05 to provide 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 capitalized 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 put into use, shall not be allowed as a deduction. Interest on money borrowed for the purpose of acquiring a capital asset pertaining to the period after the asset is put to use has to be claimed as a deduction under section 36(1)(iii). The interest of the period after the asset has been put to use cannot be capitalized as the cost of the asset.

To be precise, the position may be stated as follows :

(i) In respect of existing business, capitalisation is allowed on assets up to the date they are put to use.

(ii) In respect of capital borrowed for acquisition of an asset of an existing business, interest 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 put to use is still to be allowed as a revenue expenditure.

(iii) In respect of capital borrowed for acquisition of an asset for extension of existing business, interest for any period beginning from the date on which capital was borrowed for acquisition of the asset till the date on which such asset was put to use, will not be allowed as a revenue expenditure.

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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 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.

In case of Succession (for successor entity.) Block of assets acquired by successor company for Rs. 30,00,000	Amt	Amt
Opening WDV		42,00,000
Add:		
Acquired during the year (Used less than 180 days)		8,00,000
Assets acquired from predecessor		30,00,000
WDV Before Depreciation		80,00,000
Less: Depreciation		
On 42,00,000 @ 15%	6,30,000	
ON 8,00,000 @ 7.5%	60,000	
ON 30,00,000 (apportioned depreciation for 200 days will be allowed to successor entity.)	4,50,000	11,40,000
WDV after Depreciation		68,60,000

Apportionment of Depreciation

Predecessor company. $\frac{4,50,000}{365} * 165$ = Rs. 2,03,425

Successor company. $\frac{4,50,000}{365} * 200$ = Rs. 2,46,575

Sec.43(6) - treatment of transfer by holding to subsidary 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.

In case of Amalgamated Company		
	Amt	Amt
Opening WDV		52,00,000
Add:		
Acquired during the year (Used less than 180 days)		18,00,000
Assets acquired from amalgamation u/s 43(6)		30,00,000
WDV Before Depreciation		1,00,00,000
Less: Depreciation		
On 52,00,000 @ 15%	7,80,000	
ON 18,00,000 @ 7.5%	1,35,000	
ON 30,00,000 (apportioned depreciation for 200 days will be allowed to successor entity.)	4,50,000	13,65,000
WDV after Depreciation		86,35,000

Apportionment of Depreciation

Amalgamating Co. $\frac{4,50,000}{365} * 165$ = Rs. 2,03,425

Amalgamating Co. $\frac{4,50,000}{365} * 200$ = Rs. 2,46,575

Sec.43(6) - treatment of transfer in scheme of demerger / succession of business

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.

Explanation 2C.—Where in any previous year, any block of assets is transferred by a private company or unlisted public company to a limited liability partnership and the conditions specified in the 47 (xiiib) are satisfied, the actual cost of the block of assets in the case of the limited liability partnership shall be the written down value of the block of assets as in the case of the said company on the date of conversion of the company into the limited liability partnership.

Sec.43(6) corporotisation of stock broker

Explanation 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 established under section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), 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.

Sec.43(6) Revaluation of assets

Explanation 6. Where an assessee was not required to compute his total income for the purposes of this Act for any previous year or years preceding the previous year relevant to the assessment year under consideration,

(a) the actual cost of an asset shall be adjusted by the amount attributable to the revaluation of such asset, if any, in the books of account;

(b) the total amount of depreciation on such asset, provided in the books of account of the assessee in respect of such previous year or years preceding the previous year relevant to the assessment year under consideration shall be deemed to be the depreciation actually allowed under this Act for the purposes of this clause; and

(c) the depreciation actually allowed under clause (b) shall be adjusted by the amount of depreciation attributable to such revaluation of the asset.

Sec.43(6) Assets used for agricultural purposes

Explanation 7 : where the income of an assessee is derived, in part from agriculture and in part from business chargeable to income-tax under the head "Profits and gains of business or profession", for computing the written down value of assets acquired before the previous year, the total amount of depreciation shall be computed as if the entire income is derived from the business of the assessee

under the head "Profits and gains of business or profession" and the depreciation so computed shall be deemed to be the depreciation actually allowed under this Act.

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.

DEPRECIATION IN CASE SUCCESSION/AMALGAMATION If succession/amalgamation not taken place Depreciation @ 15%	
	Amt
Opening WDV	26,00,000
Add:	
Acquired during the year	4,00,000
	30,00,000
Less:	
Sale during the year	Nil
WDV before depreciation	30,00,000
Less:	
Depreciation @ 15%	4,50,000

Apportionment of Depreciation

Amalgamating Co. $\frac{4,50,000}{365} * 165$ = Rs. 2,03,425

Amalgamating Co. $\frac{4,50,000}{365} * 200$ = Rs. 2,46,575

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.

Explanation to Sec. 32(1) – Deemed Building		
Building	Amt	Amt
Opening WDV		16,75,800
Deemed Building (Capital expense on tenanted premises)		4,75,000
WDV before Depreciation		21,50,800
Less:		
Depreciation at 10%		2,15,080
WDV after depreciation		19,35,720

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 clarify 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(iia)

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 twenty per cent. of the actual cost of such machinery or plant shall be allowed as deduction

Additional depreciation shall be allowed to

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;';

Computation of Depreciation (Normal & Additional Depreciation)			
	Block 1	Block 2	Block 3
Rate of Depreciation	15%	30%	60%
Opening WDV	16,00,000	6,25,000	5,00,000
Add:			
Assets acquired during the year	54,00,000	12,00,000	6,00,000 (used for <180 days)
Less:			
Assets sold during the year	(4,65,000)	(3,75,000)	(2,85,000)
WDV before depreciation	65,35,000	14,50,000	8,15,000
Less:			
Normal Depreciation	9,80,250	4,35,000	3,09,000 (1,29,000 + 1,80,000)
Additional Depreciation 20%	10,80,000	3,60,000	60,000
WDV after Depreciation	44,74,750	6,55,000	4,46,000

ACTUAL COST

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.

Oridinary 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).

Actual Cost – Section 43(1) (For purpose of claiming depreciation)	Amt	Amt
Cost of Asset	15,00,000	15,00,000
Add: Interest upto the date assets first put to use	87,500	87,500
Add: Expense incurred on trial run		
Sale of product generated by trial run		
Situation 1 (1,60,000-45,000)	1,15,000	
Situation 2 (1,60,000 – 1,85,000)		(-25,000)
Cost of Assets	17,02,500	15,62,500

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)

Shifting of assets from one block to another

Where a different rate of depreciation is provided by the statute in respect of an asset which belonged to a block of assets having a different rate of depreciation, the doctrine of shifting assets from one block to another assumes importance. For example, when the rate of depreciation on computers was changed to 60 per cent. a question arose whether computers existing within the block of plant and machinery and being depreciated at 25 per cent. could be taken out of the block and depreciated at the higher rate of 60 per cent. A significant point that may be noted here is that the increased rate of depreciation for computers is a beneficial amendment since the rate of obsolescence in respect of computers is very high. Hence, applying the principles laid down by the hon'ble Supreme Court in Ellerman Lines Ltd., v. CIT [1971] 82 ITR 913 and Navnit Lal C. Javeri v. K. K. Sen, AAC of I. T. [1965] 56 ITR 198 (SC), it is reasonable to say that even computers acquired prior to April 1, 1998 and forming part of the block of assets "plant and machinery" having a rate of depreciation of 25 per cent., are eligible for the increased rate of depreciation at 60 per cent. It is significant to note that item (2)(iia) in Appendix I under the block "machinery plant" giving increased rate of depreciation to old commercial vehicles has specifically stated that such commercial vehicles must be acquired on or after October 1, 1998 but before April 1, 1999. In respect of computers the increased rate of depreciation has been given without mentioning any dates whatsoever. Therefore it is possible to take the view that wherever the statute is silent, a view that is favourable to the assessee has to be adopted.

Explanation 1

Assets used for the purpose of scientific research –

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.

Actual Cost in Special Cases Explanation 1 to Sec 43(1) Assets used for Scientific Reasons		Amt
Opening WDV		28,75,000
Add:		
Assets used for scientific research now used for ordinary business. (100% depreciation claimed u/s 35 in past)		Nil
		28,75,000
Less:		
Assets sold during the year		1,90,000
WDV before charging depreciation		26,85,000

Explanation 2

Assets acquired by means of gift will and inheritance

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.

Explanation 2 to Sec 43(1)		
Assets acquired by way of gift/inheritance		
		Amt
Opening WDV		32,85,500
Add:		
Assets acquired by way of gifts / inheritance (WDV to previous owner)		6,95,700
		39,81,200
Less:		
Assets sold during the year		-
WDV before charging depreciation		39,81,200

Explanation 3

Assets earlier used by the other person for the purpose of business or profession

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.

Explanation 3 to Sec 43(1) Second hand assets		Amt
Opening WDV		32,85,500
Add:		
Second hand assets acquired (pre-decessor used it for personal purposes) Purchase cost – 5,00,000 WDV of pre-decessor – 4,50,000 Officer consider reasonable – 3,00,000		5,00,000
Second hand assets acquired (pre-decessor used it for business) Purchase cost – 10,00,000 WDV of pre-decessor – 9,50,000 Officer consider reasonable – 8,00,000		8,00,000
		45,85,500
Less:		
Assets sold during the year		-
WDV before charging depreciation		45,85,500

Explanation 4

Assets re-acquired

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

(iii) The actual price for which the asset is re-acquired by him, whichever is less.

Explanation 4 to Sec 43(1) Assets used for B/P, sold/transferred and reacquired by him Actual cost to assessee lower at the following	Amt	Amt	Amt
Actual price for which asset is reacquired			6,00,000
Actual cost to assessee when first acquired the asset		1,50,000	
Less: Depreciation			
1st year @ 7.5%	11,250		
2nd year @ 15%	20,813		
3rd year @ 15%	17,691	49,754	1,00,246
Cost to assessee (whichever is less)			1,00,246

Explanation 4A

Sale and lease back

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.

Explanation 4A to Sec 43(1) Assets transferred & reacquired by way of lease, hire or otherwise	Amt	Amt
Actual cost to lessor will be actual cost to previous owner		2,00,000
Less: Depreciation claimed by previous owner		
1st year @ 15%	30,000	
2nd year @ 15%	25,500	
3rd year @ 15%	21,675	77,175
WDV before depreciation		122,825
Cost of asset to person who purchased the asset in scheme of sale and lease back.		

Explanation 5

Capital asset used for the purpose of business

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.

Explanation 5 to Sec 43(1) Property of assessee now used for the purpose of Business/Profession		
	Amt	Amt
Actual cost of building		20,00,000
Less: Depreciation for 3 years		
1st year	2,00,000	
2nd year	1.80.000	
3rd year	1,62,000	5,42,000
Actual cost for claiming depreciation		14,58,000

Explanation 6

Transfer by a holding to its subsidiary company and vice-a-versa

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.

Explanation 6 to Sec 43(1) Transfer of Assets by Holding Co. to 100% Subsidiary Co. Subsidiary Co.	Amt
Opening WDV	27,68,500
Add:	
Assets acquired from Holding Co.	20,00,000
	47,68,500
Less:	
Assets sold during the year	Nil
WDV before charging Depreciation	47,68,500

Explanation 7

Transfer in a scheme of amalgamation

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.

Explanation 7A

Transfer in a scheme of demerger

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.

Explanation 7 to Sec 43(1)	
Transfer of Assets in case of Amalgamation / demerger	
Amalgamating Co.	Amt
Opening WDV	9,87,600
Add: Assets acquired under scheme of Amalgamation	
WDV of the Amalgamated Co./Transferor Co.	11,25,750
	21,13,350
Less:	
Assets sold during the year	Nil
WDV before charging Depreciation	21,13,350

Explanation 8

Interest on the capital borrowed

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.

Explanation 9

Treatment of modvat

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.

Explanation 10

Treatment of subsidy

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.

Explanation 10 to Sec 43(1)	
Cost of Assets in case subsidy/Grant/Reimbursement received from Central Government/State Government	
	Amt
Cost of the Asset (P & M) (20.00+35.00+15.00)	70,00,000
Less: Subsidy received @ 25%	
25% on 15,00,000 (eligible for subsidy)	3,75,000
Cost of Asset (P & M)	66,25,000

Explanation 11

Treatment of foreign assets brought in india

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.

Explanation 11 to Sec 43(1)	
Asset brought by Non-Resident (including Foreign Co.) in India & used for Business/Profession	
Asset brought from USA	Amt
Cost of the Asset purchased in USA 3 years back (P & M)	31,50,000
Less:	
Depreciation had it been used in India (4,72,500 (15%) + 4,01,625 (15%) + 3,41,382 (15%))	12,15,507
WDV Before Depreciation	19,34,493

Explanation 12

Assets in scheme of corporatisation of recognised stock exshange

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.

Explanation 13

Assets of 35AD business

The actual cost of any capital asset on which deduction has been allowed or is allowable to the assessee under section 35AD, shall be treated as 'nil',

(a) in the case of such assessee; and

(b) in any other case if the capital asset is acquired or received,

(i) by way of gift or will or an irrevocable trust;

(ii) on any distribution on liquidation of the company; and

(iii) by such mode of transfer as is referred to in clauses (i), (iv), (v), (vi), (vib), (xiii), (xiiib) and (xiv) of section 47;

SLM BASIS – FOR POWER UNITS

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.

Manner of computation / Adjustments	Rs.
Net profit as per Profit and Loss account	108
Add:	
Balancing charge on sale of Assets by electric company (Sale proceeds-WDV) (1,75,000-2,25,000)	50
	158
Less:	
Profit on sale of assets (As per books)	140
	18

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.

Section 32(1)(i) – Depreciation for Power Generating Undertakings			
	Situation 1	Situation 2	Situation 3
	Amt	Amt	Amt
Actual cost of Asset	15,00,000	15,00,000	15,00,000
Less:			
Accumulated Depreciation on SLM (for 2 years)	1,50,000	1,50,000	1,50,000
WDV	13,50,000	13,50,000	13,50,000

Sale Proceeds	10,50,000	14,40,000	18,00,000
Less : WDV	13,50,000	13,50,000	13,50,000
	3,00,000	90,000	4,50,000
	Terminal Depreciation	Balancing charge taxable as deemed income u/s 41(2)	1,50,000 Balancing charge u/s 41(5) (18,00,000-15,00,000) = 3,00,000 STC Gain

UNABSORBED DEPRECIATION

Set-off of Current Year Depreciation 32(2)

Current year depreciation is set-off in the following manner:

(i) *Depreciation to be set-off to the extent of profits.* Depreciation is allowed to be set-off to the extent of the profits and gains of the business profession. Where profits are not sufficient to absorb the full amount of depreciation, the balance amount of depreciation becomes unabsorbed depreciation. For example, depreciation of timber business is Rs 70,000 but profits, before depreciation, are only Rs 30,000. Depreciation of Rs 70,000 can be set-off to the extent of Rs 30,000 only. The balance amount of Rs 40,000 becomes unabsorbed depreciation of "timber business".

(ii) *Unabsorbed depreciation of one business to be set-off against the profits of another business.* The unabsorbed amount of current year depreciation of one business can be set-off against the profits and gains of any other business profession, carried on by the assessee and assessable for that assessment year. For example, unabsorbed depreciation of "timber business" may be setoff against the assessable profits of "sugar business".

Similarly, unabsorbed depreciation of speculative business may be set-off against the profits of any other business even though the speculative loss cannot be set-off against business-profits.

(iii) *Unabsorbed depreciation to be set-off against the income of any other head.* If current year depreciation cannot be fully set-off against the profits of any other business, it can be set-off against the income of any other head, for example, salary, house property, capital gains, etc., but not against winnings, covered under Sec. 115BB. Finally, if current year depreciation can neither be set-off under the head business-profession, nor against the income of any other head, it is treated as finally unabsorbed depreciation of that year.

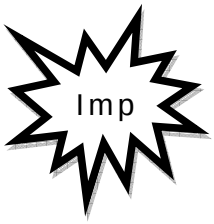
(iv) *Business loss and unabsorbed depreciation.* If there is business loss prior to setting-off current year depreciation, the whole depreciation remains unabsorbed. Under inter-head adjustment, current year business loss will have a priority over current year unabsorbed depreciation.

(v) *Carry forward of unabsorbed depreciation.* Unabsorbed depreciation will be carried forward for future set-off, without any time-limit.

Section 32(2)		
Set off & Carry forward of unabsorbed depreciation		
	Amt	Amt
Business income from charging depreciation	84,000	
Less: Depreciation on (Carried forward from earlier year 1,36,500)	84,000	Nil
Income from house property	26,750	
Less: Unabsorbed depreciation	26,750	Nil
Income from other sources	6,000	
Less: Unabsorbed depreciation	6,000	Nil
Total income		Nil
(unabsorbed depreciation 1,36,500 - 84,000 – 26750 – 6000 = 19750) Unabsorbed depreciation of Rs. 19,750 c/fd to next assessment years & merged into current depreciation of next year.		

FOREIGN EXCHANGE TREATMENT

Change in the rate of exchange of currency



Section 43A deals with the adjustments to be made in the actual cost of the asset on account of change in the rate of exchange of currency. The Finance Act, 2002 has substituted a new section 43A with effect from the assessment year 2002-03. As per this amendment, notwithstanding anything contained in any other provisions of the Act, where an assessee has acquired any asset in any previous year from a country outside India for the purposes of his business or profession and, in consequence of a change in the rate of the exchange during any previous year after the acquisition of such asset, there is an increase or reduction in the liability of the assessee as expressed in Indian currency (as compared to the liability existing at the time of acquisition of the asset) at the time of making the payment towards the whole or part of the cost of the asset or towards the repayment of whole or a part of the monies borrowed by him from any person, directly or indirectly in any foreign currency specifically for the purpose of acquiring the asset along with the interest, if any, the increase or reduction in the liability during the previous year which is taken into account at the time of making the payment, irrespective of the method of accounting followed by the assessee, is to be added to, or as the case may be, deducted from, the actual cost the asset as defined in clause (1) of section 43. In other words the extent of addition or reduction will be limited to the exchange difference actually paid during the previous year.

It may be noted that the provisions of section 43A of the Income-tax Act are in tandem with the provisions of the Companies Act, 1956. Under the Companies Act the exchange difference is to be added to or deducted from the cost or written down value of the fixed assets for being disclosed as per the requirements of Schedule VI.

However Accounting Standard-11 (revised) issued by the ICAI permits exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets, which are carried in terms of historical cost, to be adjusted in the profit and loss account. To this extent AS-11 is at variance with the provisions of the Income-tax Act, 1961. If the assessee is a company it has to comply with the requirements of AS-11 for the purpose of disclosing a true and fair view of the profit and loss account and balance-sheet. This is due to the requirements of section 211(3C) of the Companies Act, 1956. Therefore, at the time of computation of income for the purposes of the Income-tax Act, suitable adjustments have to be made in the cost of the fixed assets. However, in the case of non-corporate assessees, there is no mandatory requirement to follow the accounting standard of ICAI. As per the Guidance Note on Tax Audit, the tax auditor has to verify the compliance with the accounting standards of the ICAI even in the case of non-corporate assessees. It may further be noted that under the Income-tax Act, AS-11 of the ICAI is not a notified standard under section 145(2). Therefore, for the purposes computation of income, necessary reworking may have to be made even in the case of non-corporate assessees in order to ensure proper compliance with the provisions of section 43A.

Depreciation in respect of Assets acquired on credit/deferred payment basis Loan payable in Foreign currency Section 43A	Amt	Amt
1St Year		
Cost of Asset (Purchased & Put to use on 15/09/2010) USD 50,000 @ 45		22,50,000
Less:		
Depreciation @ 15%		3,37,500
WDV After Depreciation		19,12,500
2nd Year		
Opening WDV	19,12,500	
Add: Adjustment as per section 43A		
Loan repaid USD 25,000 @ 47.50 (47.50-45.00)	62,500	
WDV before charging Depreciation		19,75,000
Less:		
Depreciation @ 15%		2,96,250
WDV after Depreciation		16,78,750
3rd Year		
Opening WDV	16,78,750	
Add		
Add: Adjustment as per section 43A		
Loan repaid USD 25,000 @ 44 (44-45)	(-25,000)	
WDV before charging Depreciation		16,53,750
Less:		
Depreciation @ 15%		2,48,063
WDV after Depreciation		14,05,687

SCIENTIFIC RESEARCH

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 1 ¾ times of any sum paid to a 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 1 ¼ times of any sum paid to a research association which has as its object the undertaking of research in social science or statistical research or to a university, college or other institution to be used for research in social science or statistical research:
4) In respect of any expenditure of a capital nature on scientific research related to the business carried on by the assessee,
5) an amount equal to 1 ¼ times of any sum paid to a company to be used by it for scientific research: Provided that such company— (A) is registered in India, (B) has as its main object the scientific research and development, (C) is, for the purposes of this clause, for the time being approved by the prescribed authority in the prescribed manner, and (D) fulfils such other conditions as may be prescribed

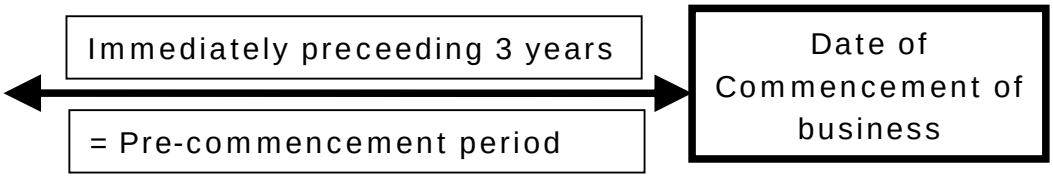
With a view to induce more investment for research and development activities, It is provided for a weighted deduction of such sums paid. The Act also vests the authority for approval, for the purposes of above clauses, in the Central Government instead of the prescribed authority.

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.



Manner of computation / Adjustments		Rs.
Net profit as per Profit and Loss account		108
Less:		
Pre-Commencement S/R expense (3 years back) (Allowed in the year of commencement)		10
Acquisition of land (not allowed)		--
		98

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, then -

1) There shall be allowed a deduction of sum equal to one and three-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:

35(1)(ii) / (iii) approval must be by government

For claming weight deduction of 175% for donation to research association, university, collage or other institutions for conducting scientific research, such association, university, etc. should be approved by way of notification by the Central Government.

Scope of various section

35(1)(ii) approved university
35(1) (iii) approved institution
35(2AA) national laboratory
35AC eligible project
35CCA institution carrying out rural development
80GGA donation for scientific research / rural development.
Donation to certain institution shall not be denied mearly because approval granted is later withdrawn

Sec.43(4) meaning of scientific research activity

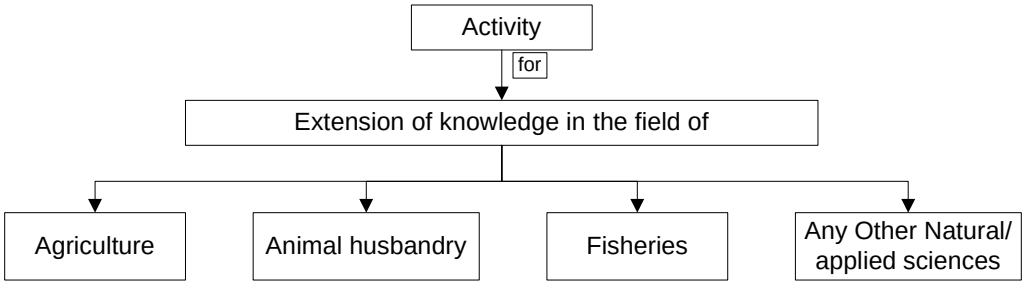
(i) "SCIENTIFIC RESEARCH" means any activities for the extension of knowledge in the fields of natural or applied science including agriculture, animal husbandry or livestock;

(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;



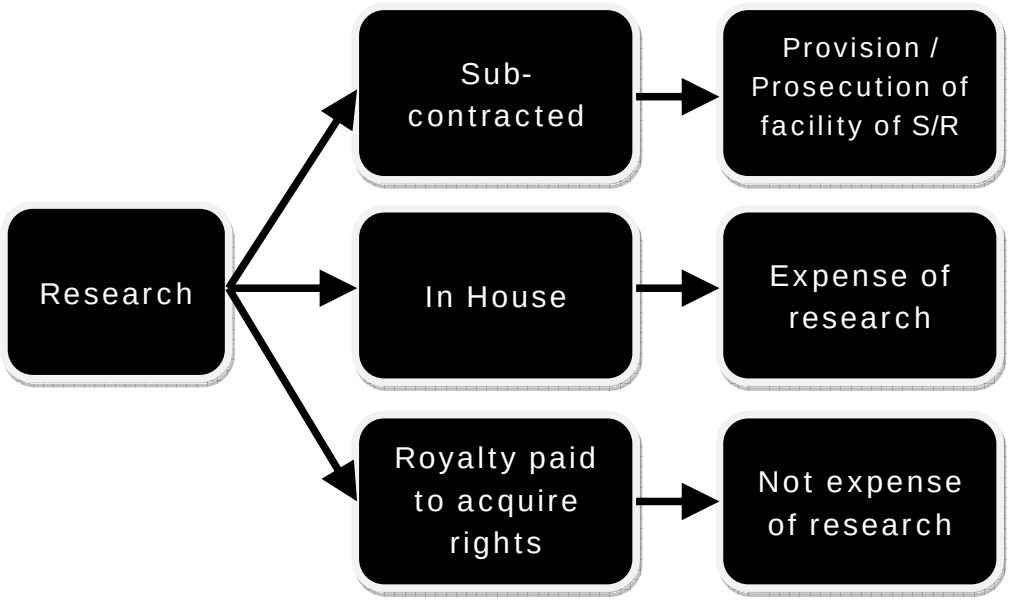
Royalty payment for rights arising out of scientific research

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.

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.

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)

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)

WDV of asset transferred to S/R department

Multi Metals Ltd. vs. CIT (Raj) Section 35 provides that if the assessee has incurred any expenditure on scientific research, he/it will be eligible for the deduction as provided under section 35 on account of the assets acquired for scientific research. For the purposes of depreciation it is enough if the assessee owns the asset but for the benefit of allowance under section 35, the assessee should incur expenditure for scientific research. In the absence of such a provision, the mere transfer entry in the

books of account from one head to other head does not make the assessee eligible for deduction under section 35.

Question

The assessee-company derives income from sale and manufacture of tubes, print rolls, etc. The brief facts in the return filed by the assessee are that the assessee claimed an expenditure of Rs. 11,53,294 incurred under the head "Capital" as expenditure relatable to scientific research. This amount included a sum of Rs. 11,14,885 which represented the written down value of assets, which assets were acquired earlier and used for the purpose of business but transferred to the scientific research department during the financial year. The claim of the assessee was that once the assets are transferred from business assets to the assets for scientific research, the assessee is entitled for the benefit of the provision contained in section 35(1)(iv), as the assessee has incurred expenditure for the assets acquired for scientific research. You are required to answer whether claim of assessee is justified or not.

Answer

There is 100% deduction for scientific research expenditure even if it were of capital nature under section 35 of the Income-tax Act. Where the asset which has been allowed full deduction is transferred for regular business use, there is no further depreciation available as specifically provided therein. Where an asset which has been in regular use is transferred for use in scientific research the claim for 100% deduction under section 35 on the written down value (WDV) as on date of transfer was negatived in Multi Metals Ltd. v. CIT [2002] 254 ITR 652 (Raj) on the ground that there is no provision for such a contingency.

S/R building under construction

Rane brake linings ltd. (mad) As per section 35(1)(iv), in respect of any expenditure of a capital nature on scientific research related to the business carried on by the assessee, such deduction as may be admissible shall be allowed. The section refers only to "capital expenditure" and does not further require that the asset brought into existence by incurring such expenditure should have been complete in all respects. The deduction is for the expenditure to the extent incurred. Expenditure incurred on on-going construction of a building designed for housing the research wing is clearly capital expenditure and is deductible under this provision.

Question

In the course of assessment, the assessee claimed deduction under section 35(1)(iv) in a sum of Rs. 4,92,467 under the head "Research and development expenses". The Assessing Officer negatived the assessee's claim on the ground that the said expenditure related to a building that was still under construction and, therefore, the assessee is not entitled for the relief. You are required to answer Whether the assessee was entitled to deduction under section 35(1)(iv) on the cost of building under construction.

Answer

As per section 35(1)(iv), in respect of any expenditure of a capital nature on scientific research related to the business carried on by the assessee, such deduction as may be admissible shall be allowed. The section refers only to "capital expenditure" and does not further require that the asset brought into existence by incurring such expenditure should have been complete in all respects. The deduction is for the expenditure to the extent incurred. Expenditure incurred on on-going construction of a building designed for housing the research wing is clearly capital expenditure and is deductible under this provision.

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.

Manner of computation / Adjustments	Rs.
Net profit as per Profit and Loss account	108
Add:	
Sale of Asset Rs. 47 used for scientific research without being used for the business purposes. (not debited / credited to P/L) (100% deduction claimed u/s 35, 4 years back Rs. 75)	47
	155

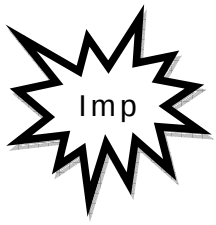
CORPORATE IN-HOUSE RESEARCH

Sec.35(2AB): in house scientific research

1) Where a company engaged in the any business of manufacture or production of any article or thing, not being an article or thing specified in the list of the Eleventh Scheduleincurs 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 200 % 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, 2012.
7) No deduction shall be allowed to a company approved U/S 35 in respect of the expenditure which is incurred after the 31st day of March, 2008

Manner of computation / Adjustments		Rs.
Net profit as per Profit and Loss account		108
Add:		
Eligible expenses debited to P/L (except acquisition of land (8) / Building (15))		25
		133
Less:		
(i) Expense incurred (200% of 25 as per Income Tax Act)	(-50)	
(ii) Expenditure incurred for acquisition of Building except cost of land (100% as per sectrion 35)	(-15)	65
		68

SPECIFIED BUSINESS. 35AD



Any expenditure of capital nature incurred, wholly and exclusively, during the year for specified business. The specified business has been defined to mean the business of setting up and operating of cold chain facilities, setting up and operating warehousing facility for storing agricultural produce and the business of laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network.

Section 35AD would, inter alia, allow one hundred per cent deduction in respect of any capital expenditure incurred, other than expenditure incurred on the acquisition of any land or goodwill or financial instrument, during the year by the specified business.

Basic condition

An assessee shall be allowed a deduction in respect of the whole of any expenditure of capital nature incurred, wholly and exclusively, for the purposes of any specified business carried on by him during the previous year in which such expenditure is incurred by him (if pre-commencement expense then in the year of commencement provided it is capitalized in books)

Conditions

- it is not set up by splitting up, or the reconstruction, of a business already in existence;
- it is not set up by the transfer to the specified business of machinery or plant previously used for any purpose;
- where the business is of the nature operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution such business, it has been approved by the Petroleum and Natural Gas Regulatory Board and notified by the Central Government in the Official Gazette in this behalf and has made not less than such proportion of its total pipeline capacity as specified by regulations made by the Petroleum and Natural Gas Regulatory Board available for use on common carrier basis by any person other than the assessee or an associated person;
- fulfils any other condition as may be prescribed.

No deduction

Where a deduction under this section is claimed and allowed in respect of the specified business for any assessment year, no deduction shall be allowed under the provisions of Chapter VI-A under the heading "C.—Deductions in respect of certain incomes" in relation to such specified business for the same or any other assessment year.

No deduction in respect of the expenditure shall be allowed to the assessee under any other section in any previous year or under this section in any other previous year.

Manner of computation / Adjustments		Rs.
Net profit as per Profit and Loss account		108
Less:		
(i) Deduction for capital expenditure (capitalized) excluding expenditure incurred on acquisition of land or goodwill or financial instruments (100% as per Income Tax Act)	11.5	
(ii) Pre-commencement Capital Expenditure allowed (capitalized)	3.5	15
		93

"cold chain facility"

Means a chain of facilities for storage or transportation of agricultural and forest produce, meat and meat products, poultry, marine and dairy products, products of horticulture, floriculture and apiculture and processed food items under scientifically controlled conditions including refrigeration and other facilities necessary for the preservation of such produce;

"specified business" means

The any one or more of the following business, namely :

i. setting up and operating a cold chain facility; (commenced on or after 01/04/2009)

ii. setting up and operating a warehousing facility for storage of agricultural produce; (commenced on or after 01/04/2009)

iii. laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network. (commenced on or after 01/04/2007)

iv. building and operating, anywhere in India, a new hotel of two-star or above category as classified by the Central Government; (commenced on or after 01/04/2010)

v. building and operating, anywhere in India, a new hospital with at least one hundred beds for patients; (commenced on or after 01/04/2010)

vi. developing and building a housing project under a scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government, as the case may be, and notified by the Board in this behalf in accordance with the guidelines as may be prescribed; (commenced on or after 01/04/2010)

Second hand plant and machinery

Any machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose, if—

(i) such machinery or plant was not, at any time prior to the date of the installation by the assessee, used in India;

(ii) such machinery or plant is imported into India from any country outside India; and

(iii) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of this Act in computing the total income of any person for any period prior to the date of the installation of the machinery or plant by the assessee;

(e) where in the case of a specified business, any machinery or plant or any part thereof previously used for any purpose is transferred to the specified business and the total value of the machinery or plant or part so transferred does not exceed twenty per cent of the total value of the machinery or plant used in such business, then, for the purposes of clause (ii) of sub-section (2), the condition specified therein shall be deemed to have been complied with;

No deduction

Any expenditure of capital nature shall not include any expenditure incurred on the acquisition of any land or goodwill or financial instrument.

Actual cost of such assets 43(1)

The actual cost of any capital asset on which deduction has been allowed or is allowable to the assessee under section 35AD, shall be treated as 'nil',—

(a) in the case of such assessee; and

(b) in any other case if the capital asset is acquired or received,—

(i) by way of gift or will or an irrevocable trust;

(ii) on any distribution on liquidation of the company; and

(iii) by such mode of transfer as is referred to in clauses (i), (iv), (v), (vi), (vib), (xiii) and (xiv) of section 47;

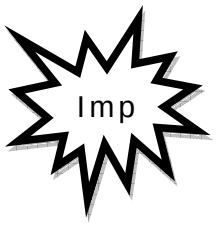
50B and 73A

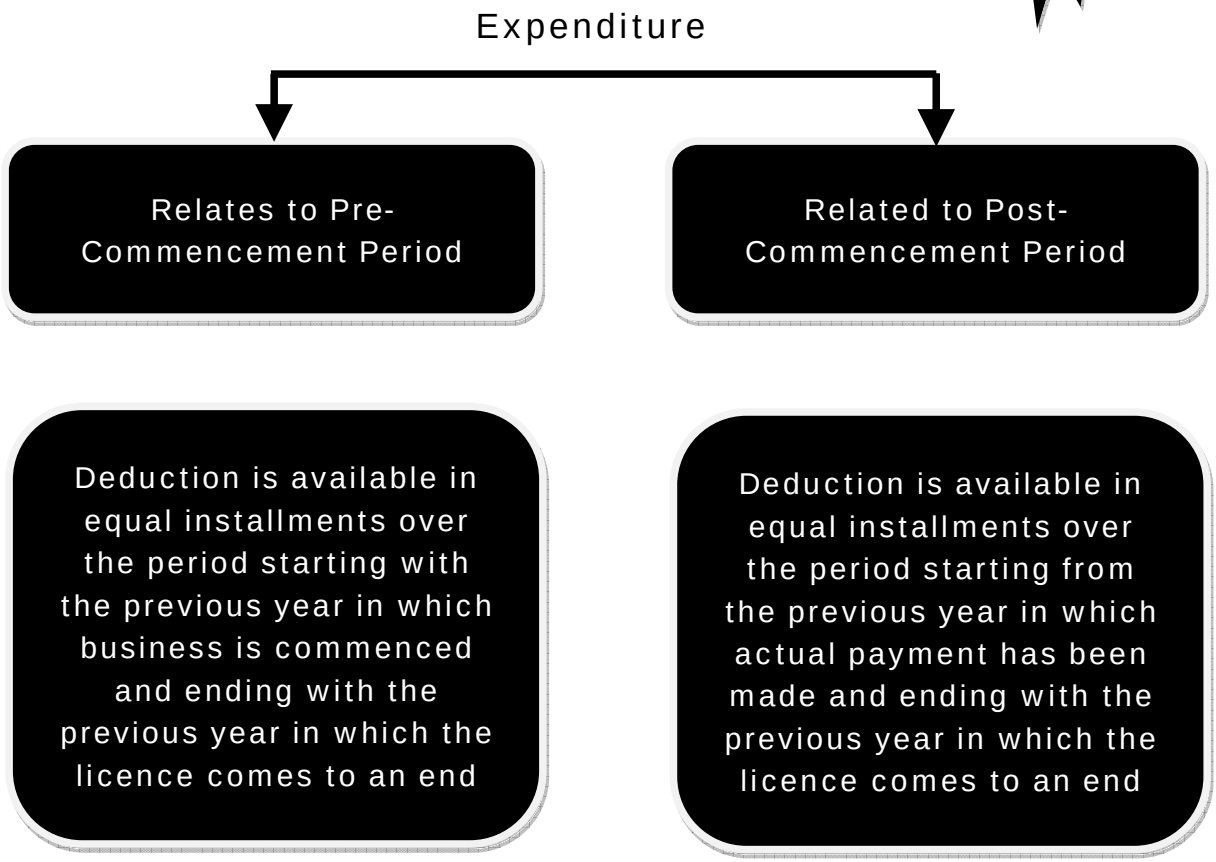
In case of slump sale cost of such asset will be nil.

If such business is a loss then it can be set off against income of such business only. If it is carried forward it can be carried forward and set off againt income of such business only.

TELECOM BUSINESS

SEC.35ABB: LICENCE FEES





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.

Manner of computation / Adjustments	Rs.
Net profit as per Profit and Loss account	108
Add:	
Amount paid to obtain licence to operate Telecommunication-10 years (if debited to P/L A/c)	50
	158
Less:	
Deduction in equal installments for 10 years (50/10)	5
	153

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.

VARIOUS CONTRIBUTIONS

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 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.

Manner of computation / Adjustments	Rs.
Net profit as per Profit and Loss account	108
Add:	
Contribution to Public Sector Co./local Authority/Assoc Inst (As debited to P/L A/c)	12
	120
Less:	
Contribution to local authority or to Association or institution approved by National Committee (100% as per Income Tax Act)	12
Note: Exemption not to be denied if approval to Asso/Inst is subsequently withdrawn)	108

AMORTISATION OF EXPENSES

SEC.35D: AMORTISATION OF CERTAIN PRELIMINARY EXPENSES

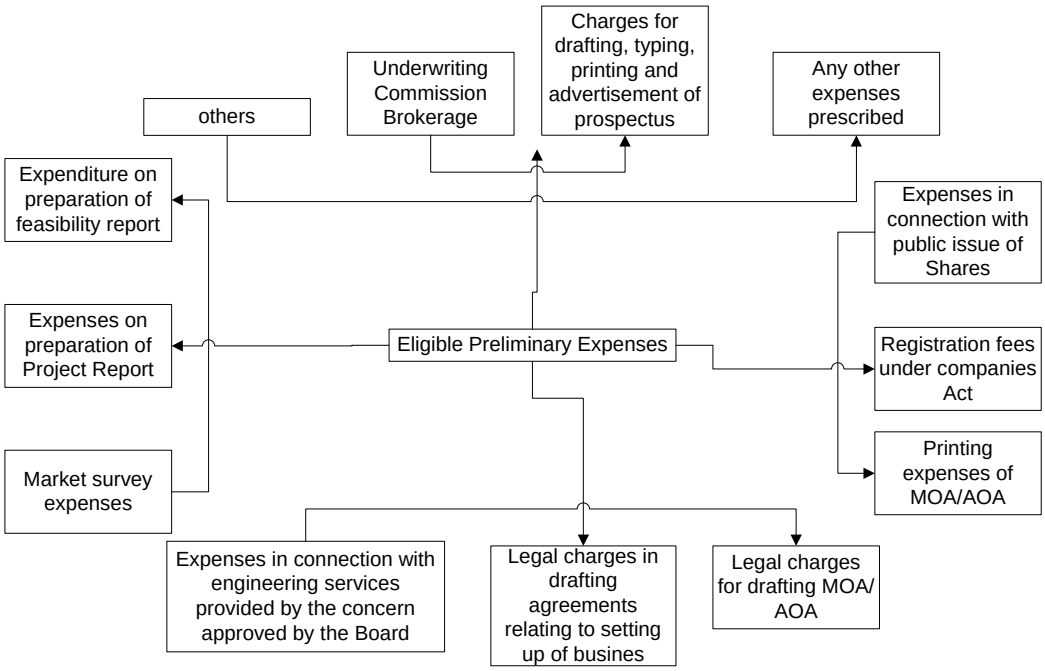
Who and when qualifies for deduction	
35(1)	Where an assessee, being an **Indian company** or a person (other than a company) who is **resident in India**, incurs, any expenditure Before the commencement of his business; or After the commencement of his business, in connection with the extension of his undertaking or in connection with his setting up a new 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 undertaking is completed or the new 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.

Manner of computation / Adjustments	Rs.
Net profit as per Profit and Loss account	108
Add:	
Pre-commencement or Preliminary Expenses	31
Less:	
1/5 of Qualifying Amount for 5 years (Qualifying amount – 5% of 500 = 25) Corporate Assessee – 5% of cost of Project or 5% of capital employed Non-corporate Assessee – 5% of cost of Project)	5
	134

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.

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)

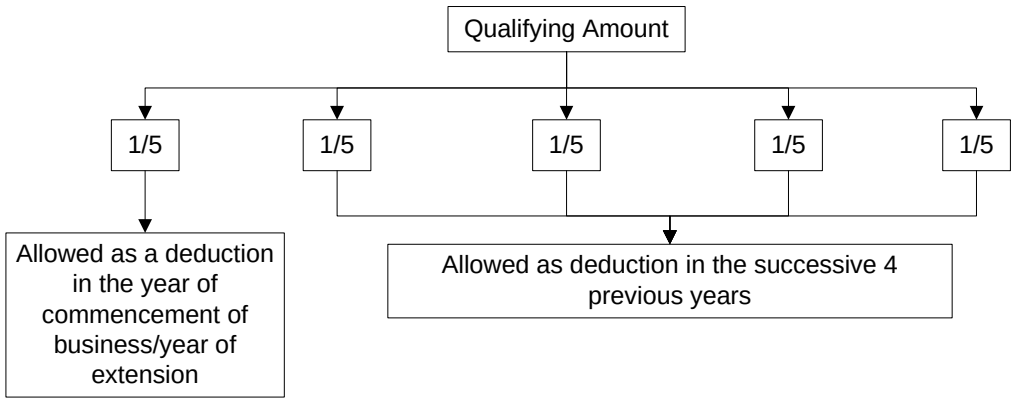
On general principles, the income-tax law does not permit the deduction of capital expenditure, except to the extent permitted by the statute. The concept of amortisation in income-tax law involves the write off of capital expenditure either in whole or over a period of years. The word "survey" occurring 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 undertaking nor for setting up of a new undertaking. Held in Appleate 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 undertaking or for setting up of a new 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 undertaking or for setting up a new 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 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.

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.

Manner of computation / Adjustments	Rs.
Net profit as per Profit and Loss account	108
Add:	
Expenditure in relation to Amalgamation / Demerber (if debited to P/L A/c)	10
	118
Less:	
Deduction 1/5 of sud Expenditure (1/5 of 10) (as per Income Tax Act)	(-2)
	116

Note: Similar prov. In case of A/D of Co-operative Banks

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.

The amortisation of expenditure incurred on voluntary retirement schemes, is being extended to the successor-entity

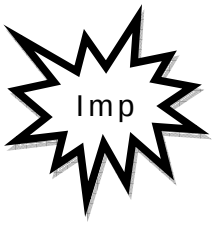
1. Undertakings of Indian companies getting amalgamated with another Indian company in a scheme of amalgamation before the expiry of the five-year period.
2. Undertakings of Indian companies transferred to another company in a scheme of demerger before the expiry of the five-year period.
3. Reorganisation 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
4. Where there has been reorganisation of business, whereby a private company or unlisted public company is succeeded by a limited liability partnership fulfilling the conditions laid down in the proviso to clause (*xiiib*) of section 47,

In all the above situations, the resulting/ successor entity will be entitled to benefit of deduction for the unexpired period.

In the year of transfer, no deduction shall be allowed to the amalgamating company / demerged company / firm / proprietary concern.

Manner of computation / Adjustments	Rs.
Net profit as per Profit and Loss account	108
Add:	
Amount paid to employees for VRS (Debited to P/L A/c)	15
	123
Less:	
Deduction 1/5 of the amount paid (1/5 of 15) (as per Income Tax Act)	(-3)
	120

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.

Manner of computation / Adjustments	Rs.
Net profit as per Profit and Loss account	108
Less:	
Deduction of 1/10 of Qualifying Amount (1/10 of 20) (For remaining no. of years to resulting Co.	(-2)
	106

SEC 44DB BUSINESS RE-ORGANISATION OF CO-OPERATIVE BANKS

44DB	Where there is any bank eligible for 35D, 35DD or 35DDA is amalgamated with another bank such deduction shall be bifurcated between transferor and ***transferee in the proportion of number of days.*** The new S. 44DB now provides that in the event of amalgamation or demerger of co-operative banks, deduction u/s.32 (Depreciation), 35D (Amortisation of preliminary expenses), and 35DD (Amortisation of amalgamation and demerger expenses) and 35DDA (Amortisation of VRS payments), which is allowable to the amalgamating or demerged bank will continue to be allowed to the amalgamated or resulting bank for the balance period. In the year of amalgamation or demerger, the deduction will be allowed to amalgamating/demerged as well as amalgamated/resulting bank on proportionate basis (based on number of days). The terms 'Amalgamation' and 'Demerger' are defined in the same manner in S. 2(1B) and S. 2(19AA) which apply to limited companies.

OTHER DEDUCATIONS

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 polices was not deductible under section 36(i) - CIT V/s. Khodidas Motriam 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;

Now, said section shall be amended to provide that the said premium can be paid by other mode also except cash.

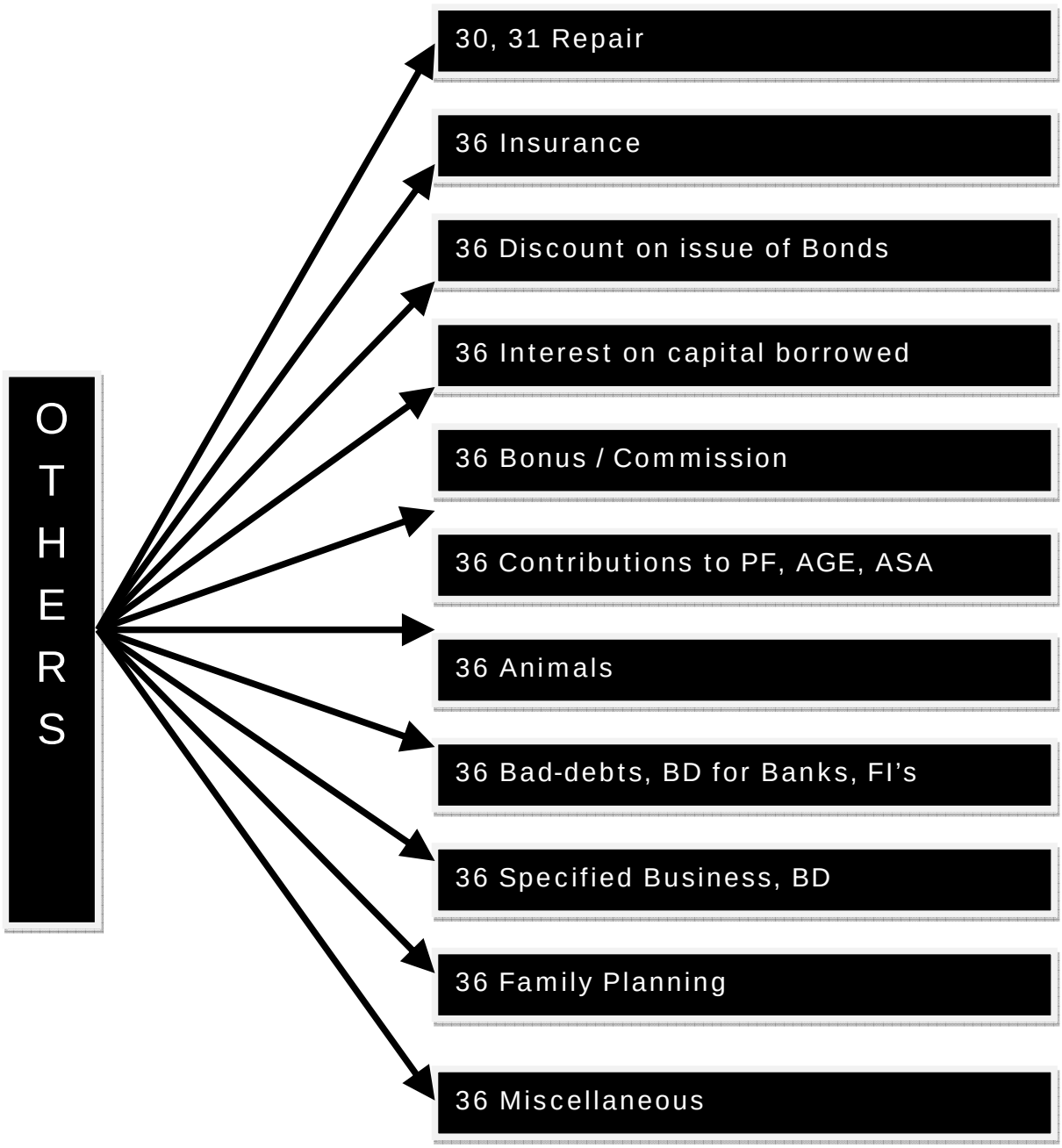
SEC.36(1)(III): INTEREST ON BORROWED CAPITAL

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.

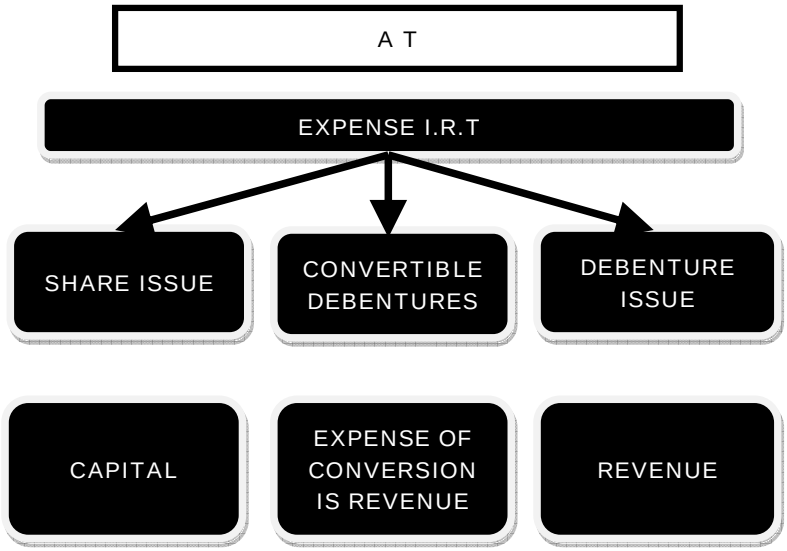
Provided that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset for extension of existing business or profession (whether capitalised in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of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

Manner of computation / Adjustments	Rs.
Net profit as per Profit and Loss account	108
Add:	
Interest on capital borrowed for acquisition of asset for extension of business. (Capitalised to cost of Asset till put to use)	1
	109


OTHERS
30, 31 Repair
36 Insurance
36 Discount on issue of Bonds
36 Interest on capital borrowed
36 Bonus / Commission
36 Contributions to PF, AGE, ASA
36 Animals
36 Bad-debts, BD for Banks, FI's
36 Specified Business, BD
36 Family Planning
36 Miscellaneous

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).

	Option 1	Option 2
	Liquidate FD and use for Personal Purpose.	Make FD as security and borrow funds for Personal Purpose.
Interest income (FD)	- -	10
Interest Expense (Borrowed funds for personal purposes.)	- -	9
Point to note	As tax planning advise must not borrow funds for exempt income or personal purposes.	Interest not allowable as expense.

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.)

	If expensed in books 45.	Extension of business.	If capitalized in books 30
36(1)(iii) -	45	15	15
Capitalise (Interest prior to asset being put to use.)	--	30	30
Total Interest	45	45	45
Section	36(1) (iii)	Prov 1	36(1) (iii) RW MOA

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.)

Nexus theory

In CIT v. Rockman Cycle Industries Ltd. [2009] 176 Taxman 21, the Punjab and Haryana High Court held that merely because the interest-free loan has been advanced by the assessee to the sister concerns, no such inference can be drawn that the said advances were not made for any business connection or purpose, especially in view of the Supreme Court decision in S.A. Builders Ltd. v. CIT (Appeals) [2007] 288 ITR 1/158 Taxman 74 referring to commercial expediency barometer. In this case, the Tribunal had recorded a finding of fact to the effect that the interest-free loan given to sister concern was for a business consideration.

The assessee borrowed a term loan for purchase of shares to be held as investment. Interest was disallowed by the Assessing Officer on the ground that the borrowing was not for the assessee's business, so as to be admissible under section 36(1)(iii). The dividend as and when received would, no doubt, be assessable under "Other sources". The Income-tax Officer's objection was that there were no dividends against which the deduction can be allowed, but the Tribunal allowed the deduction. The High Court in CIT v. Gorawara Plastics and General Industries P. Ltd. [2007] 289 ITR 224 (All) dismissed the departmental appeal following the decision in CIT v. Rajendra Prasad Moody [1978] 115 ITR 519 (SC), where it was decided that the fact that there was only nil dividend income during the year does not justify the disallowance. It may, however, be remembered that the decision was rendered when dividend income was taxable in the hands of the shareholder.

Where the assessee lends money without interest, there can be no inference of notional income based on reasonable interest, which the assessee might have charged for lending to relatives or sister concerns. But then, it is possible in such cases to disallow a proportionate part of interest paid on such borrowed capital, if any, to the extent that the borrowed funds are utilised for interest-free advances. The disallowance is on the ground, that it will not be eligible for deduction as expenditure incurred for purposes of business. If the assessee could, however, show that such interest-free advances have an element of commercial expediency, though not quid pro quo, it may not need disallowance as held by the Supreme Court in S. A. Builders Ltd. v. CIT (Appeals) [2007] 288 ITR 1. It deals with a case, where the assessee contested such disallowance relating to interest-free loans given to sister concerns. Notwithstanding the fact that the Tribunal had confirmed the disallowance and the High Court upheld the same, the Supreme Court found that the evidence suggested that the interest on borrowing should have been allowed. It was argued on behalf of the assessee, that the advance had been made out of a bank account, wherein both its own and borrowed funds were mixed up, so that there was no direct nexus between borrowing and the advances. It was further argued and accepted by the Supreme Court, that the loan to a sister company, which in this case was a subsidiary of the assessee company is one, which should be treated as prompted by commercial expediency, so that the amount was even otherwise allowable.

The Supreme Court, inter alia, endorsed the decision of the Delhi High Court in CIT v. Dalmia Cement (B.) Ltd. [2002] 254 ITR 377, that no businessman need be compelled to maximise his profit. The authorities should put themselves in the shoes of the assessee and consider what a prudent businessman would do. It is not the case of the Income-tax Department that the funds lent to the subsidiary company were used for non-business purposes. It was in this view, that the Supreme Court set aside the disallowance upheld by the High Court. The judgment, though in line with the established principles of the law on the subject, would indicate that the authorities had ignored the special relationship between the holding and subsidiary company, both in business, so that such

advance should be taken as prompted by commercial expediency, so as to be deductible under section 37, if not under section 36(1)(iii) of the Act.

	1	2	3	4
Source of Funds	own	Own	Borr.	Borr.
Lending interest Free	Yes	No	Yes	No
	One to one nexus between borrowal and lending not there.		Nexus is there	
Interest Payment whether dis-allowable	No	No	Yes	No

Mixed use of funds - presumption

The Bombay High Court in CIT v. Reliance Utilities & Power Ltd. [2009] 178 Taxman 135 held that if as per balance sheet there are funds available, both, interest-free and overdraft and/or loans taken, then a presumption would arise that investments would be out of interest-free funds generated or available with company, provided said funds are sufficient to meet investments. In this case, the Tribunal took into account the share capital, reserves including depreciation reserve to aggregate the interest free funds total and the High Court uprightly accepted the presumption made by the Tribunal.

Moneys borrowed for personal purposes on mortage of FD

DR. V. P. GOPINATHAN (SC) The assessee had put moneys in fixed deposit with a bank and had earned interest of Rs. 100,000. On the security of the amount so deposited, the assessee took a loan from the bank and paid in respect of the loan interest of Rs. 90,000. The question was whether the assessee could be taxed only on the difference of Rs. 10,000 or the gross income of Rs. 100,000. Held, that the interest that the assessee received from the bank on the fixed deposit was income in his hands and it could stand diminished only if there was a provision in law permitting such diminution. There was no such provision of law and the interest on the loan taken from the bank did not reduce his income by way of interest on the fixed deposit.

In other words such interest is not for earning the income from fixed deposits, so as to be allowed as a deduction under section 57(iii) [Same as 37(1)]. If the loan had been taken for purposes of business, such interest would have been allowable as a deduction from business income. If the assessee had borrowed moneys on interest and deposited such money in the bank, interest on such borrowing would have been allowed as a deduction against such interest on fixed deposits. One could borrow from a bank against deposits, say, for one's daughter's marriage, in which case interest paid on security of fixed deposit will not be allowed under any other head, while it would be so allowed if the borrowing was for business. But if the assessee instead of borrowing money against fixed deposits had foreclosed the fixed deposits, the contingency of his having to pay tax on the interest from fixed deposits may not have arisen or the damage would have been limited.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

The assessee had put moneys in fixed deposit with a bank and had earned interest of Rs. 100,000. On the security of the amount so deposited, the assessee took a loan from the same bank and paid in respect of the loan interest of Rs. 90,000. your are required to answer whether assessee is to be assessed on the gross amount of interest received by him on his fixed deposit or on the interest received as reduced by the amount of interest paid on the loan taken on the security of such deposit ?

ANSWER

The interest that the assessee received from the bank on the fixed deposit was income in his hands and it could stand diminished only if there was a provision in law permitting such diminution. There was no such provision of law and the interest on the loan taken from the bank did not reduce his income by way of interest on the fixed deposit. If the loan had been taken for purposes of business, such interest would have been allowable as a deduction from business income. Thus assessee do not qualify for deduction for the interest paid.

Sufficient available funds – No nexus

Radico Khaitan Ltd. (All) In order to claim allowance on interest on borrowed capital the following three conditions should be fulfilled : (i) the capital must have been borrowed or taken for the purpose of the business or profession ; (ii) the interest should have been payable ; and (iii) if the borrowing is not for business purposes and is for private purpose or is not connected with the business, interest paid on such borrowings cannot be allowed as a deduction under section 36(1)(iii).

In view of the findings recorded by the Tribunal that the assessee company had sufficient funds other than the borrowed money for giving the amount in question as loan to its sister concern, which finding had not been specifically challenged in the present appeal, the conditions of section 36(1)(iii) of the Act had been complied with and, therefore, the assessee-company was entitled to full allowance of the amount of interest paid by it on borrowed capital.

No notional income

S. A. BUILDERS LTD (SUPREME COURT OF INDIA) Where the assessee lends money without interest, there can be no inference of notional income based on reasonable interest, which the assessee might have charged for lending to relatives or sister concerns. But then, it is possible in such cases to disallow a proportionate part of interest paid on such borrowed capital, if any, to the extent that the borrowed funds are utilised for interest-free advances. The disallowance is on the ground, that it will not be eligible for deduction as expenditure incurred for purposes of business. If the assessee could, however, show that such interest-free advances have an element of commercial expediency, though not quid pro quo, it may not need disallowance as held by the Supreme Court in S. A. Builders Ltd. v. CIT (Appeals) [2007] 288 ITR 1. It deals with a case, where the assessee contested such disallowance relating to interest-free loans given to sister concerns. Notwithstanding the fact that the Tribunal had confirmed the disallowance and the High Court upheld the same, the Supreme Court found that the evidence suggested that the interest on borrowing should have been allowed. It was argued on behalf of the assessee, that the advance had been made out of a bank account, wherein both its own and borrowed funds were mixed up, so that there was no direct nexus between borrowing and the advances. It was further argued and accepted by the Supreme Court, that the loan to a sister company, which in this case was a subsidiary of the assessee company is one, which should be treated as prompted by commercial expediency, so that the amount was even otherwise allowable.

The Supreme Court, inter alia, endorsed the decision of the Delhi High Court in CIT v. Dalmia Cement (B.) Ltd. [2002] 254 ITR 377, that no businessman need be compelled to maximise his profit. The authorities should put themselves in the shoes of the assessee and consider what a prudent businessman would do. It is not the case of the Income-tax Department that the funds lent to the subsidiary company were used for non-business purposes. It was in this view, that the Supreme Court set aside the disallowance upheld by the High Court. The judgment, though in line with the established principles of the law on the subject, would indicate that the authorities had ignored the special relationship between the holding and subsidiary company, both in business, so that such advance should be taken as prompted by commercial expediency, so as to be deductible under section 37, if not under section 36(1)(iii) of the Act.

SEC.36(1)(IIIA): 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 or scheduled bank 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).

Manner of computation / Adjustments	Rs.
Net profit as per Profit and Loss account	108
Add:	
Discount on issue of Zero coupon bonds (Debited to P/L)	7.5
	115.5
Less:	
Deduction on prorate basis of the life of the bonds (in calendar months) 7.5/30 months*8 months	(-2.00)
	113.5

SEC.36(1)(IV): CONTRIBUTION TO RPF OR ASF

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.

Manner of computation / Adjustments		Rs.
Net profit as per Profit and Loss account		108
Add:		
Employees contribution to PF (not debited to p/l)	0.20	
Employees contribution to PF (not debited to p/l)	0.25	0.45
		108.45
Less:		
Employees contribution paid as per 43B before the due date of furnishing return of income.		0.25
		108.20

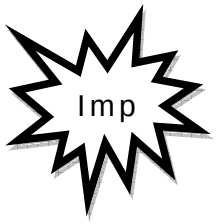
SEC.36(1)(V) CONTRIBUTION TO APPROVED GRATUITY FUND

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.

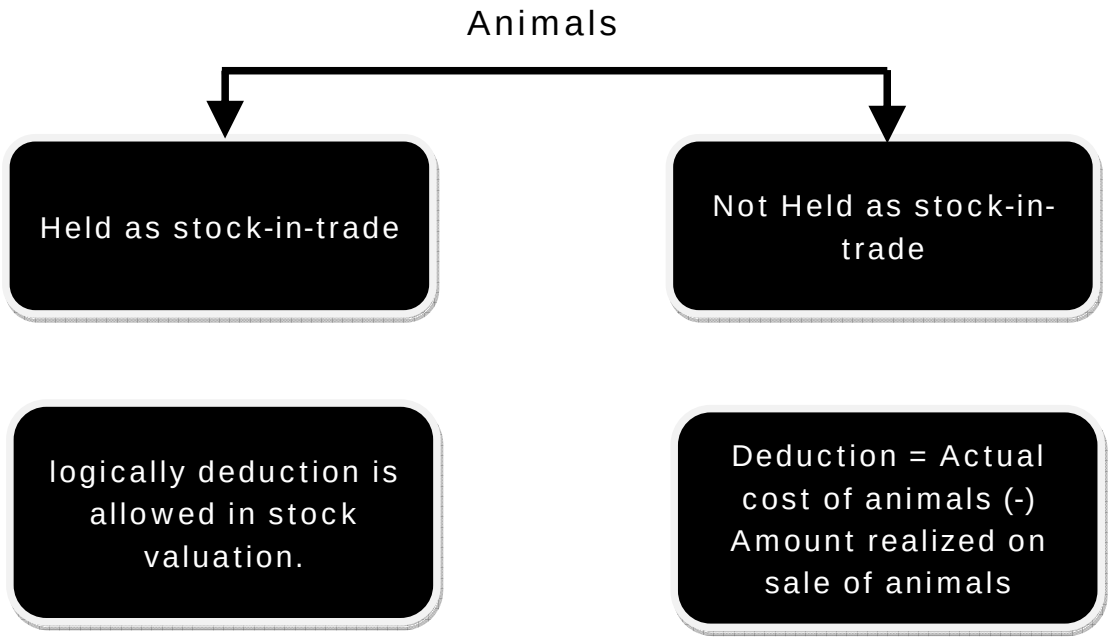
SEC.36(1)(VA) CONTRIBUTION TOWARDS AN APPROVED FUND

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.

Manner of computation / Adjustments	Rs.
Net profit as per Profit and Loss account	108
Add:	
Provision for Bad & Doubtful Debts (Debited to P/L A/c)	1
	109
Less:	
Actual Bad Debts written off	(-0.50)
	108.50

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 he 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

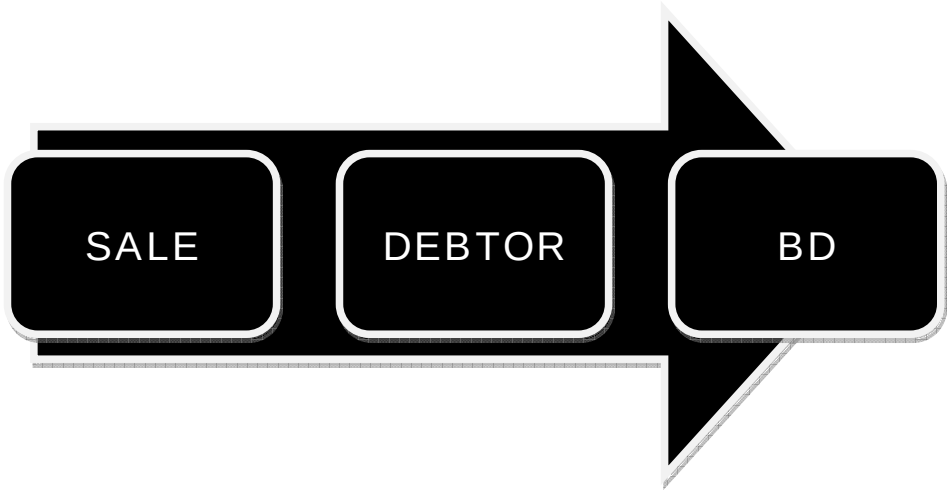
4) The amount should be written off as irrecoverable in the accounts of the assessee for that accounting year in which the claim for deduction is made for the first time - Sarangpur Cotton Mfg. Co. Ltd. V/s. CIT [1983] 143 ITR 166 (Guj.)

Relationship of the debtor and creditor:

A bad debt pre-supposes the existence of a debt and, therefore, a relationship of debtor and creditor is essential. Unless there was an admitted debt and it became irrecoverable, it cannot be written off as bad debt,

Bad debt be written-off in accounts:

A claim for bad debt is to be allowed in the year in which such bad debt is actually written-off by the assessee in the accounts as irrecoverable. No deduction is allowed for bad debts on the basis of provision for bad and doubtful debts [Explanation to Sec. 36(l)(vii)]. (iii) *Debt is taken into account in income computation or represents money lent in the business of banking or money lending [36(2)(i)]:*



Generally accepted accouting flow of transaction.

But for tax purposes even the trading loss can be considered for the purpose of deduction where originally there is no sales involved. Ex. Advance to creditors turning bad.

Bad debt under mercantile system:

The amount of debt must have been taken into account in computing the income of the assessee of that previous year or an earlier previous year. When accounts are kept on the basis of mercantile system of accounting, the tax is charged on profits, which may not have been realised by the assessee. If the debts of business or profession become irrecoverable, a deduction for such bad debts becomes necessary in order to arrive at the true profits and gains. Thus, no claim of bad debt can arise where accounts are kept on cash basis because a receipt goes to swell the profits only when it is actually realised. Thus, no tax is paid on due basis. Hence, no claim for bad debt can arise in such a case.

Bad debt in the business of banking or money-lending:

In case of banking or money-lending business the assessee is entitled to deduction in respect of irrecoverable loans advanced in the ordinary course of business, irrespective of the method of accounting employed. The reason is that money is the stock-in-trade or the circulating capital of a banker or money-lender. In the business of money-lending, each and every lending may not be in the ordinary course of business. For example, where a money-lender invests his capital or accumulated profits in government securities and debentures and suffers a loss on the investment such a loss is capital loss and cannot be deducted as bad debt against the profits and gains of money-lending business.

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)

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

Mere debit to the profit and loss account may not be sufficient

The Gujarat High Court, in Dhall Enterprises & Engineers (P.) Ltd. v. CIT [2007] 162 Taxman 114, held that mere debiting the amount is not sufficient for claiming a deduction under section 36(1)(vii). As per the Court, the requirement is that the assessee should also prove that the debt has become bad in that particular year. The Court also pointed out that if bad debt is not allowed in a particular year and the assessee shows that the amount of debt has become bad in some other subsequent year, he can approach the authorities for deduction in such year.

On the contrary, the Delhi High Court in CIT v. Morgan Securities & Credits (P.) Ltd. [2007] 162 Taxman 124 held that the previous practice of having to establish that a debt had become bad in the previous year has no relevance after 1989 amendment and a debt write off is a permissible deduction no sooner than it was written off in the books of the assessee. The Court made specific mention of the Board Circular No. 551, dated 23-1-1990 to remove one's doubts in this regard.

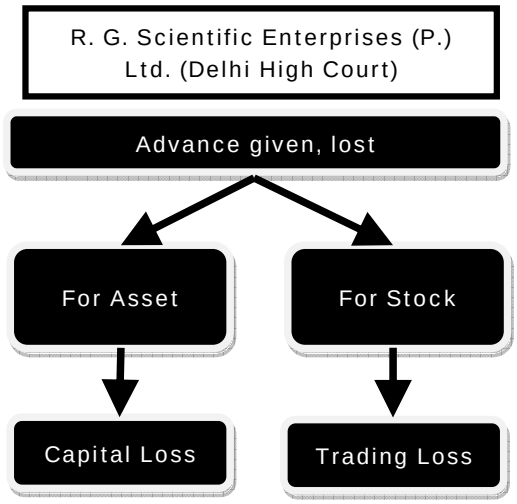
In CIT v. Sawhney Exports [2007] 162 Taxman 376 (Delhi), bad debts amounting to Rs. 1,25,36,852 were written off. The Reserve Bank of India had given permission in respect of a sum of Rs. 90,36,518 to be written off in the books of account. In respect of balance amount of Rs. 31,62,238, the Assessing Officer denied the benefit of writing off the bad debts since the approval from the Reserve Bank of India had been received subsequently. Allowing benefit of deduction of balance sum of Rs. 31,62,238, the Commissioner (Appeals) held that the approval from the Reserve Bank of India is not mandatory condition for writing off under the provisions of the Act.

Before the Delhi High Court it had been contended by the revenue that mere entry in the books of account 'writing off the debts' is not sufficient to make a claim for deduction under section 36(1)(vii) and the onus is still on the assessee to prove that the debt have become irrecoverable beyond doubt. The High Court showed preference to the view of the Commissioner when it held that as per provisions of section 36(1)(vii), the assessee is required to write off bad debts in its books of account which had been written off during the previous year relevant to the assessment year.

In another decision of CIT v. Autometers Ltd. [2007] 292 ITR 45, the Delhi High Court held that after the amendment of section 36(1)(vii) with effect from 1-4-1989, the assessee has only to write off the debt as irrecoverable in its accounts in order to claim deduction of bad debt.

Capital advances write off – Not allowed

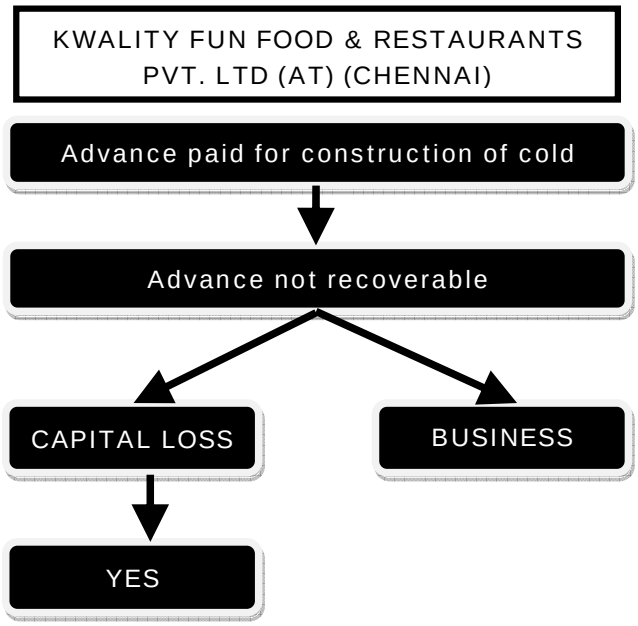
The Delhi High Court in CIT v. R.G. Scientific Enterprises (P.) Ltd. [2008] 166 Taxman 161 held that non recovery of sums advanced for purchase of premises would constitute a capital loss and not a business loss. In a recent decision of Chennai Tribunal in Kwality Fun Foods & Restaurants (P.) Ltd. v. Dy. CIT [2007] 108 ITD 274, the assessee had paid advance for erection of plant. However, the work could not be executed due to some reasons. He, thus, recovered part amount and the balance he wrote off as business loss. The Tribunal held such loss as capital in nature. Even it did not allow such loss as bad debt. The decision of the Supreme Court in Swadeshi Cotton Mills Co. Ltd. v. CIT [1967] 63 ITR 65 goes to hold that a payment made with the object of avoiding an unnecessary investment in capital assets will be in the nature of a capital expenditure. In this case, the machinery which was agreed to be purchased for carrying out expansion was, in fact, never purchased having regard to altered circumstances and the assessee had to pay certain compensation to the supplier. The Supreme Court held that the sum claimed as deduction was really paid for



breach of contracts in respect of purchase of textile machinery which would have been a capital asset. The payment is held to be one to avoid a larger capital expenditure that would not have served the interests of the assessee. It further held that the payment was neither made for the purpose of earning profits, nor for the purpose of furthering, protecting or continuing its business which was to be carried on from day-to-day. The payment was made with the object of avoiding an unnecessary investment in capital assets, and was an amount which was altogether outside the account of profits and gains, in the computation of which deductions are allowable for expenditure incurred wholly and exclusive for earning those profits and gains.

Also the Delhi High Court, in Edward Keventer(s) (P.) Ltd. v. CIT [1971] 81 ITR 126, held that the payment made for the purpose of getting rid of a permanent disadvantage or onerous liability arising with regard to the lease of land which was a permanent asset of the business would a have capital character.

Again in Dalmia Dadri Cement Ltd. v. CIT [1973] 90 ITR 297 (Punj. & Har.) the assessee-company had placed an order for the import of a dryer plant for its cement manufacturing business and, as desired by the supplier, opened an LC in its favour. Subsequently, on account of some difference regarding the specifications of the plant, the assessee requested the bankers to cancel the LC, but were told that the LC could not be cancelled without the consent of the manufacturers. The manufacturers refused to release the LC. A compromise was entered into whereby the LC was released on payment of £15,000 to the manufacturers. The assessee claimed this amount as revenue expenditure. The Punjab and Haryana High Court held that the expenditure for the acquisition of a plant was surely of a capital nature and any loss suffered in that transaction would naturally be of a capital nature. The Court followed Swadeshi Cotton Mills Co. Ltd.'s case (supra).



In Patel Brass Works v. CIT [2006] 286 ITR 598/[2007] 163 Taxman 279 (Raj.), the assessee gave up its plan to expand the business and cancelled the order for supply of machinery. The suppliers decided to return Rs. 36,000 after deducting Rs. 80,000 as cancellation charges out of earnest money. The assessee claimed deduction of this amount as business loss and alternatively as short-term capital loss. The assessee in the light of the ratio of the Apex Court's decision in the case of Swadeshi Cotton Mills Co. Ltd's case (supra) did not press for allowance of business loss before the Gujarat High Court. Even the alternative plea was not accepted by the High Court.

P/L 1-4 to 31-3			
Particulars	Amount	Particulars	Amount
Capital advance w. off (not bad-debts, not allowable)	12345		

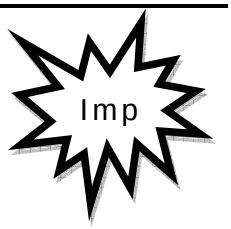
1.	R. G. Scientific Enterprises (Delhi High Court)
2.	Swadeshi Cotton Mills Co. Ltd. (SC)
3.	Kwality Fun Foods & Restaurants (P.) Ltd. (Chennai)
4.	Edward Keventer(s) (P.) Ltd. (Delhi High Court)
5.	Dalmia Dadri Cement Ltd. (P & H)

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.

Manner of computation / Adjustments	Rs.
Net profit as per Profit and Loss account	108
Add:	
Recovery of Bad Debts (Earlier allowed as deduction u/s 36(1)(vii))	20
	128

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



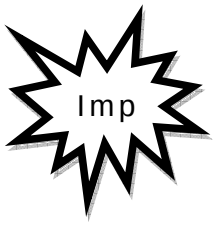
The amount of deduction in respect of provision for bad and doubtful debts is given below:

	In the case of a scheduled bank, co-operative 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 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.		

Manner of computation / Adjustments		Rs.
Net profit as per Profit and Loss account		108
Add:		
Provision for bad & Doubtful debts	7.5	
Bad Debts written off (Debited to P/L A/c)	2.5	10
		118
Less: Deduction u/s 36(1)(viia)		
7.5% of Gross Total Income (7.5% of 118)	8.85	
10% of Aggregate Advance by Rural Branches (10% of 275.00 lakhs)	27.50	36.35
		81.65

A scheduled bank or a non-scheduled bank or co-operative 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 ENGAGED IN PROVIDING LONG-TERM FINANCE FOR INDUSTRIAL OR AGRICULTURAL DEVELOPMENT OR FOR HOUSING.



In respect of any special reserve created and maintained by a specified entity which is engaged in specified business, an amount not exceeding 20 % of the profits derived from such business of providing long-term finance (5 years or more) (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.

Specified entity	***Eligible business***
Financial corporation (public sector company or specified in 4A of company law.)	Long term finance for Agri / Industrial / Infrastructure development in India / development of housing in India
Bank / co-operative bank	-do-
Housing finance company	Long term finance for housing
Other financial corporations	Long term finance for infrastructure facility in India

Manner of computation / Adjustments		Rs.
Net profit as per Profit and Loss account (eligible profits 110 and other loss 2)		108
Less: Lower of the following		
Amount transferred to Special reserve A/c	7.5	
20 % of eligible Profits before claiming deduction u/s 36(1)(viii)	22.00	
200 % of paid up share capital and general reserve. – opening balance of reseve (20 * 200 % - 13)	27.00	7.5
		100.50

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.

Manner of computation / Adjustments	Rs.
Net profit as per Profit and Loss account	108
Add:	
Amount withdrawn from Special Reserve maintained u/s 36(1)(viii)	82
	190

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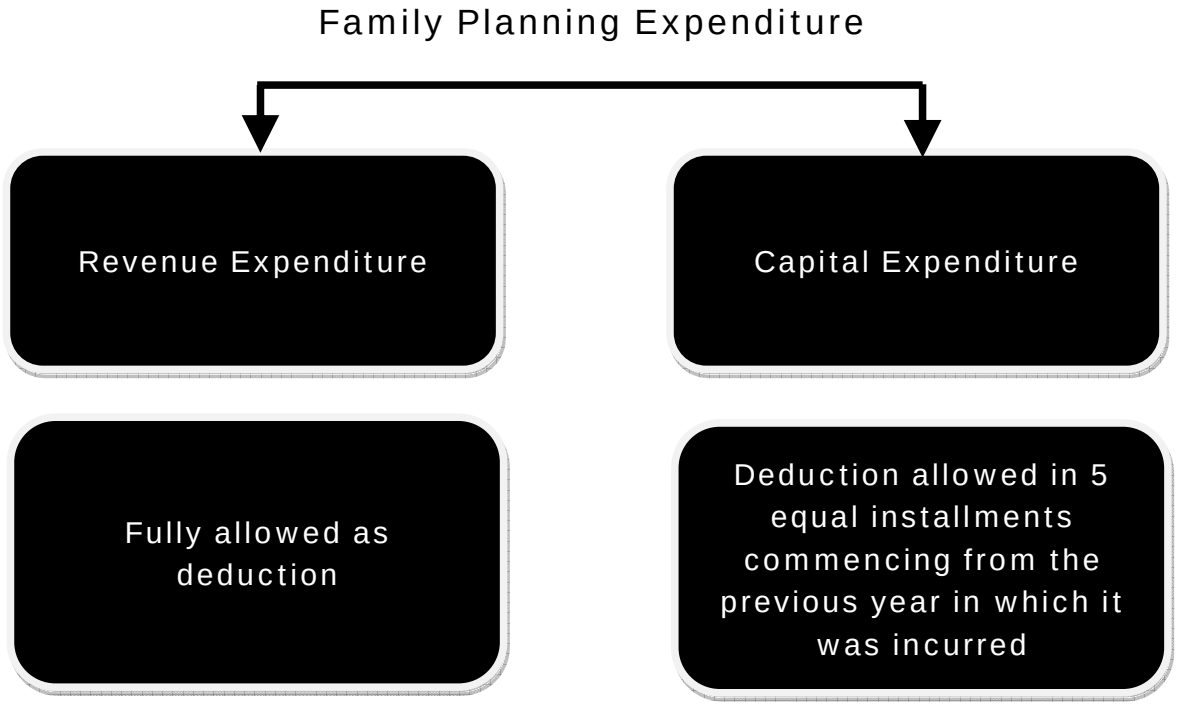
SEC.36(1)(IX) EXPENDITURE BY COMPANIES ON PROMOTION OF FAMILY PLANNING AMONG ITS EMPLOYEES.

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.



Manner of computation / Adjustments		Rs.
Net profit as per Profit and Loss account		108
Add:		
Expenditure on family planning (Debited to P/L A/c)		7
		115
Less: Deduction as per Income Tax Act.		
Revenue 2 – 100%	2	
Capital expense 5 * 1/5 (to be treated like depreciation.)	1	(-3)
		112

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 36(1)(XIV) CONTRIBUTION TO SPECIFIED FUND BY PFI

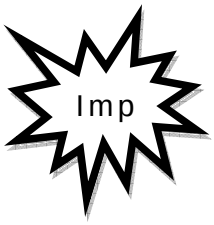
This provides deduction of any sum paid by a public financial institution by way of contribution to such credit guarantee fund trust for small industries as the Central Government may, by notification in the Official Gazette, specify in this behalf.

SEC 36(1)(XV) SECURITIES TRANSACTION TAX

An amount equal to the securities transaction tax paid by the assessee in respect of the taxable securities transactions entered into in the course of his business during the previous year, if the income arising from such taxable securities transactions is included in the income computed under the head "Profits and gains of business or profession". "securities transaction tax" and "taxable securities transaction" shall have the meanings respectively assigned to them under Chapter VII of the Finance (No. 2) Act, 2004 (23 of 2004).

EXPENSE FOR EARNING EXEMPT INCOME

NO DEDUCTION FOR EXPENDITURE 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

14A is amended to provide that the Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total income, in accordance with such method as may be laid down by the Central Board of Direct Taxes by rules, if the Assessing Officer having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of expenditure in relation to income which does not form part of the total income. Sub-section (3) is also inserted to provide that provisions of sub-section (2) shall also apply in relation to a case where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income.

Nature of business	Taxable	Exempt
Gross income	125	126
Gross Expense	74	99
Admin and other Expense (identifiable)	12	15
Common expense - 16	Reasonable Basis	Reasonable Basis

Expense for earning exempt income

The issue, how the expenses relating to exempt dividend should be quantified, had come up in Asst. CIT v. Citicorp Finance (India) Ltd. [2008] 300 ITR (AT) 398 (Mumbai). It was felt that there is no discretion to the Assessing Officer in this matter, since such expenses have to be identified and set off against exempt income shifting it from non-exempt income. Estimate of 4.06 per cent by allocating the expenditure between exempt income and non-exempt income was, however, not considered justified, while the assessee's argument that administrative expenses for running the company cannot be set off against business income was also found unacceptable. The matter was, therefore, remanded for quantification with reference to section 14A(2) and (3) in accordance with law. The Tribunal in CIT v. Dhanalakshmi Bank [2007] 12 SOT 625 (Coch) had decided that quantification would fail for lack of a prescribed method. Section 14A has since been amended empowering the Board to prescribe the method. The power has now been exercised by prescribing a method under rule 8D by notification dated March 24, 2008, by Income-tax (Fifth Amendment) Rules, 2008 ([2008] 300 ITR (St.) 88) requiring an allocation by providing a formula, which is now made mandatory.

TATA INVESTMENT CORPORATION LTD. (AT) (MUM))	
Co. x (Investment Co.)	
Interest Income	20
Dividend Income (exempt)	30
Less : Salary expense	Reasonable To allow. 14A

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Section 14A has since been amended empowering the Board to prescribe the method

	Exempt	Taxable
Dividend	10	-
Sale of shares (Capital Gain) (Profit)	-	6
Interest on Capital for shares acquisition	-	1
Income	10	5

(However Board has power to prescribe rules)

Ever since dividend income was exempt on shifting of liability from the shareholder to the company under section 115-O of the Act, the issue as to the deductibility of interest on borrowed capital against dividend income in the hands of the investor has surfaced. While a dealer would be eligible for the deduction from business income, the investor is faced with section 14A in view of the fact that the dividend income is exempt. But being exempt, section 14A would prima facie bar any deduction against it. The only possible argument against such disallowance can be based upon the substance rather than the form. In fact, such preference for substance has been indicated by the Central Board of Direct Taxes in Circular No. 9 of 2007 dated December 20, 2007 (see [2008] 297 ITR (St.) 1), when it advised that fringe benefits tax borne by the employer could be treated as suffered by the employee, so as to merit the benefit of the Double Tax Avoidance Agreement for the non-resident employee in the country of his residence. On such reasoning, the deductions could be allowed against dividend income. As otherwise, it distorts the income. Though a favourable view based upon substance was taken by the Mumbai Bench in Mafatlal Holdings Ltd. v. Addl. CIT [2004] 85 TTJ (Mum) 821 and two other cases, the preponderant view of the Tribunal against the taxpayer was followed in Mohananlal M. Shah v. Dy. CIT [2008] 303 ITR (AT) 221 (Mumbai).

This is a matter, which requires the attention of the Board for a reasonable view that the exemption for dividend under section 10(33)/10(34), though placed under Chapter III, is not an absolute exemption in view of the fact that such dividend suffers income-tax. Section 10(33) and now 10(34) clearly provide that what is exempt is "any income by way of dividend referred to in section 115-O". Section 115-O clearly charges by way of a distinct tax described as additional tax on dividend income not on the income of the company, but on dividend distributed by it. The objective of introduction of section 115-O or section 14A was not to distort the real income of the assessee, but for the convenient mode of taxation of dividend in the hands of the company rather than the numerous shareholders avoiding possible leakage of revenue in the process. But the Tribunal working under the constraint of not being able to go behind the plain meaning of the section was probably helpless. Can the Revenue insist upon what practically amounts to double taxation, when such dividend is taxed on the gross amount in the hands of the company, while part of such dividend income relating to the expenses incurred suffers tax again as disallowance of expenditure? Even so, in view of the conflicting views of the different Benches of the Tribunal, the issue should have been referred to a Special Bench and for the taxpayers to take up the matter with the Government, since it is totally an unintended result.

Section 14A has since been amended empowering the Board to prescribe the method

	Exempt	Taxable
Dividend	10	-
Dealers of Shares profit	-	11
Interest on capital for shares acquired	-	1
	10	10

(However Board has power to prescribe rules)

What is exempt under section 10(33)/10(34) is not net dividend as is understood for purposes of section 80M, but the gross dividend covered under section 115-O, so that no deduction can be referable to it under section 14A. Even under section 14A, what is required to be disallowed against taxable income is expenditure allowable against exempt income, so that it follows that there can be no objection against deduction of expenditure, which is not allowable against income because of exemption of gross income itself under section 10(33) or 10(34). In fact, section 115-O bars any deduction to the shareholder against such dividend income, so that there can be no disallowance of any legitimate expenditure incurred by a shareholder as pertaining to such exempt income.

The Tribunal in the case under comment also went further and held that the payment of interest for holding on to the investment for the period cannot be treated as cost of improvement, so as to merit deduction of such amount from capital gains on sale of such shares, contrary to the direct decisions of different High Courts accepted by the Revenue as in CIT v. Mithlesh Kumari [1973] 92 ITR 9 (Delhi) ; Addl. CIT v. K. S. Gupta [1979] 119 ITR 372 (AP) and CIT v. Maithreyi Pai [1985] 152 ITR 247 (Karn). Section 14A dealing with expenditure in computation of income under different heads cannot have application as wrongly understood in this case, since what is allowable under the head "Capital gains" is not barred under section 14A.

Section 14A would require expenditure to be allocated to the relative income. Where the assessee has income from business, which includes sub-letting of properties, interest and dividend assessable under different heads, the manner in which interest on borrowings for its business has to be allocated became an issue. Part of it was disallowed by the Assessing Officer as pertaining to non-taxable income from dividend. The proviso to section 14A spares retrospective application of the section, though the provision itself was retrospective. Understanding both the provision and the proviso in section 14A harmoniously, it was held that all pending assessments at whatever stage would be covered by the amendment, so that the proviso would have no application in the assessee's case, where re-assessment proceedings were pending on May 11, 2001, when the proviso became law : Aquarius Travels P. Ltd. v. ITO [2008] 301 ITR (AT) 111 (Delhi) [SB].

Only actual expenditure to be disallowed

The Punjab and Haryana High Court in CIT v. Hero Cycles Ltd. [2010] 189 Taxman 50 held that whether in a given situation, any expenditure was incurred which was to be disallowed, is a question of fact. In the instant case, the assessee having shown that interest bearing funds had been invested in units and non interest bearing funds had been used in dividend yielding investments succeeded in its

claim that for earning exempted income, no expenditure had been incurred. The High Court in particular refuted application of rule 8D knowing actual facts of utilization of interest bearing loans.

Proportionate disallowance of interest stood confirmed

In CIT v. Popular Vehicle & Services Ltd. [2010] 189 Taxman 14 (Ker.), the assessee suffered disallowance of interest as it was found that it had advanced interest free loan out of borrowed capital to a partnership firm in which it was a partner solely for the reason that the share of profit from such firm was exempt under the Act. The Kerala High Court did not find much interest in the plea of commercial expediency when it distinguished the facts in the assessee's case with the facts in S.A. Builders Ltd. v. CIT [2007] 288 ITR 1/158 Taxman 74 (SC).

The Kolkata Bench of ITAT in Dy. CIT v. Lt. Binod Kumar Chirania Through LRs [2010] 129 TTJ (UO) 41 held that the Assessing Officer having not proved any nexus between the borrowed funds and the amounts invested by an assessee in the purchase of shares or diversion of borrowed funds for non-business purpose cannot make any disallowance of interest on borrowings.

GENERAL DEDUCATION

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.

Provisions for Admissibility of Deduction u/s 37(1) Outlay should be an Expenditure

Section 37(1) allows deduction for an expenditure which denotes "spending" or "paying out" or "paying away". It is something which is gone irretrievably or which would not form part of assessee's fund again. If there is a possibility that the payment would become part of assessee's funds again, it could not be called an expenditure. Take an example. Sec. 15 of the payment of Bonus Act provides that where the allocable surplus exceeds the statutory maximum ceiling of bonus, such excess or 20% of total salary or wages, payable to employees, whichever is less, should be transferred to a fund to meet any shortfall in allocable surplus in next 4 years. The amount so transferred to the fund cannot be claimed as expenditure. The fund money could revert back to the assessee if the allocable surplus in next 4 years would not fall below the minimum statuory ceiling of the bonus. Hence, it could not be termed as "expenditure" [Mysore Lamp Works Ltd. *v.* CIT (1990) 185 ITR 96 **(Kar.)].**

REVENUE OR CAPITAL EXPENSE

Expenditure vs. Contingent Liability.

Expenditure is not necessarily confined to the money which has been actually paid out. Expenditure may also cover a provision for a liability which has accrued or which has been incurred during the year but which has not been paid.

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).

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'

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).

Contingent liabilities

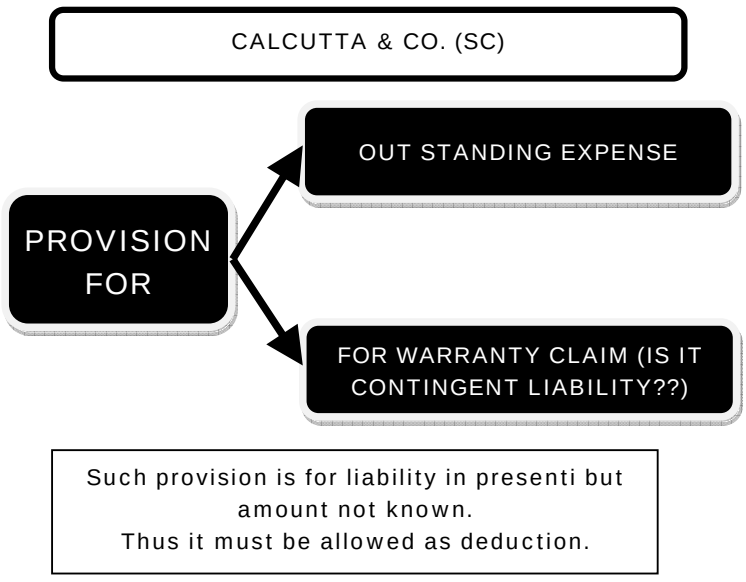
Contingent liabilities do not constitute expenditure and cannot be the subject-matter of deduction even under the mercantile system of accounting. Expenditure which is deductible for income-tax purposes is towards a liability actually existing at the time but the setting apart money which might become 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.

Warranty 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)

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).

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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).

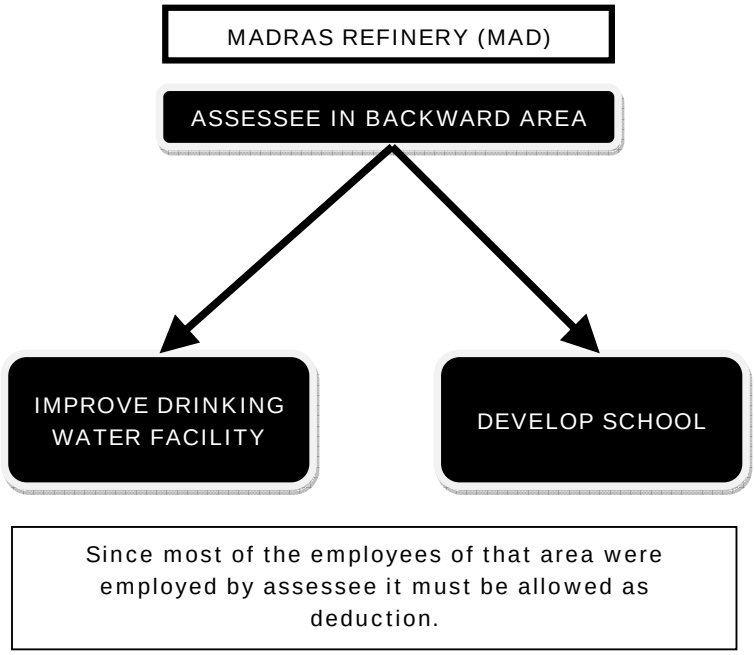
What is material to consider is the nature of the advantage in a commercial sense and it is only when the advantage is in the capital field that the expenditure would be disallowable on an application of this test. If an advantage consists merely in facilitating the assessee's trading operations or enabling 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.

Whether a particular expenditure is capital or revenue expenditure

(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.

(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.

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).

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

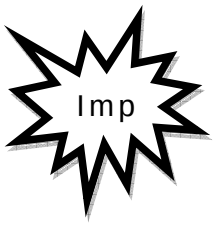
17) With regard to expenses incurred by members of delegation going abroad for exploring new markets for Indian products and similar export promotional activities, all reasonable expenditure incurred by the members of the delegations should be allowed in the assessment of the members concerned.

18) Business concerns are required to take the following civil defence measures as part of the civil defence plan in respect of their property:

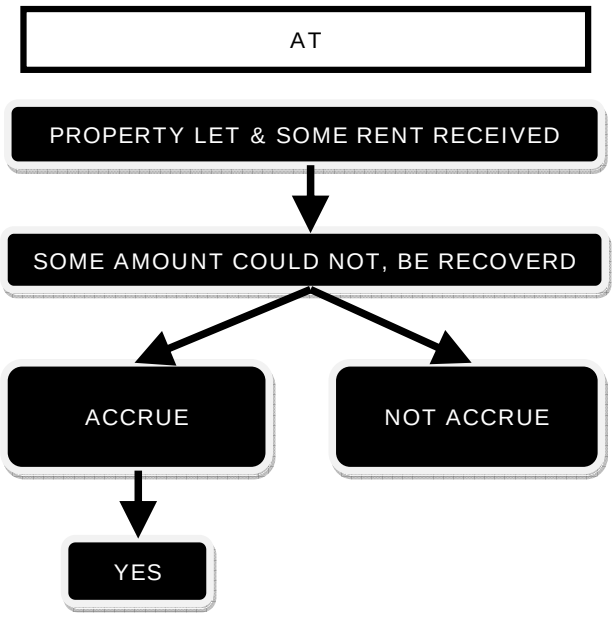
- Raise, train the following civil defence services at the scale laid down in the Home Ministry's hand books: Messenger service, casualty service, rescue service, etc.
- Purchase of civil defence equipment, stirrup pump, helmets, sirens, etc., as per prescribed scale.
- Fire-fighting system is to be 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.

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.

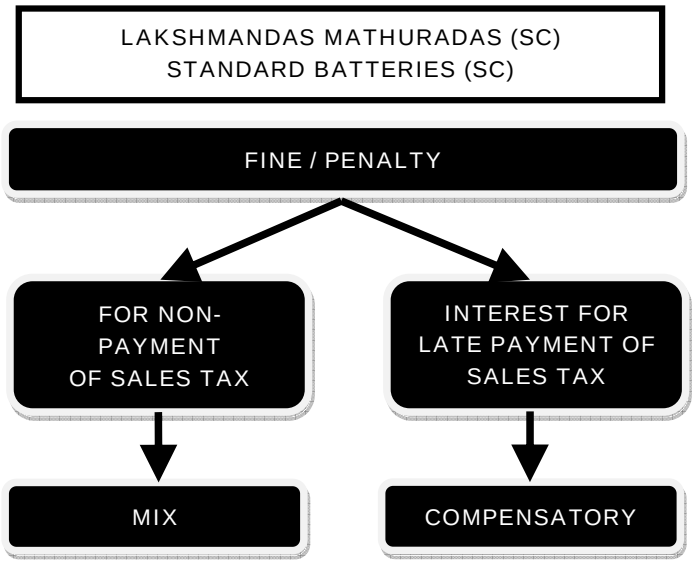
It was however conceded that application of the above principles in a particular case is not easy. There is no strait-jacket formula applicable for all occasions. In a recent judgment, the Supreme Court in CIT v. Shiv Prakash Janak Raj & Co. Pvt. Ltd. [1996] 222 ITR 583 had occasion to review the case 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.

EXPENDITURE WITH A TAINT 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.

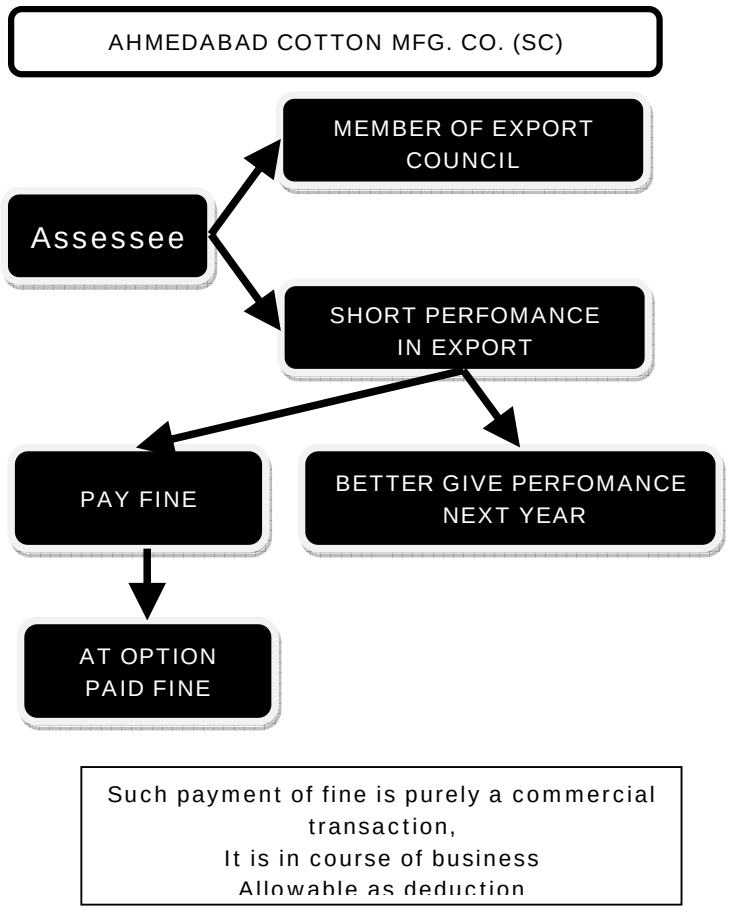
Our law has wrongly understood that allowance of an illegal expenditure would tantamount to endorsement of such illegality on the part of the courts. The English law, on the other hand, in Minister of Finance v. Smith [1927] AC 193 (PC) took the view that by defining an illegal expenditure admissible 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, 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).

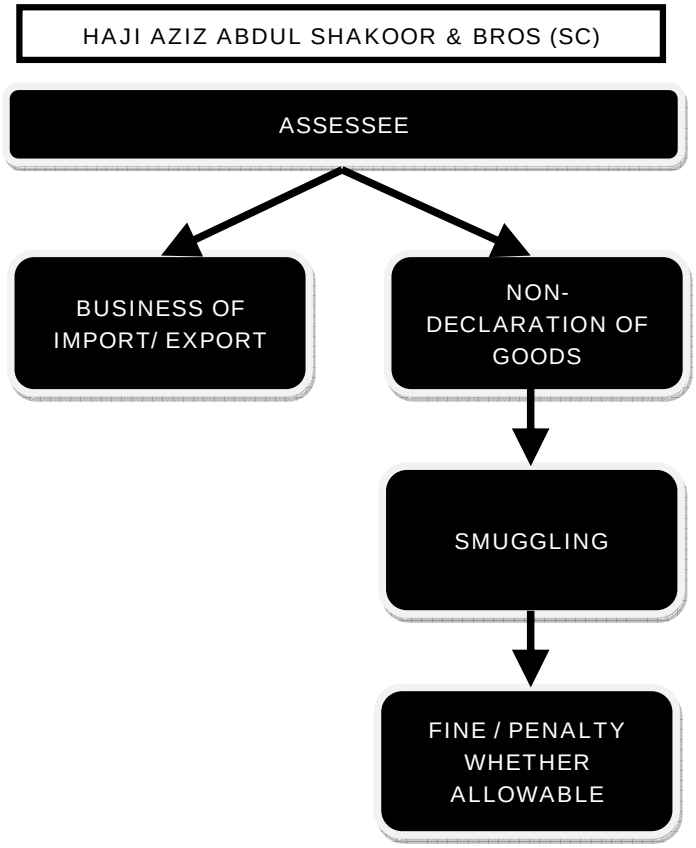
Some High Courts also found their way to justify deductions in some cases. A fine for infraction of import restrictions was allowed in CIT v. PC Tangal [1990] 184 ITR 88 (Bom); redemption fine for importing without licence in CIT v. N. M. Parthasarathy [1995] 212 ITR 105 (Mad); demurrage paid

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).



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 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 adverting 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.



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.)

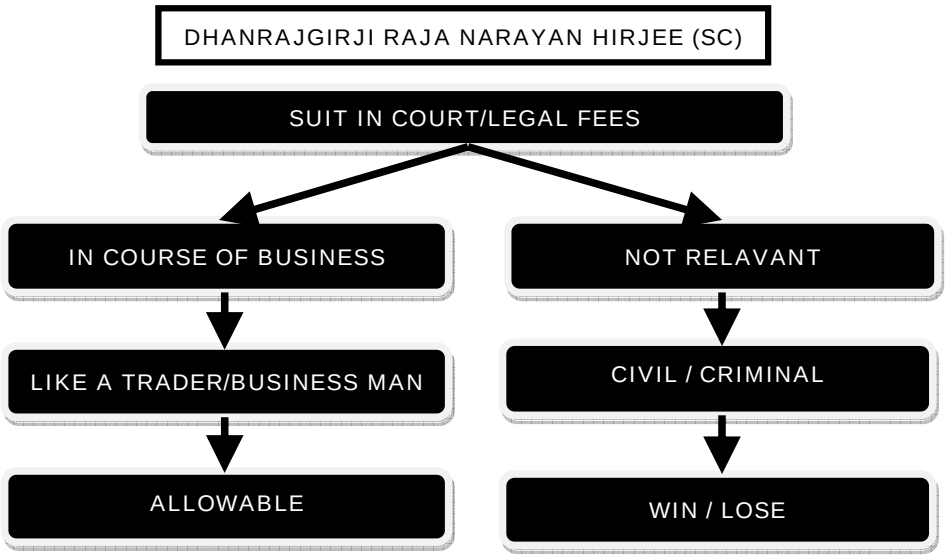
Commission payments

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).

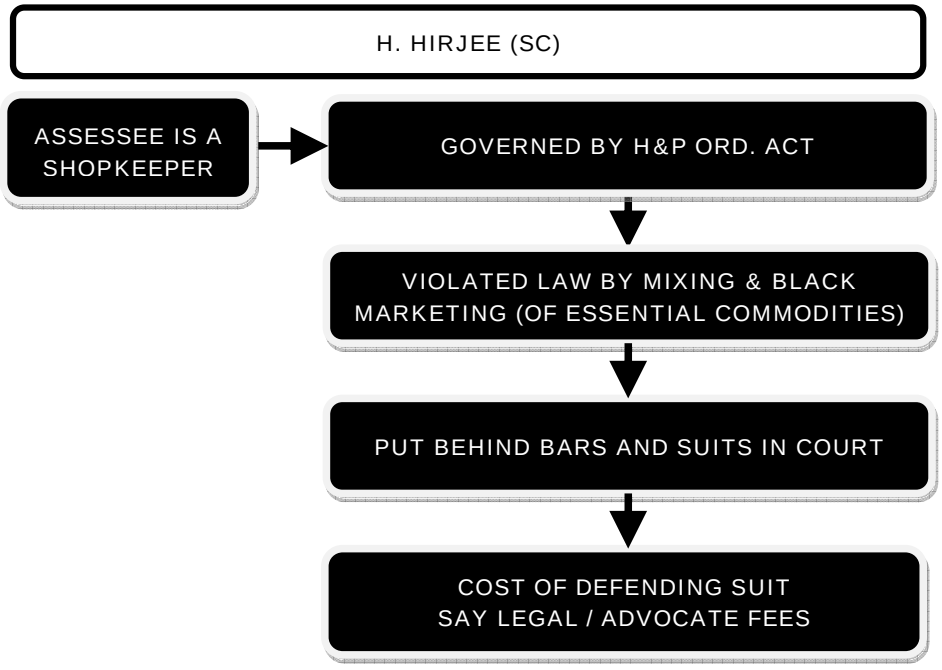
LITIGATION / LEGAL EXPENSES

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).

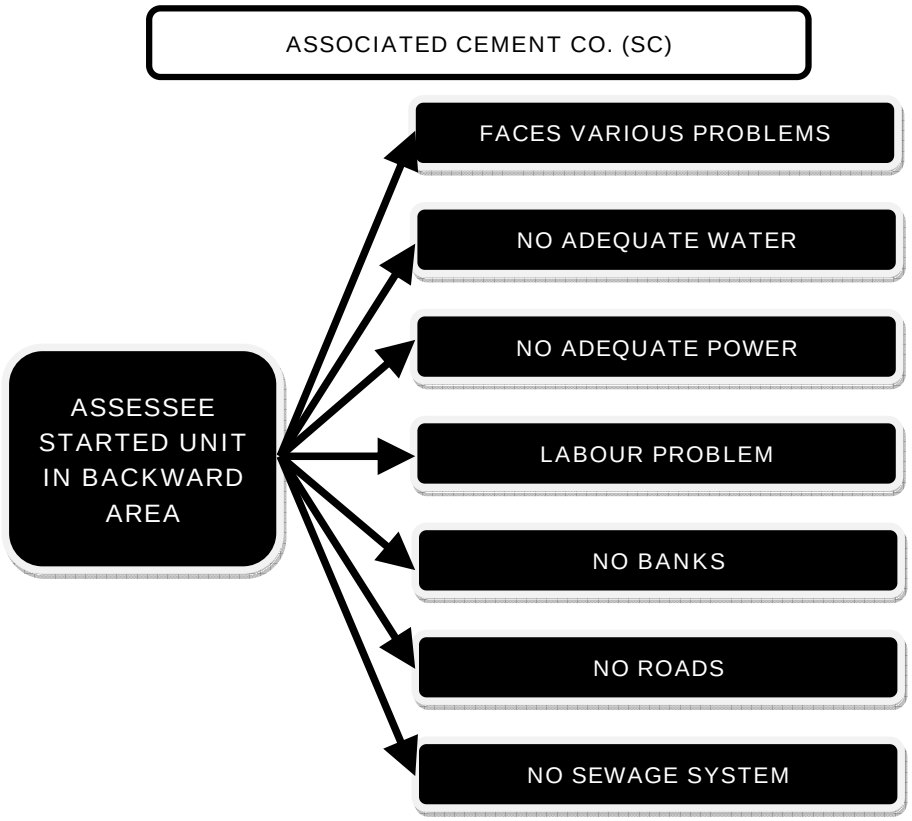
In every criminal case where the matter is defended to protect the good name of a businessman or a professional, the fear of possible fine or imprisonment must always be there. It cannot therefore be said that in every such case the expenses incurred by a person exercising a trade or profession in defending 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

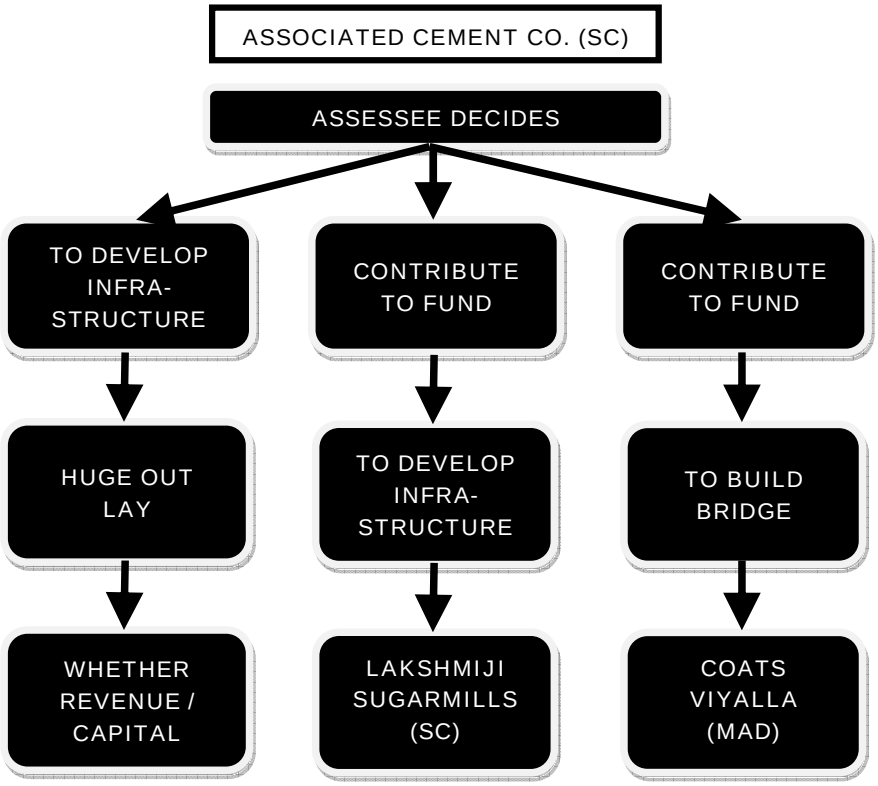


would be idle to suggest that it was for the income-tax authorities to prove in such cases that the conviction might result in sentence of imprisonment and that, in the absence of such proof, there was at the most only a chance of conviction and fine. Expenses incurred in respect of such offences are not deductible - CIT V/s. H. Hirjee [1853] 23 ITR 427 (SC).

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).

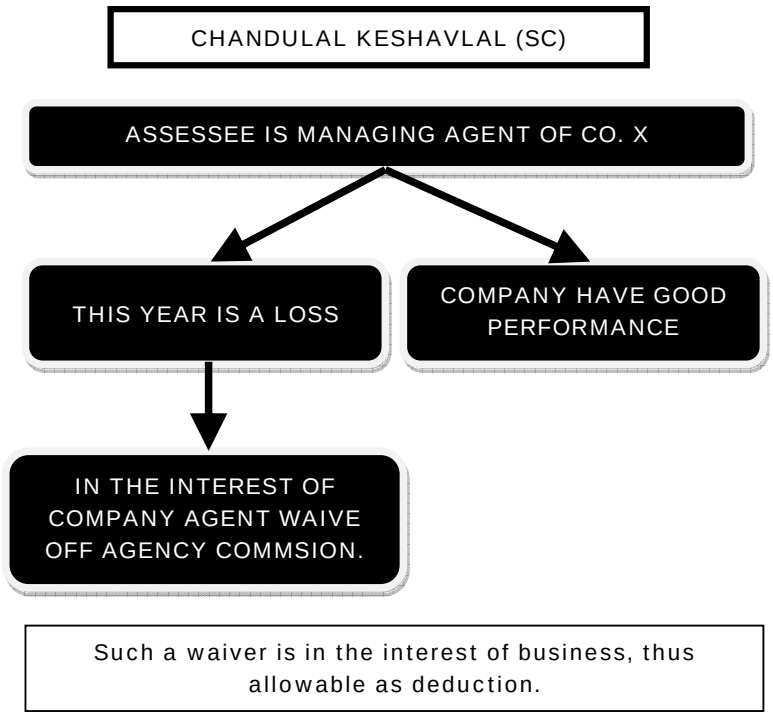




Commercial expediency must be judged not in the light of the 19th century laissez faire doctrine which regarded man as an economic being concerned only to protect and advance his self-interest, but in the context of current socio-economic

It must be allowed as deduction.

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."

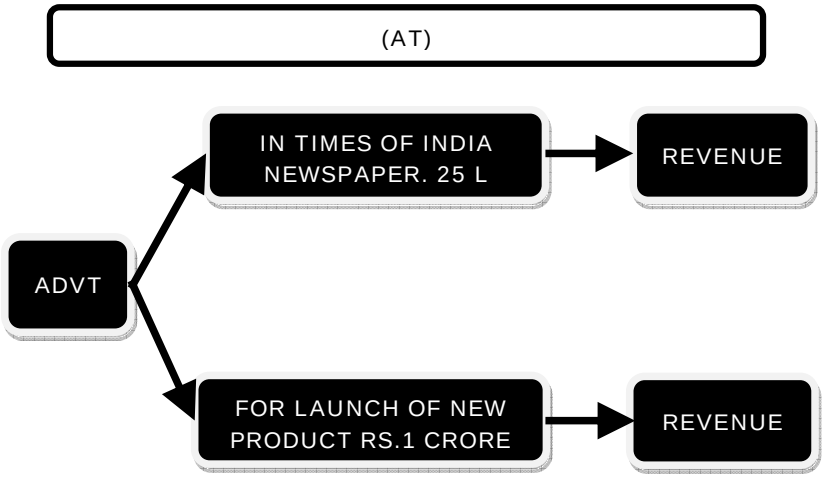
Construction of roads

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).

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).

'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. 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).

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).

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. 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.

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).

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).

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 seen 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).

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.

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.).

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).

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).

RETRENCHMENT COMPENSATION / REMUNERATION / COMMISSION

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)

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).

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).

Warding of 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).

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SHARE / DEBENTURE ISSUE EXPENSE

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) 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 Develoment 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.).

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).

FINES AND PENALTIES

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 an dare 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

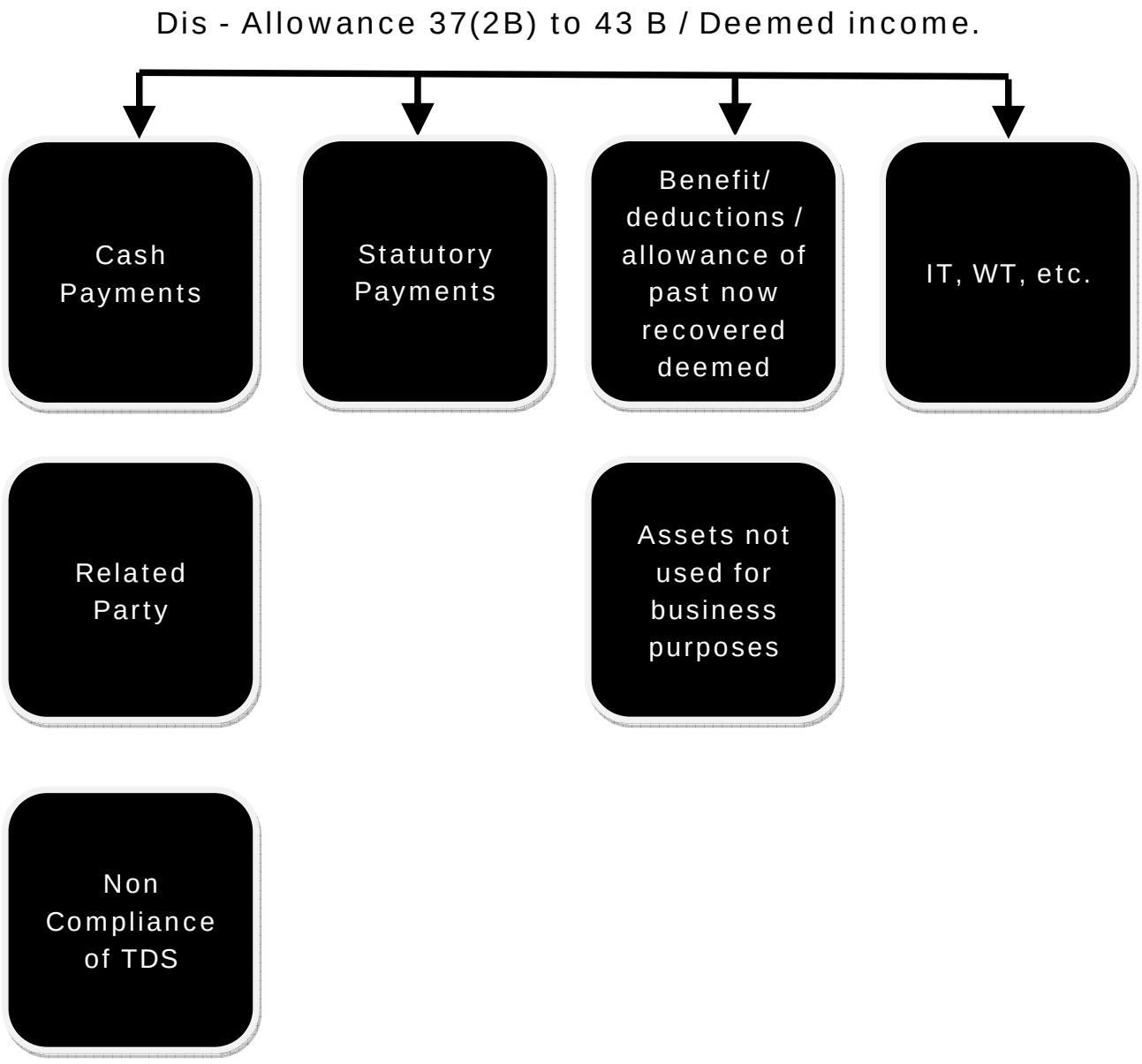
Where assessee claimed deduction under section 37(1) for interest and damages paid by it for delayed payment of sales tax under Bombay Sales Tax Act and for delayed payment of contribution under ESI Act, appellate authorities were not justified in refusing to allow assessee's claim under section 37(1) 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).

CERTAIN DIS-ALLOWANCE

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.



DEPRECIATION DIS-ALLOWANCE

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

Manner of computation / Adjustments		Rs.
Net profit as per Profit and Loss account (25 % of property used for personal purposes.)		108
Add:		
25% of Municipal Taxes	0.50	
25% of Repairs & Insurance	0.75	
25% of Depreciation (Debited to P/L A/c)	0.75	2
		110

Section 38(2) Assets partly used for personal purpose Motor car used for personal purpose	Amt	Amt
Cost of car		5,00,000
Less:		
Depreciation @ 15%		75,000
WDV after charging depreciation		4,25,000
Disallowance in computation of income.		
U/s 31 Repairs & Insurance of car 25% (40,000)		10,000
U/s 32 Depreciation		18,750

(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.

Manner of computation / Adjustments	Rs.
Net profit as per Profit and Loss account	108
Add:	
Royalty paid to Non-Resi (debited to P/L) (TDS not paid before due date of section 200)	3
	111

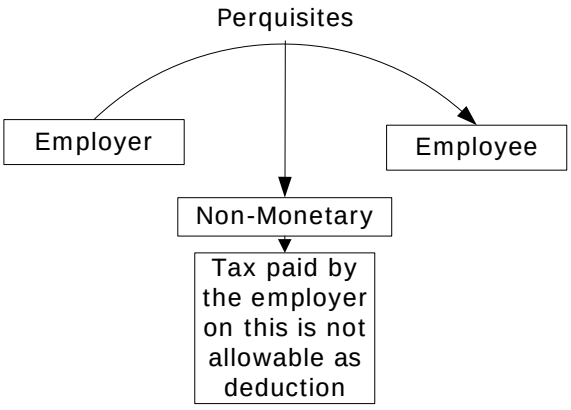
(ia) any interest, commission or brokerage, rent, royalty, fees for professional services or fees for technical services payable to a resident, or amounts payable to a contractor or sub-contractor, being resident, for carrying out any work (including supply of labour for carrying out any work), on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid has not been paid on or before the due date specified in section 139(1),

Provided that where in respect of any such sum, tax has been deducted in any subsequent year, or has been deducted during the previous year but paid after the due date specified in section 139, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

Manner of computation / Adjustments	Rs.
Net profit as per Profit and Loss account	108
Add:	
Comm/Brokerage to Resident (debited to P/L) (Tax deducted but not paid before due date u/s 139(1))	1
	109

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; Any sum paid on account of any rate or tax levied includes and shall be deemed to have always included any sum eligible for relief of tax under section 90 or, as the case may be, deduction from the Indian income-tax payable under section 91.
(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 ; 

Manner of computation / Adjustments		Rs.
Net profit as per Profit and Loss account		108
Add:		
Income Tax Paid (Debited to P/L A/c)	5.00	
Wealth Tax Paid (Debited to P/L A/c)	1.00	6
		114

Manner of computation / Adjustments	Rs.
Net profit as per Profit and Loss account	108
Add:	
Salary to Non-Resident (debited to p/L and tax not deducted)	5
	103

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.)

Manner of computation / Adjustments	Rs.
Net profit as per Profit and Loss account	108
Add:	
Purchse from related party Market Price adopted (Unreasonable sum disallowed i.e. 75 - 68)	7
	115

SEC.40(A)(3) CASH PAYMENT

(a) Where the assessee incurs any expenditure in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds twenty thousand rupees, no deduction shall be allowed in respect of such expenditure.

and

(b) where an allowance has been made in the ***assessment for any year in respect of any liability incurred*** by the assessee and subsequently during any previous year, the assessee makes payment in respect thereof, otherwise than by an ***account payee cheque drawn on a bank or account payee bank draft,*** the payment so made shall be deemed to be the profits and gains of business or profession and accordingly chargeable to income-tax as income of the subsequent year if the amount of payment exceeds 20,000 rupees.

Provided further that in the case of payment made for plying, hiring or leasing goods carriages, the provisions shall have effect as if for the words "twenty thousand rupees", the words "thirty-five thousand rupees"

However, no disallowance shall be made and no payment shall be deemed to be the profits and gains of business or profession where any payment exceeding twenty thousand rupees is made in such cases and such circum-stances as may be prescribed, having regard to the nature and ***extent of banking facilities available, considerations of business expediency and other relevant factors***

Past years liability paid during previous year

It may be noted that S. 40A(3) applies to expenditure claimed as deduction for computation of income from business or profession and income from other sources. ***This Section does not apply to capital expenditure.***

Manner of computation / Adjustments		Rs.
Net profit as per Profit and Loss account		108
Add:		
Salary paid in cash	0.24	
Payment to creditors by cross cheque (debited to P/L A/c)	0.76	1
		109

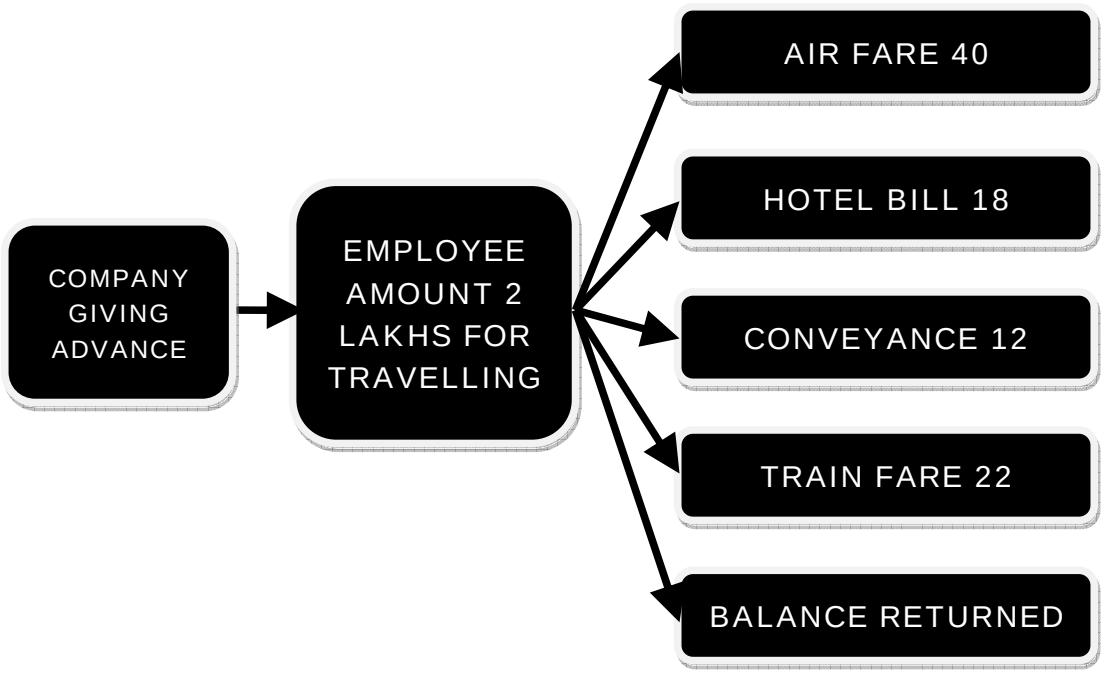
Manner of computation / Adjustments	Rs.
Net profit as per Profit and Loss account	108
Payment made in cash for acquisition of asset. (No adjustment is required)	--
Add : amounts paid to creditors in advance (balance sheet item not debited to P/L, but it is payment of trading liability in cash so added to income.)	3
Add : Stationety expense paid in cash (debited to profit and loss)	1
Business Income	112

Scope of provisions

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. 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 circum stances, 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 assessees, 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.



Payment to employee is like payment to agent and thus should not be considered for the dis-allowance. However when employee made respective payments in cash it must be considered for dis-allowance as payments. If the payments made by employees violate the section then it must be dis-allowed.

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.).

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.

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.

Manner of computation / Adjustments	Rs.
Net profit as per Profit and Loss account	108
Add:	
Remission to Trading liability (Purchase debited to p/L A/c of earlier years)	2
	110

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)

Various examples of deemed business income.	Amt	Taxable
Deemed Income		
· Sales tax Refund	10	Y
· Creditors discount	2	Y
· Prior Period items (Revenue)	6	Y
· Duty draw back	8	Y
· Creditors written off	7	Y
· Advance for sale of asset written off	12	N

SEC.43B: DEDUCTIONS ONLY ON 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. Explanation 3C clarify that if any sum payable by the assessee as interest on any loan or borrowing is converted into a loan or borrowing, the interest so converted, shall not be deemed as actual payment.	
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") Explanation 3C clarify that if any sum payable by the assessee as interest on any loan or borrowing is converted into a loan or borrowing, the interest so converted, shall not be deemed as actual payment.	
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)

Illustration	DATE	AMT
Excise liability of	31.03.04	40
Excise liability of	31.03.05	30
Date of payment	01-06-05	70
What will be the amount of deduction for P.Y. 31.03.2005 ? P.Y. 31.03.2005 = 30 paid within extended dates. P.Y. 31.03.2006 = 40 Upon the payment basis.		

Employee's contribution to be treated as income of the employer [Sec. 2(24)(x)]:

Any sum received by the employer from the employees as their contribution to a provident fund (i.e. recognised provident fund, approved superannuation fund or approved gratuity fund) is treated as business income of the employer. Thus, it should be credited to the profits and loss account of the business,

Deduction to be allowed on actual payment to be made on due date, under service agreement or provident fund rules:

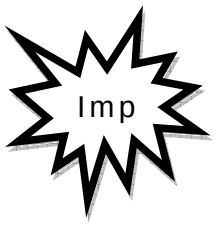
Employee's contribution should be paid to the credit of their account on the due date as provided either under agreement or provident fund rules.

If the payment is made on due date by cheque but cheque is encashed after the due date, the deduction is allowable.

Manner of computation / Adjustments	Rs.
Net profit as per Profit and Loss account	108
Add:	
Sales Tax Disallowed (u/s 43B – Not paid before due date) (debited to P/L)	7
	115

Manner of computation / Adjustments	Rs.
Net profit as per Profit and Loss account	108
Add:	
Bonus payable to Employees (debited to P/L and not paid)	1
Employee contribution to Providend Fund (debited to P/L and not paid)	2
Sales Tax Disallowed (u/s 43B – Not paid before due date) (debited to P/L)	7
Interest on loans from (converted into loan)	4
Less:	
Sales tax Deduction u/s 43B – upon payment basis.	6

44AA. MAINTENANCE BOOKS.



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 44AE, 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,	--do--
where the profits and gains from the business are deemed to be the profits and gains of the assessee under section 44AD and he has claimed such income to be lower than the profits and gains so deemed to be the profits and gains of his business and his income exceeds the maximum amount which is not chargeable to income-tax during such previous year,	--do--

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.

Section 44AA	
Maintenance of Books of Accounts	
Person of Specified Profession	
	Amt
Gross receipts of 3 years preceding previous year	
3 years before	3,62,000
2 years before	4,97,000
1 year before	1,87,500
All 3 years prec. Previous year exceeds 1,50,000	
Maintain Book of A/cs other documents	
New Profession set up in the previous year	
Gross receipts likely to exceed	1,50,000
Require to maintain books of A/cs other documents	

Section 44AA		
Persons carrying on Business/Non-Specified Profession		
Existing Business	Total Income from B/P	Total Sales /Gross Receipts
Three years immediately preceeding relevant previous year		
3 years before	87,500	9,79,000
2 years before	1,26,250	8,73,250
1 year before	1,13,900	12,55,000
FY	1,23,400	13,75,650
In year 2 the income > 1,20,000 or year 3 the turn over exceed 10,00,000, must maintain books of A/cs or other documents.		
Newly set up Business in Previous Year		
Expected Total Income		1,32,000
Expected turn over		13,85,000
Either of it exceeding the specified limit compulsorily maintain books of A/cs		

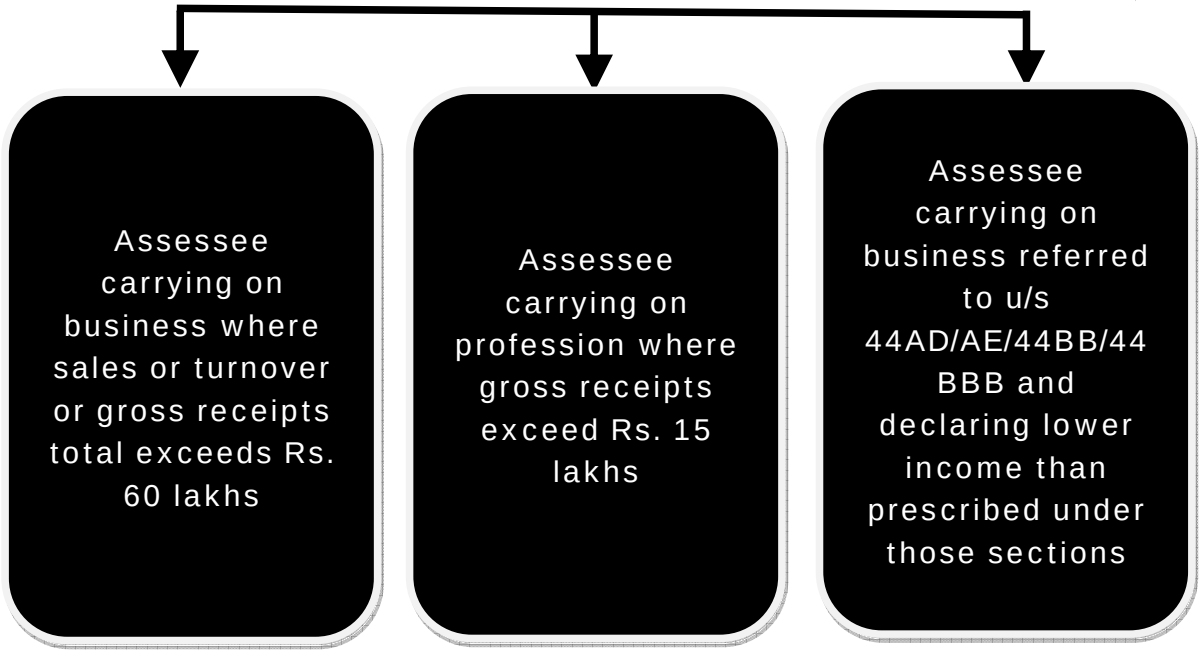
Failure to keep, maintain or retain books of account, documents, etc. 271A

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

Imp

Persons covered by tax audit



Every person carrying on business	If his total sales, turnover or gross receipts, as the case may be, in business exceed or exceeds **Sixty 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 **Fifteen 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 the business shall, if covered by section 44AE 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.**
carrying on the business shall, if the profits and gains from the business are deemed to be the profits and gains of such person under section 44AD and he has claimed such income to be lower than the profits and gains so deemed to be the profits and gains of his business and his income exceeds the maximum amount which is not chargeable to income-tax in any previous year,	--do--

Section 44AB COMPULSORY TAX AUDIT PERSONS HAVING BUSINESS	Amt
(1) TOTAL SALES/TURNOVER/GROSS RECEIPTS	
Year 1	51,68,750
Year 2	63,75,000
Compulsory Tax Audit for Year 2	
(2) PERSON HAVING ANY BUSINESS	
Gross Receipts	48,00,000
Deemed income u/s 44AD 8% (48.00)	3,84,000
Assessee claims laws profits	3,16,500
Compulsorily to maintain book of A/cs & other documents & has to compulsorily get books audited.	
(3) NON-RESIDENT PROVIDING SERVICES TO OIL EXPLORATION BUSINESS	
Amount received	4.5 Crs
Deemed income u/s 44BB 7.5% (4.5 Crs)	34 lakhs
Assessee claims lower profits	23.75 lakhs
Compulsorily to maintain books of A/cs & other documents & compulsory Tax Audit.	

Section 44AB PERSONS HAVING PROFESSION	Amt
Gross Receipts	
3 years before	18,99,650
2 years before	13,59,470
1 year before	16,17,650
Previous Year	8,95,920
Audit not required since gross receipt or collection for the previous year is less then the specified amount.	

Meaning of "specified date"

Specified date in relation to the accounts of the assessee means 30th September 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 assessees, 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.

Penalty Provisions			
Section	Nature of Default	Minimum penalty	Maximum Penalty
271A	Failure to keep or maintain books of account, documents, etc., as required under section 44AA.	Rs. 25,000	Rs. 25,000
271B	Failure to get accounts audited under section 44AB or furnish said report as required under section 44AB	½ % of the total sales, turnover, or gross receipts	Rs. 1,50,000

44AD. PRESUMPTIVE INCOME FOR CERTAIN BUSINESS, ETC.



(1) eligible assessee engaged in an eligible business, a sum equal to eight per cent of the total turnover or gross receipts of the assessee in the previous year on account of such business or, as the case may be, a sum higher than the aforesaid sum claimed to have been earned by the eligible assessee, 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".

(2) 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 :

Provided that where the eligible assessee is a firm, the salary and interest paid to its partners shall be deducted from the income subject to the conditions and limits specified in 40(b).

(3) The written down value of any asset of an eligible business shall be deemed to have been calculated as if the eligible assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment years.

(4) The provisions of Chapter XVII-C (advance tax) shall not apply to an eligible assessee in so far as they relate to the eligible business.

(5) Notwithstanding anything contained in the foregoing provisions of this section, an eligible assessee who claims that his profits and gains from the eligible business are lower than the profits and gains specified and whose total income exceeds the maximum amount which is not chargeable to income-tax, shall be required to keep and maintain such books of account and other documents as required in 44AA and get them audited and furnish a report of such audit as required under section 44AB.

Explanation.—For the purposes of this section,—

(a) "eligible assessee" means,

  (i) an individual, Hindu undivided family or a partnership firm, who is a resident, but not a limited liability partnership firm and

  (ii) who has not claimed deduction under any of the sections 10A, 10AA, 10B, 10BA or deduction under any provisions of Chapter VIA;

(b) "eligible business" means,—

  (i) any business except the business of plying, hiring or leasing goods carriages referred to in section 44AE; and

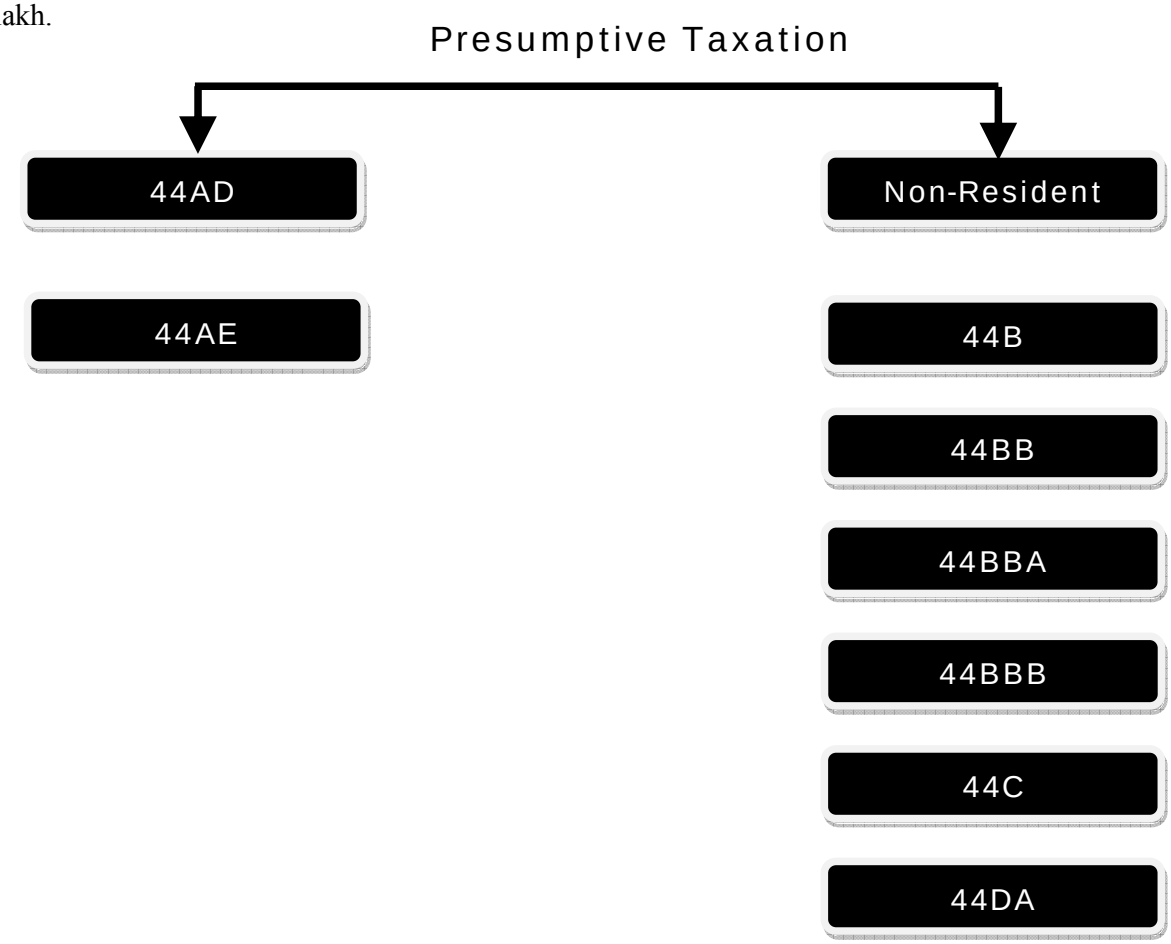
  (ii) whose total turnover or gross receipts in the previous year does not exceed an amount of 60 lakh rupees.

Section 44AD Presumptive Taxation Business of Construction	Amt	Amt
Gross Receipts		52.00
8% of Receipts		4.18
Less:		
Interest to partners (In case of firm)	0.25	
Partners Remuneration (Working Partners)	2.75	3.00
Taxable Income		1.18

Section 44AD Whether covered by Section 44AD?	
Nature of Business	Yes/No
Trading Business	Yes
Manufacturing & Trading	Yes
Health Clubs & Gyms (Service industry)	No
Civil Construction	Yes
Beauty Parlors/Saloons (service industry)	No
Security Agencies (service industry)	No
Manufacturing & Sale of Mithai's	Yes
Event Management (service industry)	No
Apna Bazar (Retail Business)	Yes
Animation & Photography	No
Reliance fresh	Yes
Coaching Classes (service industry)	No
Recruitment Agency (service industry)	No

Turnover ceiling:

Total turnover of the retail business should not exceed Rs 60 lakh. The expression turnover has not been defined in the Act. It refers to the aggregate of sale prices, received and receivable during the previous year. Sale of unusable, empties and packages may form part of turnover. Sales tax or any other levy would form part of the turnover having regard to the composite charge for the supply. Discount received on purchases would not form part of the turnover. It will reduce the cost of the goods purchased. Discount allowed on sales would reduce the amount of turnover. Closing stock cannot form part of the turnover. Where an assessee is carrying on more than one retail trade business, the aggregate sales/turnover/gross receipts of all the retail trade business will be taken into account in determining the turnover ceiling of Rs 60 lakh. Thus, where an assessee has got two retail trade businesses X and Y, and the gross turnover of each business is Rs 21 lakh, the estimated income scheme would not apply as the total turnover of the two retail trade businesses exceed Rs 60 lakh.



44AE. 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 **Five Thousand 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 **Four thousand five hundred** 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. 5000 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. 4500 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.

Section 44AE		
Business of Plying/Hiring Goods Vehicle	Amt	Amt
(i) 4 Heavy Goods Vehicles (5,000*11*4)	2,20,000	
(ii) 5 Other than heavy vehicles (4,500*12*5)	2,70,000	4,90,000
Income before interest & remuneration to partners		4,90,000
Less:		
Interest to partner @ 12% p.a.	40,000	
Remuneration to working partner u/s 40(b) subject to limits	3,60,000	4,00,000
Taxable income		90,000

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. 4500 × 10) + (Rs.4500 × 9) + (Rs. 4500 × 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. 5000 × 10) + (Rs. 4500 × 9) + (Rs. 4500 × 12)

DIVERSION OF INCOME BY OVERRIDING TITLE

Income-tax is a tax on real income, i.e., the profits, arrived at on commercial principles subject to the provisions of the Income-tax Act. Real profit can be ascertained only by making permissible deductions. There is a clear-cut distinction between deductions made for ascertaining the profits and distributions made out of the profits. In a given case whether the outgoings fall in one or the other of the heads is a question of fact to be found on the relevant circumstances, having regard to business principles.

Under the scheme of the Act, it is the total income of an assessee, computed under the provisions of the Act, which is assessable to income-tax. So much of the income which an assessee is not entitled to receive by virtue of an overriding title created in favour of a third party would get diverted at source and cannot be added in computing the total income of the assessee. The principle is simple enough but more often than not, the question arises what are the criteria to determine, and when does the income attributable to an assessee get diverted by overriding title? The determinative factor is the nature and effect of the assessee's obligation with regard to the amount in question. When a third person becomes entitled to receive the amount under an obligation of an assessee even before the assessee could lay a claim to receive it as his income, there would be a diversion of income by overriding title ; but when after receipt of the income by the assessee, the same is passed on to a third person in discharge of the obligation of the assessee, it will be a case of application of income by the assessee and not of diversion of income by overriding title. While delivering the judgment in the case of H. M. Kashiparekh and Co. Ltd. v. CIT [1960] 39 ITR 706 the Bombay High Court observed that 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. The decisions of the Privy Council in Raja Bejoy Singh Dudhuria v. CIT [1933] 1 ITR 135 and P. C. Mullick v. CIT [1938] 6 ITR 206 together are illustrative of the principle of diversion of income by overriding title. In Raja Bejoy Singh Dudhuria's case [1933] 1 ITR 135 (PC), under a compromise decree of maintenance obtained by the step-mother of the assessee, a charge was created on the properties in his hand. The Judicial Committee of the Privy Council, reversing the judgment of the Calcutta High Court, held that the amount of maintenance recovered by the step-mother was not a case of application of the income of the assessee. In contrast, in P. C. Mullick's case [1938] 6 ITR 206 (PC) under a will, certain payments had to be made to the beneficiaries by the executors and the trustees (assessees) from the property of the testator. It was held by the Privy Council that such payments could only be out of the income received by the assessees from the property, therefore, such payments were assessable to income-tax in the hands of the assessees and there was no diversion of income at source. Whereas in the former case, the step-mother of the assessee acquired the right to maintenance by virtue of the charge created by the decree of the court on the properties of the assessee even before he could lay his hands on the income from the properties, in the latter case, the obligation of the assessee to pay amounts to the beneficiaries was required to be discharged after receipt of the income from the properties.

The true criteria for determining whether the income is diverted by overriding title were laid down in the case of CIT v. Sitaldas Tirathdas [1961] 41 ITR 367 (SC). Having considered, among others, the aforesaid two judgments of the Privy Council, the Court laid down the test as follows (page 374) : "In our opinion, the true test is whether the amount sought to be deducted, in truth, never reached the assessee as his income. Obligations, no doubt, there are in every case, but it is the nature of the obligation which is the decisive fact. There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation cannot be said to be a part of the income of the assessee. Where by the obligation income is diverted before it reaches the assessee, it is deductible; but where the income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence, in law, does not follow. It is the first kind of payment which can truly be excused and not the second. The second payment is merely an obligation to pay another a portion of one's own income, which has been received and is since applied. The first is a case in which the income never reaches the assessee, who even if he were to collect it, does so, not as part of his income, but for and on behalf of the person to whom it is payable."

In that case, the respondent-assessee derived his income from many sources. He sought to deduct certain sums of money on the ground that, under a consent decree, he was required to pay those sums as maintenance to his wife and children. Though no charge was created on the properties of the assessee by the compromise decree, the decreed sums were, in fact, paid by the assessee to his wife and children. The High Court took the view that, notwithstanding the absence of specific charge upon the properties of the assessee, the assessee was under an obligation to pay maintenance under the decree which could be enforced by a court of law. Setting aside the judgment of the High Court, the Supreme Court held (page 375) :

"In our opinion, the present case is one in which the wife and children of the assessee who continued to be members of the family received a portion of the income of the assessee, after the assessee had received the income as his own. The case is one of application of a portion of the income to discharge an obligation and not a case in which by an overriding charge the assessee became only a collector of another's income . . . In our opinion, the case falls outside the rule in Bejoy Singh Dudhuria's case [1933] 1 ITR 135 (PC) and rather falls within the rule stated by the Judicial Committee in P. C. Mullick's case [1938] 6 ITR 206 (PC).

In K. A. Ramachar v. CIT [1961] 42 ITR 25 (SC), the assessee was a partner in a firm. He executed three deeds of settlement in favour of his wife, a married daughter and a minor daughter, assigning to each of them one-fourth of his share of the profits in the firm. They were entitled to receive and collect their share from the firm under the settlement. The assessee contended that the amounts covered by the settlements could not be included in his total income for the purpose of assessment to income tax. Applying the principle laid down in Sitaldas Tirathdas' case [1961] 41 ITR 367 (SC), it was held that under the law of partnership, it was the partner and the partner alone who was entitled to profits and that a stranger, even if he were an assignee, did not have and could not have any direct claim to the profits. The claim of the assessee was negatived on the ground that what was paid was in law a portion of his income, and as such the amounts have to be included in his total income.

In Moti Lal Chhadami Lal Jain v. CIT [1991] 190 ITR 1 (SC), a company took over the business of the Hindu undivided family (referred to as "the landlord"). Under the agreement of lease with the landlord, the company was required to pay rupees ten thousand to a college run by a trust out of the annual rent of Rs. 21,000. In a subsequent agreement entered into between the landlord the company, the trust and the college, it was stipulated, inter alia, that in the event of failure to pay the amount to

the college, it would have full right to recover the said amount by recourse to the court and that the college shall have the first charge on the property. The landlord claimed that the amount paid to the college was the income of the college as it got diverted by overriding title and ceased to be the income of the landlord. That contention was rejected by the Tribunal as well as the High Court. On appeal to the Supreme Court, applying the principle in Sitaldas Tirathdas' case [1961] 41 ITR 367, it was held by a Bench of three learned judges, that the stipulation in the agreement to pay rupees ten thousand out of the annual rent directly to the college was only a mode of application of the income of the landlord, which made no difference to its liability to pay tax on the entire rent of rupees twenty one thousand which had accrued to the landlord. The fact that the college was given the right to sue and recover rupees ten thousand directly from the company in case of default, it was observed, did not alter the position, nor would creation of charge in favour of the college make any difference.

In Murlidhar Himatsingka's case [1966] 62 ITR 323 (SC), one of the partners of the firm constituted a sub-partnership firm with his two sons and a grandson. The deed of sub-partnership provided that the profits and losses of the partner in the main firm shall belong to the sub-partnership and shall be borne and divided in accordance with the shares specified therein. The question in that case was whether the share of the partner in the main firm, who had become a partner in the sub-partnership, could be assessed in his individual assessment. It was held that there was overriding obligation which converted the income of the partner in the main firm into the income of the sub-partnership and, therefore, the income attributable to the share of the partner had to be included in the assessment of the sub-partnership. That was on the principle that a partner in the sub-partnership had a definite enforceable right to claim a share in the profits accrued to or received by the other partner in the main partnership, as on entering into a sub-partnership, such a partner changes his character vis-a-vis the sub-partners and the income-tax authorities. Further, a sub-partnership creates a superior title and results in diversion of the income from the main firm to the sub-partnership before the same becomes the income of the concerned partner. In such a case, even if the partner receives the income from the main partnership, he does so not on his behalf but on behalf of the sub-partnership. Distinguishing K. A. Ramachar's case [1961] 42 ITR 25 (SC), it was observed (page 332)

"In that case it was neither urged nor found that a sub-partnership came into existence between the assessee who was a partner in a firm and his wife, married daughter and minor daughter. It was a pure case of assignment of profits (and not losses) by the partner during the period of eight years. Further the fact that a sub-partner can have no direct claim to the profits vis-a-vis the other partners of the firm and that it is the partner alone who is entitled to profits vis-a-vis the other partners does not show that the changed character of the partner should not be taken into consideration for income-tax purposes."

It is apt to notice that there is a clear distinction between a case where a partner of a firm assigns his share in favour of a third person and a case where a partner constitutes a sub-partnership with his share in the main partnership. Whereas in the former case, in view of section 29(1) of the Indian Partnership Act, the assignee gets no right or interest in the main partnership, except, of course, to receive that part of the profits of the firm referable to the assignment and to the assets in the event of dissolution of the firm but in the latter case, the sub-partnership acquires a special interest in the main partnership. The case on hand cannot be treated as one of a sub-partnership, though in view of section 29(1) of the Indian Partnership Act, the trust, as an assignee, becomes entitled to receive the assigned share in the profits from the firm not as a sub-partner because no sub-partnership came into existence but as an assignee of the share of income of the assignor-partner.

In the case of CIT v. Sunil J. Kinariwala [2003] 259 ITR 10 (SC), the assessee, a partner in the partnership firm, known as "Kinariwala R. J. K. Industries", Ahmedabad, had a ten per cent. share therein. On December 27, 1973, he created a trust named "Sunil Jivanlal Kinariwala Trust" by a deed of settlement assigning fifty per cent. out of his ten percent right, title and interest (excluding capital), as a partner in the firm, and a sum of rupees five thousand out of his capital in the firm in favour of the said trust. There were three beneficiaries of the trust-the assessee's brother's wife, the assessee's niece and the assessee's mother. In the assessment year 1974-75, he claimed that as fifty per cent. of the income attributable to his share from the firm, stood transferred to the trust resulting in diversion of income at source, it could not be included in his total income for the purpose of his assessment. The Income-tax Officer rejected the claim on the view that it was a case of application of income and not diversion of income at source ; he also found that section 60 of the Act was attracted as only income without a transfer of asset was settled. Against the order of assessment, the assessee appealed before the Appellate Assistant Commissioner of Income-tax who allowed the appeal directing that a sum of Rs. 20,141 which stood transferred to the trust under the settlement, be excluded from the total income of the assessee. However, on appeal by the Revenue, the Tribunal reversed the order of the Appellate Assistant Commissioner. The matter was taken up in appeal before the High Court.

The High Court, relying on the judgments of the Supreme Court in CIT v. Bagyalakshmi and Co. [1965] 55 ITR 660 and Murlidhar Himasingka v. CIT [1966] 62 ITR 323 held, inter alia, that on assignment of fifty per cent. share of the assessee in the firm, it became the income of the trust by overriding title and it could not be added in the total income of the assessee. In that view of the matter, the questions were answered in the affirmative, in favour of the assessee and against the Revenue. The Supreme Court reversed the judgment of the High Court holding that the determinative factor is the nature and effect of the assessee's obligation in regard to the amount in question. When a third person becomes entitled to receive the amount under an obligation of an assessee even before he could lay a claim to receive it as his income, there would be a diversion of income by overriding title ; but when after receipt of the income by the assessee, the same is passed on to a third person in discharge of the obligation of the assessee, it will be a case of application of income by the assessee and not of diversion of income by overriding title.

The Supreme Court had an occasion to explain the judgment rendered in the case of CIT v. Sitaldas Tirathdas [1961] 41 ITR 367 (SC), in the case of Moti Lal Chhadami Lal Jain v. CIT [1991] 190 ITR 1 (SC), wherein it held as under (headnote) :

"The expressions `reaches the assessee' and `has been received' have been used by the Supreme Court in the case of Sitaldas Tirathdas [1961] 41 ITR 367 not in the sense of the income being received in cash by one person or another. What the court emphasised is the nature of the obligation by reason of which the income becomes payable to a person other than the one entitled to it. Where the obligation flows out of an antecedent and independent title in the former (such as, for example, the rights of dependants to maintenance or of coparceners on partition, or rights under a statutory provision or an obligation by a third party and the like), it effectively slices away a part of the corpus of the right of the latter to receive the entire income and so it would be a case of diversion. On the other hand, where the obligation is self-imposed or gratuitous, it is only a case of application of income."

There are occasions when a corporate body has to assign and keep apart certain sums to fulfil the requirements of the statutes. The character of such receipts has been examined and discussed in

several cases. In the case of Associated Power Co. Ltd. v. CIT [1996] 218 ITR 195 (SC) by reason of the provisions of the Electricity (Supply) Act, 1948, and the Sixth Schedule thereto, the assessee appropriated a sum of Rs. 46,460 out of its revenues to a contingent reserve account during the previous year, relevant to the assessment year 1973-74. This amount was claimed by the assessee as a deduction in the computation of its total income for the purposes of income-tax. The Income-tax Officer rejected the claim. The Appellate Assistant Commissioner allowed the assessee's appeal, relying upon the decision of the Kerala High Court in Cochin State Power and Light Corporation Ltd. v. CIT [1974] 93 ITR 582 and the Bombay High Court in the case of Amalgamated Electricity Co. Ltd. v. CIT [1974] 97 ITR 334. The Revenue filed an appeal before the Tribunal and cited the judgment of the Madras High Court in Vellore Electric Corporation Ltd. v. CIT [1977] 109 ITR 454. The Tribunal relied on the decision of the Madras High Court, which had disagreed with the view taken by the Kerala and Bombay High Courts and set aside the order of the Appellate Assistant Commissioner. It referred the following question to the Supreme Court (page 197) :

"Whether, on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was correct in holding that the sum of Rs. 46,460 transferred to the contingencies reserve account is not allowable as a deduction in arriving at the taxable business income of the assessee-company ?" While answering this question, the Supreme Court held as under (headnote of 218 ITR) :

"Clause II of the Sixth Schedule to the Electricity (Supply) Act, 1948, requires the electricity company to create certain reserves if its clear profit exceeds a reasonable return. Monies standing to the credit of the contingencies reserve which are set apart to be utilised by the electricity company for the purposes set out in clause V of the Sixth Schedule are to meet expenses or recoup loss of profits arising out of accidents, strikes or other circumstances which the electricity company could not have prevented ; to meet expenses on replacement or renewal of plant or works ; and for payment of compensation required by law for which no other provision has been made. These are all expenses which the electricity company has to incur. The reservation is made so that money is always available for meeting these expenses and the supply of electricity is not interrupted. For the same reason, payments out of the contingencies reserve can be made only with the State Government's approval. It is particularly noteworthy that the electricity company can make good from out of the contingencies reserve even a loss of profit arising out of strikes, accidents and other circumstances over which it has no control. There can be no doubt, in the circumstances, that the monies in the contingencies reserve belong to the electricity company, and are not diverted away from it. It is the electricity company which has to invest the sums appropriated to the contingencies reserve. The investment would be in its name and it would be the owner thereof. The restriction that the investment can be made only in securities mentioned in the Indian Trusts Act makes no difference to this position. The fact that on the purchase of the undertaking the contingencies reserve has to be handed over to the purchaser and maintained as such is only to make explicit the obvious, for the reserve is for the purposes of the undertaking that is being transferred. There is nothing in the statute to suggest that the amount standing to its credit cannot be taken into consideration in arriving at the purchase price. For the purposes of sale to a State Board or Government, a different statute lays down how the price is to be fixed. The amount credited to the contingencies reserve is not diverted by reason of an overriding obligation or title and, in determining the business profits of the assessee, it must be taken into account. The amount appropriated to the contingencies reserve is set apart to meet possible exigencies. It is not a provision for known, existing liabilities. It is not deductible as business expenditure."

In the abovesaid decision, the Supreme Court pointed out that the application of the doctrine of diversion of income by reason of an overriding title is quite inappropriate. The doctrine applies when by reason of the overriding title or obligation, income is diverted and never reaches the person in whose hands it is sought to be assessed. In the present case, the statute requires the electricity company to create certain reserves if its clear profit exceeds a reasonable return (clause II, Sixth Schedule). Again, the contingencies reserve is to be created from existing reserves or from "the revenues of the undertaking". This clearly indicates that the monies which have to be put in the contingencies reserve reach the electricity company and are not diverted away from it. The Supreme Court further pointed out that the amount standing to the credit of the contingencies reserve could not be said to be an amount which had gone out of the hands or control of the assessee and become the subject-matter of ownership of somebody else. The statute had imposed certain restrictions over the disposal of that amount by the assessee but that did not mean that the amount had ceased to be money belonging to the assessee. What was meant by diversion of profits by overriding title was that a part of the profits earned by an assessee was not really his profit, but it belonged to somebody else and the assessee had no title. As far as the contingencies reserve was concerned, the statute had clearly indicated the purposes for which it could be spent and those purposes clearly showed that they were connected with the business of the assessee and it was the assessee, which would have to utilise it. Equally the fact that the assessee was required to invest the amount standing to the credit of the contingencies reserve in securities authorised under the Indian Trusts Act, 1882, did not in any way affect this position. The assessee continued to be the owner of the investment and, however limited be the benefit that the assessee might derive from such an investment, it could not be held that the investment was not the assessee's investment, but somebody else's investment.

Before the Supreme Court, the assessee contended that there was no distinction between the "consumers benefit reserve", which had been considered by the Supreme Court in the case of Poona Electric Supply Co. Ltd. [1965] 57 ITR 521, and the "contingencies reserve". The Supreme Court pointed out that the argument is fallacious. The emphasis is on the fact that the amount paid into the consumers' benefit reserve has to be returned to the consumers. Therefore, it is as if the electricity company had not received the amount, which it was obliged to return. The amount that it was obliged to return was not a part of its income. This is altogether different from the case of monies standing to the credit of the contingencies reserve, which are set apart to be utilised by the electricity company for the purposes set out in clause V of the Sixth Schedule. These are to meet the expenses or recoup loss of profits arising out of accidents, strikes or other circumstances, which the electricity company could not have prevented, to meet expenses on replacement or removal of plant or works ; and for payment of compensation required by law for which no other provision has been made. These are all expenses, which the electricity company has to incur. Reservation is made so that money is always available for meeting these expenses and the supply of electricity is not interrupted. For the same reason, payments out of the contingencies reserve can be made only with the State Government's approval. It is particularly noteworthy that the electricity company can make good from out of the contingencies reserve even a loss of profit arising out of strikes, accidents and other circumstances over which it has no control. There can be no doubt, in the circumstances, that the monies in the contingencies reserve belong to the electricity company.

This decision of the Supreme Court was distinguished by the Madras High Court in the case of CIT v. Salem Co-operative Sugar Mills Ltd. [1998] 229 ITR 285. In this case the assessee was directed to collect a certain amount along with the price fixed for alcohol under the Molasses Control (Amendment) Order. Therefore, even before collection of the amount as directed by the Central

Government under the Molasses Control (Amendment) Order, the assessee was directed to keep this amount under a separate account under the head "Molasses storage fund". Though the assessee collected this amount under the statutory obligation, it did not belong to the assessee, but it belonged to the molasses storage fund. The assessee could not utilise the amount in the said fund for any other purpose. The fund had got to be utilised for the purpose of constructing a storage tank as per the specifications given by the Central Government. If the assessee failed to collect such amount as directed by the Molasses Control (Amendment) Order, the Central Government would construct a molasses storage tank and recoup the construction charges from the assessee. Therefore, there was diversion of title even at the source of the income collected as per the directions given under the Molasses Control (Amendment) Order. The High Court, distinguishing the facts of the case cited supra held that, the amount in that case would stand to the credit of the contingency reserve. The reserve was only for the utilisation by the assessee at a later stage when such contingency arises. Therefore, the assessee had control and domain over the contingency reserve created according to the statute. After the amount was realised, the assessee was asked to create a contingency reserve. As against this, in the present case, the assessee was directed to collect separately the amount for the molasses storage fund, over which the assessee had no control or domain. Further, since it was not a provision for a known or existing liability, the amount appropriated to the contingency reserve was not deductible as business expenditure according to the Supreme Court. For the foregoing reasons, the High Court was of the opinion that the judgment of the Supreme Court rendered in Associated Power Co. Ltd. v. CIT [1996] 218 ITR 195, would not be applicable to the facts arising in this case.

It would thus be seen that the issue of diversion of income at source or its application depends on the facts of the case. In the end it could be said that the golden line laid down by the Supreme Court in the case of CIT v. Sitaldas Tirathdas [1961] 41 ITR 376 : "Obligations no doubt, there are in every case, but it is the nature of the obligation which is the decisive fact. There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation cannot be said to be a part of the income of the assessee", is what would clinch the issue while deciding such cases.

SCHEME OF TAX PLANNING

In India, rates of taxation are not only high but tax laws are also very complicated. Therefore, a tax-payer should plan his financial affairs in such a way that he is not trapped in the tax-net. He should make every effort not only to maximise his profits, but also try to maximise post-tax profits. He should keep the incidence of tax at minimum possible point so that the profits after tax can be maximised. Tax planning is a step in this direction and, therefore, it has become indispensable for every taxpayer.

Meaning of Tax Planning. Tax planning implies keeping the incidence of tax at lowest possible point in a lawful manner. Tax planning is neither tax-avoidance nor tax-evasion. Tax planning minimises incidence of tax in a legal framework by taking full advantage of various tax exemptions, deductions, rebate, relief, beneficial circulars and judicial rulings.

Tax planning is the arrangement of one's affairs in such a manner that the tax planner may either reduce the incidence of tax wholly or reduce it to the maximum possible extent as may be permissible within the framework of the taxation land. It does not amount to evasion of tax. It is an act of prudence and farsightedness on the part of the tax-payer who is entitled to reduce the burden of his tax liability to the maximum possible extent under the existing laws.

Tax planning ensures not only accrual of tax benefits within the four corners of law, but it also ensures that the tax obligations are properly discharged to avoid penal provisions.

Tax planning should be distinguished from "tax avoidance" and "tax-evasion". Tax planning is neither tax avoidance nor tax-evasion.

"Tax avoidance" is a device which technically satisfies the requirement of the law, but in fact it is not in accordance with the legislative intent. "Tax avoidance" is an attempt to reduce incidence of tax by taking advantage of loopholes in tax laws. Take an example. Prior to the amendment by the Finance Act, 1997 the income from the shipping business of a non-resident was computed on deeming basis, that is, 7.5% of the amount paid or payable on account of carriage of passengers, livestock, mail or goods. In order to reduce the taxable income from this source, some assessees started splitting their receipts in such a manner that the receipts in respect of carriage of passengers, livestock, mail, etc., were reduced and the receipt in respect of other charges, such as demurrage or handling charges, were inflated. The result was that while the liability of the client remained the same, the amount on which the deemed income was computed under Sec. 44B got reduced. In order to avoid the loss of revenue on this account, the Finance Act, 1997 clarified that the expression "the amount paid or payable on account of carriage" will include any charges by way of demurrage or handling, by whatever name called, and any other charges of similar nature. The amendment was made operative retrospectively, from the assessment year 1976-1977 and subsequent years.

Take another example. In a sale transaction, the buver directly paid the excise duty on the removal of goods from the factory. The seller did not include excise duty in "sale price". Accordingly, sales tax was charged on "sale price" exclusive of excise duty. Thus, the sales tax liability was reduced. It was held to be a case of "tax avoidance" [McDowell & Co. Ltd. v. Commercial Tax Officer (1985) 154ITR148 (SC)]. The Supreme Court has held that "tax avoidance" is illegal.

Tax avoidance is not dependable because as and when the loopholes in tax laws become public, the legislature steps in to plug them. Besides, it is also risk-bearing because sometimes the law may be amended with retrospective effect. If the time-limit for reopening or rectification of completed assessments has not expired by that time, they can be re-opened or rectified creating additional liability for the tax-payer. Therefore, it is not advisable for a tax-payer to adopt tax avoidance as a

device for tax planning. Tax avoidance is against the spirit of law whereas tax planning follows legislative intentions and opinions.

"Tax-evasion" is a device to evade or reduce tax liability by fraudulent means like suppression or omission of receipts, inflating the expenses and claiming bogus deductions/losses in fictitious transactions. It is illegal, immoral and highly risky. A tax-evader has to pay not only monetary penalty, but he also bears the risk of prosecution proceedings being launched against him. For example, where a person is found guilty of concealment of income, a penalty may be imposed on him. Minimum penalty is 100% and maximum penalty may extend up to 300% of the amount of tax sought to be evaded [Sec. 271(l)(c)(iii)]. Besides this, he may also be prosecuted. Where the amount of tax sought to be evaded exceeds Rs 1,00,000, he may be prosecuted for a minimum period of 6 months and the maximum prosecution may extend up to seven years and with fine [Sec. 276C(1)]. Thus, tax-evasion is not tax planning because tax evasion amounts to breach of law, whereas tax planning is devised within the legal framework by following legislative intentions.

TAX PLANNING AND TAX AVOIDANCE IS CONSTITUTIONALLY LEGITIMATE

Tax avoidance and tax planning are perfectly constitutionally legitimate. Taxes are indubitably an interference with the right to property because they involve expropriation by the State without a direct corresponding benefit to the taxpayer. Under article 300A of the Constitution, every person has a right to his/her property unless it is taken away by the authority of law. In relation to expropriation of property by a tax, this principle is specifically mandated by article 265, which reads, "No tax shall be levied or collected except by authority of law." The corollary of this principle is that even if a tax is levied with the authority of law, any exaction over and above the bare minimum required by law is illegal and is not required to be paid by any person. This, in my view, provides the constitutional backing for tax avoidance schemes. As Lord Clyde brilliantly puts it : "No man in this country is under the smallest obligation, moral or other, so to arrange his legal relations to his business or to his property as to enable the Inland Revenue to put the largest possible shovel into his stores."

The Constitution in India and in England, it appears, specifically legitimizes tax avoidance and tax planning because the right to property is the rule and the tax is the exception-and it is well accepted in law that the rule is always read wider than the exception.

TAX AVOIDANCE V. TAX EVASION

Thus, the right to property to me plays a crucial role in the distinction between tax avoidance and evasion and indeed in the debate on economic growth and development. Every person is possessed of a constitutional right to orient his property in such a way so as to pay the least amount of tax and so tax avoidance is very different from tax evasion. Tax evasion involves an illegality and judges must attack this but tax avoidance is as Professor Wheatcroft has quipped the "art of dodging tax without actually breaking the law".

PART – C

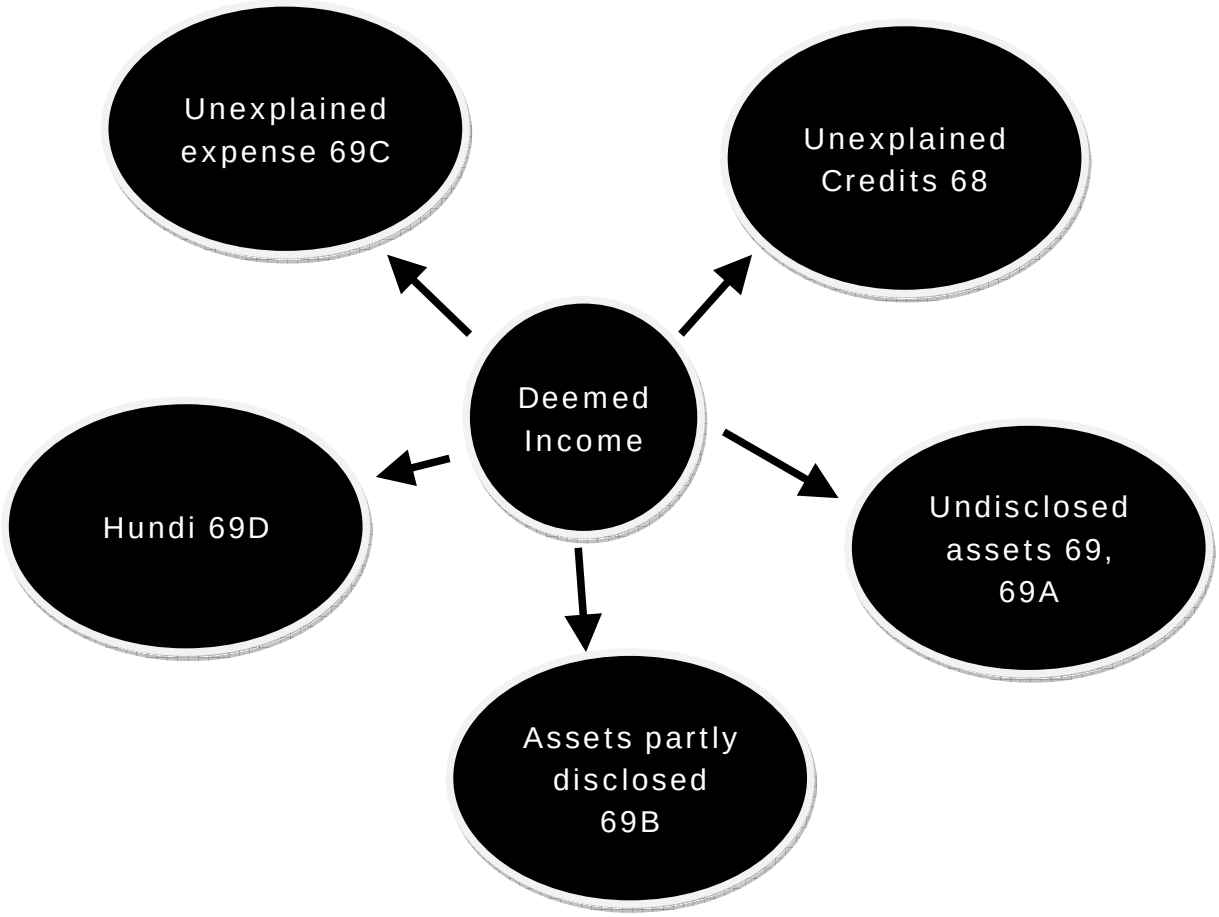
DEEMED INCOME

SUCCESSION

DISCONTINUATION

GIFTS

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 unrebutted 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.)

Cash Credit be Found Appearing in the Books of Assessee.

For chargeability, cash credit should be found appearing in the books of the assessee himself and not of any other person. The books of account of the firm in which the assessee is a partner, cannot be treated as the books of the assessee for the purposes of this section. [Sunderlal *v.* CIT 117 ITR 316, Anand Ram *v.* CIT 233 ITR 544]. A bank pass book is not a book maintained by the assessee for treating unexplained cash credit as his income [CIT *v.* BhaichandMl ITR 67].

No Deduction of Any Head is Available from Cash Credit.

Where the assessee fails to explain the source of cash credit satisfactorily, it is deemed to be his income and no source of income, not even other sources, can be assigned to it. Thus, the deductions which are available under any head of the income, are not applicable [Faquir Mohmed Hazi Hasan *v.* CIT 247 290].

Income Computation at Flat Rate and Addition on Account of Cash Credit, Both may Apply simultaneously.

Where books of accounts, containing cash credits, are rejected and business income is estimated on a percentage basis, cash credit may not be further added to the estimated business profit. But this rule is not of universal application. The facts may justify the estimate of business profits on percentage basis and at the same time the addition of cash credits [Kalakhan *v.* CIT 84 ITR 519].

Income-addition on Account of Cash Credit, No Ground for Automatic Imposition of Penalty.

Additions to income on the ground of unexplained cash credit do not automatically justify the impastation of a penalty [Nation Textiles *v.* CIT 249 ITR 125],

Cash Credit Appearing on the First Day of Previous Year.

Cash credit appearing in books on the first day of the accounting year may also be treated income of the assessee in absence of any satisfactory explanation [CIT *v.* Ashok 125 ITR 336].

Public issue subscription

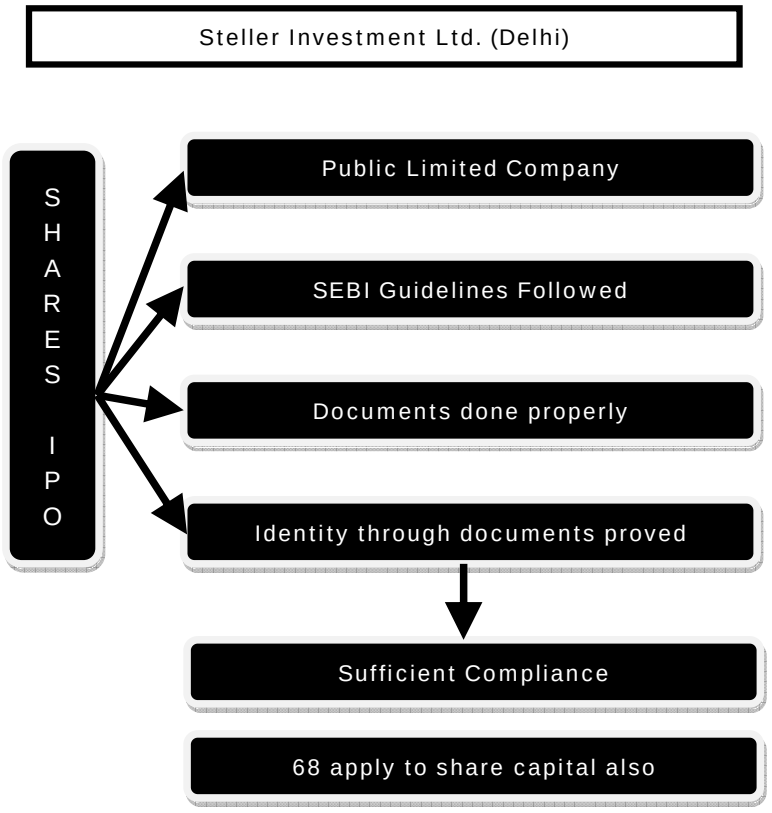
In CIT v. Divine Leasing & Finance Ltd. [2007] 158 Taxman 440 (Delhi) the assessee company received subscription to public issue from the directors/promoters and also by way of a public issue through the banking channels and thereafter allotted the shares to the subscribers. The Assessing Officer made certain additions on account of amount received by way of share capital by the assessee under section 68. The Delhi High Court laid down the following propositions of law in the context of section 68 when the assessee has to prima facie prove (1) the identity of the creditor/subscriber; (2) the genuineness of the transaction, namely, whether it has been transmitted through banking or other indisputable channels; (3) the creditworthiness or financial strength of the creditor/subscriber; (4) if relevant details of the address or PAN identity of the creditor/subscriber are furnished to the department along with copies of the shareholders register, share application forms, share transfer register, etc., it would constitute acceptable proof or acceptable explanation by the assessee. Further, (1) the department would not be justified in drawing an adverse inference only because the creditor/subscriber fails or neglects to respond to its notices; (2) the onus would not stand discharged if the creditor/subscriber denies or repudiates the transaction set up by the assessee nor should the Assessing Officer take such repudiation at face value and construe it, without more evidence against the assessee; (3) the Assessing Officer is duty-bound to investigate the creditworthiness of the creditor/subscriber, the genuineness of the transaction and the veracity of the repudiation. In this case the Tribunal found that the Assessing Officer had not brought any positive material or evidence, which would indicate that the shareholders were (a) 'benamidars' or (b) fictitious persons or (c) that any part of the share capital represented the company's own income from undisclosed sources. Further the Tribunal had categorically held that the assessee had discharged its onus of proving the identity of the share subscribers. At this the Court pointed out that had any suspicion still remained in the mind of the Assessing Officer, he could have initiated 'coercive process' and not just rested by making an addition under section 68.

Drawing reference to the Apex Court decision in CIT v. Mussadilal Ram Bharose [1987] 165 ITR 14/30 Taxman 546H the High Court suggested that it is for the Parliament to introduce legislation if the duty presently resting on the Department is thought to be too onerous. We ought not to twist the language of a statute to remove the burden of proof altogether from the Department even though it has the necessary wherewithal to discharge it. The malaise can also be arrested if unclaimed share subscriptions are taken over by the State and/or if the assessee concerned is precluded from distributing dividends, bonus shares etc. against such share subscriptions unless they are duly claimed by the original subscribers within a prescribed period, perhaps not exceedings three years. Thereafter the shares could automatically stand transferred to the State on the principle of escheat. For these events to happen, requisite amendments to the Income-tax Act may be required.

Share capital contribution

There have been twin decisions of the Delhi High Court ruling and several interpretations by other High Courts as far as application of the provisions of section 68 in the matter of receipt of moneys towards share capital contributions is concerned.

In the first Division Bench decision in the case of CIT v. Steller Investment Ltd. [1991] 192 ITR 287/ 59 Taxman 568, the Delhi High Court simply dismissed the action under section 263 at the instance of the Commissioner to make detailed investigation regarding genuineness of subscribers to share capital with the following shunting conclusion :



> "It is evident that even if it be assumed that the subscribers to the increased share capital were not genuine, nevertheless, under no circumstances, can the amount of share capital be regarded as undisclosed income of the assessee. It may be that there are some bogus shareholders in whose names shares had been issued and the money may have been provided by some other persons. If the assessment of the persons who are alleged to have really advanced the money is sought to be reopened, that would have made some sense but we fail to understand as to how this amount of increased share capital can be assessed in the hands of the company itself ."

This decision did not dither the revenue so that it went on to make additions of like nature even thereafter and then came Full Bench decision which somewhat carried more weightage if one really were to follow legal discipline.

The Full Bench decision in CIT v. Sophia Finance Ltd. [1994] 205 ITR 98/[1993] 70 Taxman 69 (Delhi), made a dissenting note to the previous observations made in the Steller Investment Ltd.'s case (supra) to the effect that even if the subscribers to the capital were not genuine "under no circumstance could the amount of share capital be regarded as undisclosed income of the company".

Needless to mention that the Full Bench sat because the correctness of the observations in the judgment of a Division Bench in the case of Steller Investment Ltd.'s (supra) was doubted. Interestingly, in the two decisions of Steller Investment Ltd.'s case (supra) and Sophia Finance Ltd.'s case (supra), Justice B. N. Kirpal shared the Bench.

But in all this, everyone missed a point. That was that the Full Bench wrote two big If's" so as to say the following words in a way that it pointed out to only one exception :—

> "If the shareholders exist then, possibly, no further enquiry need be made. But if the Income-tax Officer finds that the alleged shareholders do not exist then, in effect, it would mean that there is no valid issuance of share capital. Shares cannot be issued in the name of non-existing persons".

And once a person has a Permanent Account Number or carry proof such as passport, driving licence, ration card, election card, etc., the identity would get established and the Court never did require a further investigation in such a case.

Thereafter, in affirming the decision of the Division Bench of the Delhi High Court, the Supreme Court made the following order : "We have read the question which the High Court answered against the revenue. We are in agreement with the High Court. Plainly, the Tribunal came to a conclusion on facts and no interference is called for. The appeal is dismissed. No order as to costs."

Thus, after such decision of the Apex Court, the rule prevailed that no addition would rest in the case of company in all circumstances including a case where the identity is under question. Alas the matter did not end here and, thus, additions continued even after the Supreme Court decision.

The Delhi High Court, in CIT v. Achal Investment Ltd. [2004] 268 ITR 211/136 Taxman 335 held that the confirmation letters in respect of the amounts invested by the promoters in the share capital sufficiently explain the receipt in the hands of the company so that no addition is warranted under section 68 for any share application sums received. In this case, the assessee received Rs. 3,05,500 as share application money. It is also noted that certain confirmation letters in respect of the amounts invested by the promoters in the share capital were filed. Following the Supreme Court decision in CIT v. Steller Investment Ltd. [2001] 251 ITR 263/115 Taxman 99, the Delhi High Court initiated action against the assessee recipient of share application money.

Several Courts then started interpreting the two decisions of the Delhi High Court and the Supreme Court and, thus, wholesome confusion prevailed.

For the first time, the Allahabad High Court in their scathing decision in Jaya Securities Ltd. v. CIT [2008] 166 Taxman 7 made the following worthy observations when it pointed out that the issue is now well-settled by the Supreme Court :

> "7. The matter was carried by the revenue before the Apex Court in Civil Appeal No. 7668 of 1996. The Apex Court while dismissing the appeal had clearly held that 'we are in agreement with the High Court'. It clearly means that the reasoning given by the Delhi High Court reproduced above (steller case), stand confirmed by the Apex Court and , therefore, the principle which emerges is that no addition to section 68 can be made in the investment in the share capital of a company limited by shares whether public or private.
>
> 8. It may be mentioned here that the Apex Court had decided the Civil Appeal and not passed the order while considering the Special Leave Petition. While deciding the Special Leave Petition, it may not have amounted to confirmation of the reasoning given by the Delhi High Court but as the Apex Court has decided the Civil Appeal expressing in agreement with the reasoning given by the Delhi High Court. It would amount to confirmation of the principle laid down by the Delhi High Court.
>
> 9. In view of the settled legal position, the Tribunal was, therefore, not justified in remanding the matter to the Assessing Officer for further enquiries and ought to have decided the appeal on merits."

After this decision there does not remain any doubt that no addition is warranted in the hands of the company for any amounts received towards share capital contributions for any failure in meeting queries on the identity, capacity or genuineness of such sums whereas the Assessing Officer would be competent to refer such transactions to the appropriate ranges for their own independent inquiries to ascertain the source of such payment only in case of any doubt.

Share capital outside perview of 68 - myth

There is a view that amounts received towards share capital are totally outside the scope of assessment, even if they are unproved, on the ground, that they cannot be treated as cash credits falling within the purview of section 68. Such a view was adopted in CIT v. Electro Polychem Ltd. [2007] 294 ITR 661 (Mad) purportedly following the decisions in CIT v. Steller Investment Ltd. [2001] 251 ITR 263 (SC). Such a proposition would appear to be too wide. The view upheld by the Supreme Court in Steller Investments' case [2001] 251 ITR 263 (SC) was rendered in the context of a Departmental appeal against the rejection of reference on the decision of the Tribunal, reversing the decision of the Commissioner (Appeals) setting aside the assessment for detailed investigation regarding the genuineness of the subscriptions towards share capital. It was the order setting aside, which was reversed in the circumstances, where lack of genuineness was not established by the Assessing Officer. The reason, why the Supreme Court upheld the High Court order was that the Tribunal's decision was based on facts. It may not be correct to assume from this decision that the share capital, even if unproved and non-genuine, is outside the scope of assessment. Section 68 is only a rule of evidence and is not intended to be a charging section. Meanwhile, the Full Bench of the Delhi High Court itself had overruled its earlier decision in Steller Investment Ltd.'s case [2001] 251 ITR 263 (SC) in CIT v. Sophia Finance Ltd. [1994] 205 ITR 98 (Delhi) [FB].

In yet another case in CIT v. Bhagwati Jewels Ltd. [1993] 201 ITR 461 (Delhi), the High Court even without the benefit of the Full Bench decision in Sophia Finance Ltd.'s case (supra) distinguished the High Court decision in Stellar Investment's case. The Calcutta High Court had been deciding in a series of cases depending on the facts of each case. It did not accept that the Supreme Court decision in Steller Investment Ltd.'s case (supra) had bound the Income-tax Department to accept share capital amounts as falling outside section 68 in CIT v. Ruby Traders and Exporters Ltd. [2003] 263 ITR 300 (Cal) and some other decisions. In Hindusthan Tea Trading Co. Ltd. v. CIT [2003] 263 ITR 289 (Cal), it found that the amounts received as share capital by way of cheques on nationalised banks after advertisement in newspapers inviting share capital, cannot be subject to addition.

In fact, the issue came up before the Supreme Court itself in CIT v. Gujarat Heavy Chemicals Ltd.[2002] 256 ITR 795 in respect of credits by way of share capital in the names of certain Sikkim companies, which were not genuine with the source of funds attributed to one Sanjay Dalmia, so that it was for this reason, that it was not assessable in the hands of the company as decided by the Tribunal and sustained ultimately by the Supreme Court.

In Down Town Hospital Pvt. Ltd. [2004] 267 ITR 439 (Gauhati), the High Court reviewed the case law on the subject and concluded, where the identity of the shareholders is established, the further requirement as to the source may not be expected, since the burden shifts to the Revenue once the identity is established.

A review of the case law would appear to indicate that the degree of responsibility in respect of share capital on the company may well be less, but it cannot disown the responsibility especially if it is a private company, where the shareholders may ordinarily be expected to be known to the company. In Electro Polychem's case [2007] 294 ITR 661 (Mad), the case under comment, the Tribunal had upheld the order in first appeal for a year on the finding of the Commissioner (Appeals) that there was no justification for addition on the merits. The Departmental appeal was dismissed by the Tribunal. For another year, where he upheld the addition, the Tribunal allowed the assessee's appeal probably again on the facts. The High Court would have been justified in dismissing the appeal of the Revenue for this year on the ground, that the decisions were on the facts and probably not because as decided by it, that "under no circumstances the amount of share capital could be regarded

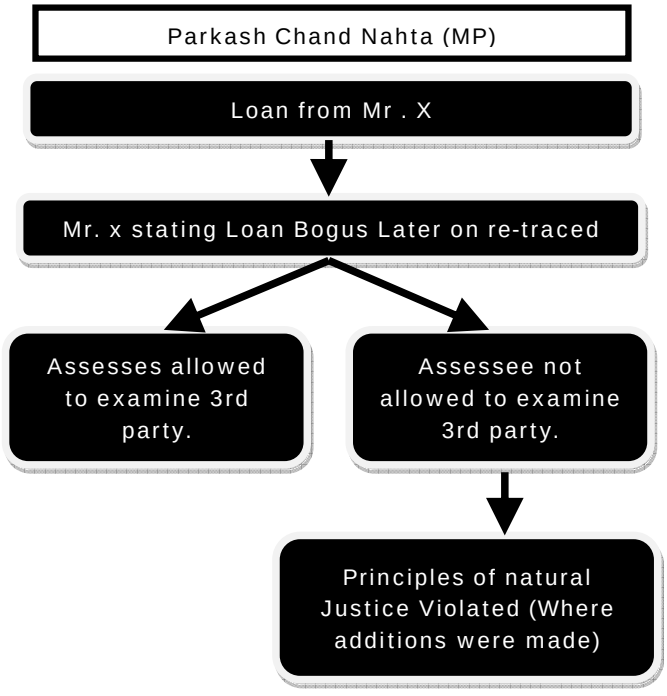
as undisclosed income of company".

The same issue came up before the same High Court before a different Bench in CIT v. Gobi Textiles Ltd. [2007] 294 ITR 663, where the assessee had on the request of the Assessing Officer produced evidence regarding share capital contributions of more than Rs. 1 lakh each. Salary certificates were produced to show their identity as well as capacity to subscribe for the shares. The identity of the shareholders was not in doubt. The Assessing Officer accepted the genuineness of one shareholder and added the share capital of nine others. The Commissioner (Appeals) not only confirmed the addition but also sustained the penalty. The Tribunal deleted the addition, since the assessee had discharged the onus by the identification and proof as to source, so that the addition could only be taken as made on mere surmises. The finding of the Tribunal being one of fact, the High Court declined to interfere. It incidentally endorsed the reasoning of the Delhi High Court in Sophia Finance Ltd.'s case [1994] 205 ITR 98 for its conclusion, that the addition was not justified, since no enquiry was conducted by the Assessing Officer to discredit the claim of genuineness. This decision of the Madras High Court would appear to be a more satisfactory statement of the law on share capital, than the one rendered in Electro Polychem's case [2007] 294 ITR 661 (Mad). Share capital cannot be routinely treated by the Assessing Officers on par with cash credits and for the assessee to treat the share capital route as a passport or a licence to introduce unaccounted funds.

Co-operation and principles of natural justice

263 ITR 0692- CIT VS. KAMDHENU VYAPAR CO. LTD. (CAL) and
263 ITR 0289 - HINDUSTHAN TEA TRADING CO. LTD. VS. CIT (CAL)

Simple disclosure of certain materials will not help the assessee to discharge the burden of proving the credits under section 68 of the Income-tax Act, 1961. Until the onus is prima facie discharged by the assessee, it never shifts on the Department. But in order to ascertain whether prima facie onus has or has not been discharged, the Assessing Officer has a duty to enquire into the materials so disclosed. The assessee may seek assistance of section 131 of the Act for the purpose of proving its own case. Section 131 empowers the Assessing Officer to exercise the same power as vested in a civil court for compelling attendance of witnesses. An opportunity in-built in section 68 of the Act has been given to the assessee to prove to the satisfaction of the Assessing Officer that the apparent is real and the transaction was genuine. In the process of availing of such opportunity, the assessee may seek aid of section 131 of the Act. If in the process, in order to secure attendance of a person a request is made by the assessee to the Assessing Officer for issuing of summons, it is incumbent on the Assessing Officer to issue such summons in order to enable the assessee to avail of the opportunity provided by the statute, otherwise the Assessing Officer would be denying the



opportunity provided to the assessee, inbuilt in section 68. [2003] 263 ITR 0692- CIT VS. KAMDHENU VYAPAR CO. LTD. (CAL)

Where it was not a cash transaction but deposits were obtained through cheques and that too through nationalised banks after having invited subscription through public advertisement. Therefore, when the income-tax file numbers were given, it was for the Income-tax Officer to enquire into the same and find out the creditworthiness of the subscribers and genuineness of the transaction. Even though despite service of notices, the 14 persons failed to respond, it was incumbent on the income-tax authority to ascertain from the income-tax file numbers whether the files were in existence and on the basis of such files whether the identity of the shareholders could be established. Until such enquiry was made, it could not be said that the income-tax authority had acted upon the materials so disclosed. [2003] 263 ITR 0289 - HINDUSTHAN TEA TRADING CO. LTD. VS. CIT (CAL)

Question

Shares were floated by the company X and subscriptions were invited from the public through advertisement in the newspapers and the whole paraphernalia of subscription for shares was undergone in accordance with law. These subscriptions were dealt with through nationalised banks and were received by cheques. In the proceedings, the company had disclosed the names and addresses of each of the subscribers. The Assessing Officer had issued notice upon 37 subscribers on test basis. Out of these 37 persons, ten persons appeared and produced satisfactory evidence regarding the genuineness about the persons and the sources of the funds out of which the shares were subscribed. 14 persons though served did not respond. The assessing officer came to the conclusion that deposits of 14 subscriber is from undisclosed source and thus intended to make addition under section 68. Further assessee pleaded that to prove his case and to verify the matter officer must co-operate with him and issue the summons under section 131 requiring the depositor to appear before him and prove the case. The officer has declined to exercise his powers under section 131. You are required to answer whether officer is justified in so doing or not.

Answer

In Hindusthan Tea Trading Co. Ltd. v. CIT [2003] 263 ITR 289 (Cal), subscriptions were invited from the public through advertisements in newspapers and collected through nationalised banks by way of cheques. The assessee had disclosed all the particulars available with it along with the name and address of each subscriber. In such a case, the assessee could not have been expected to establish the genuineness of the amount and the amount could not be treated as income of the company without any material to suggest any link between the subscribed amount and the company. Where the subscribers did not respond, the Assessing Officer is not justified in treating it as the assessee's income especially where file particulars were given in the applications and since the amounts were received by cheque. The High Court felt that the income-tax authorities should have made proper enquiries and that the Tribunal was not justified in coming to a conclusion on the basis of half hearted or incomplete enquiries.

Where the assessee pleads its inability to produce the shareholders and requests the Assessing Officer to issue summons under section 131 to enable verification, the Assessing Officer has no option except to comply with the request before proceeding further in the matter as was pointed out in CIT v. Kamdhenu Vyapar Co. Ltd. [2003] 263 ITR 692 (Cal). This requirement is often overlooked by the authorities, who imagine that the responsibility of producing the creditors is solely on the assessee even where he is unable to produce them of his own accord. The Assessing Officer is obliged to assist the assessee to get the witnesses produced or to have documents made available, since the assessee himself does not have such power, while the Assessing Officer has.

It is also to be noted that in CIT v. Ruby Traders and Exporters Ltd. [2003] 263 ITR 300 (Cal) also, the High Court after discussing the effect of Stellar Investment's case and concluding that the inference in each case would depend upon its facts found the view of the Tribunal that the share capital cannot be treated on par with cash credits to be incorrect. But, in this case there was no remand. The question referred has therefore to be understood as decided in favour of the Revenue, because the assessee had done nothing further than supplying merely a list of subscribers even during remand proceedings. Apparently it chose to rely upon the law, which was accepted by the Tribunal but faulted by the High Court. It should also place the taxpayers on guard so that they could also make their own enquiries besides making available all the information in their hands, so that the ultimate decision does not rest on burden of proof but on available information.

264 ITR 0154- ITC CLASSIC FINANCE LTD. VS. DCIT (BOM)

The Assessing Officer has the right to question the genuineness of a transaction, if the circumstances warrant it. Where the assessee acquired shares at par from the promoters' quota and sold the shares at a concessional rate of Rs. 18.90 as against estimated realisable price of Rs. 54, it is certainly open to the Assessing Officer to question such abnormally low price. The assessee had, no doubt, documentation to justify the price of sale of shares, which were made through a recognised stock broker, supported by a contract note. The adoption of the market rate was questioned on the ground that there was no finding that the transaction was sham nor was there any evidence for a finding that the transaction was a device for tax evasion. It was argued that there was no justification for an assessment on a notional profit. The High Court found that the assessee was trading in shares, buying and selling shares being its business. The concurrent finding of fact was that the income, which belonged to the assessee was diverted to some other person by this process of underselling. The sale having been made through a broker, there was no explanation, why it should have been sold at such a low price. No information was given as to who purchased the shares from the broker. The contract note only showed that it was sold through a broker and not to the broker. The information indicated that the diversion was to Harshad Mehta. The court did not consider it necessary to fathom the ultimate destination in the absence of clear indication, that the transaction was above board. The High Court had asked the assessee to produce any record indicating delivery of shares by the assessee to the broker. An affidavit from the broker was also called for by the High Court, but it was not obtained. It is under these circumstances, that the High Court in ITC Classic Finance Ltd. v. Deputy CIT [2003] 264 ITR 154 (Bom) confirmed the addition.

Question

The assessee is in the business of leasing, financing, hire purchase, dealing in shares and other financial activities. it acquired 1,00,000 equity shares of Rs. 10 each at par from the promoters' quota out of total capital consisting of 10,00,000 shares of ITC Agro-Tech Ltd. The said shares were sold at Rs. 18.90 per share, resulting in a profit of Rs. 8,90,000. The assessee offered the whole of the profit to tax. The Assessing Officer took the view that the assessee had suppressed income, that there was no reason for the assessee, which was a trader, to sell the shares, when the procedure for listing was pending before the Calcutta Stock Exchange, that, the shares obtained were from the promoters' quota and they were listed on the Calcutta Stock Exchange later on. Therefore, the Assessing Officer took the sale price at the rate of Rs. 54 per share and made an addition of Rs. 35.10 lakhs. You are required to answer whether the action of the officer is justified or not.

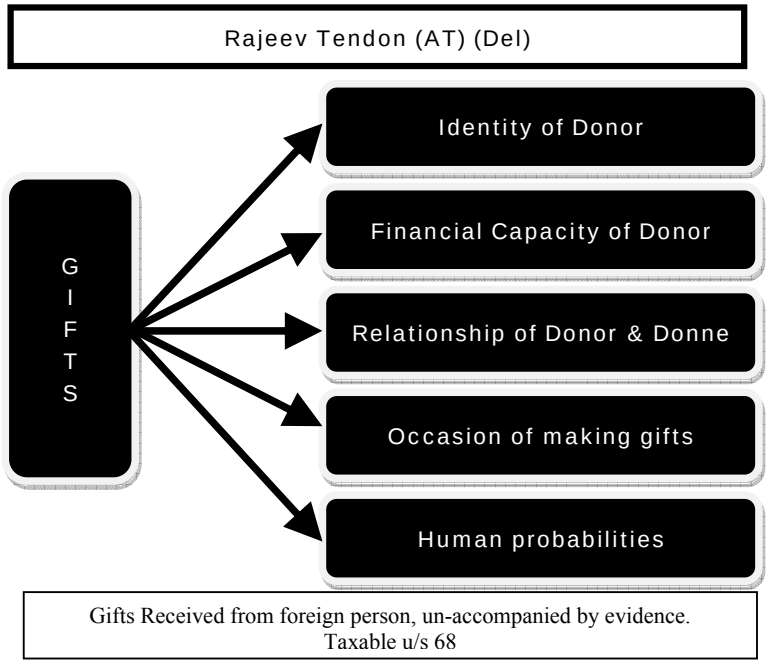
Answer

It has been Held in case of [2003] 264 ITR 0154- ITC CLASSIC FINANCE LTD. VS. DCIT (BOM) , that there was a concurrent finding of fact recorded by the authorities below that the shares

were obtained through the promoters' quota which had a lock-in-period. There was a concurrent finding of fact recorded by the authorities below that the income which belonged to the assessee had been earned by some other person. The sale took place through the contract note. No particulars had been given by the assessee with regard to this particular sale. On the facts and in the circumstances of the case and in law, addition of Rs. 35.10 lakhs being the difference between the sale price of the shares in question at the rate of Rs. 18.90 per share, and the estimated realisable price of Rs. 54 after listing on the Calcutta Stock Exchange as suppressed income was justified.

264 ITR 0254- NEMI CHAND KOTHARI VS. CIT (GAU)

In order to establish the receipt of a cash credit, as required under section 68 the assessee must satisfy three conditions, viz., (i) identity of the creditor, (ii) genuineness of the transaction, and (iii) creditworthiness of the creditor. A person may have funds from any source and an assessee, on such information received, may take a loan from such a person. It is not the business of the assessee to find out whether the source or sources from which the creditor had agreed to advance the amounts were genuine or not. If a creditor has, by any undisclosed source, a particular amount of money in the bank, there is no limitation under the law on the part of the assessee to obtain such amount of money or part thereof from the creditor, by way of cheque in the form of loan and in such a case, if the creditor fails to satisfy as to how he had actually received the said amount and happened to keep it in the bank, the said amount cannot be treated as income of the assessee from undisclosed sources.



In the facts before the High Court in Nemichand Kothari's case, though the amount financed was about Rs. 4,35,000, the creditor himself was borrowing from three ladies, Rs. 1,20,000 each with balance from his own source, with the three "sub-creditors" themselves claiming to have business, which was inferred by the Tribunal to be doubtful. But what was wrong was the approach of the Revenue and the Tribunal that it was for the assessee to prove the genuineness of the "sub-creditors" in the same manner as in respect of the immediate creditor. There was something more necessary since the amount was received by cheque, so that it was for the Revenue to show that the creditor was a mere intermediary, an inference which was probably possible with more investigation. It was equally probable that the creditor was the intermediary of someone else laundering the money through the same intermediary. At any rate, a further investigation not merely based upon negative inferences but on positive facts would have taken such cases out of the scope of burden of proof, whether failure to gather all relevant facts is on account of the fault of the taxpayer or of the Revenue. Law is no substitute for facts.

Question

Mr. X carried on the business of supply of bamboo had taken loans amounting to Rs. 4,35,000 and

Rs. 5 lakhs during the previous year. The amounts were paid by cheques by the creditors to the assessee. The creditors received the said amount by way of loans from their sub-creditors by means of cheques. The Assessing Officer declined to treat the loan amount of Rs. 4,35,000 as genuine. As regards Rs. 5 lakhs he declined to treat the loan amount to the extent of Rs. 4,25,000 as genuine. The Assessing Officer added the two amounts to the total income of assessee as income from undisclosed sources. You are required to answer whether the action of the officer is justified or not.

Answer

Held in case of [2003] 264 ITR 0254- NEMI CHAND KOTHARI VS. CIT (GAU) that the assessee had established the identity of the creditors. The assessee had also shown, in accordance with the burden, which rested on him under section 106 of the Evidence Act, that the said amounts had been received by him by way of cheques from the creditors which was not in dispute. Once the assessee had established these, the assessee must be taken to have proved that the creditor had the creditworthiness to advance the loans. Thereafter, the burden had shifted to the Assessing Officer to prove the contrary. The failure on the part of the creditors to show that their sub-creditors had creditworthiness to advance the said loan amounts to the assessee, could not, under the law be treated as the income from undisclosed sources of the assessee himself, when there was neither direct nor circumstantial evidence on record that the said loan amounts actually belonged to, or were owned by, the assessee. The Assessing Officer failed to show that the amounts, which had come to the hands of the creditors from the hands of the sub-creditors, had actually been received by the sub-creditors from the assessee. Therefore, the Assessing Officer could not have treated the said amounts as income derived by the assessee from undisclosed sources.

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.

Discrepancies in Stores may be Treated as Undisclosed Income.

If there are differences between the value of stocks declared hypothecated to the bank and the value recorded in assessee's books, and the assessee failed to explain the differences, no exception could be taken to the addition made by the authorities [Century Foam (P) Ltd. *v.* CIT (1994) 210 ITR 625 (All.)].

Where books of account reveal sales but there is no corresponding material to show that the assessee could purchase the commodity for the purposes of offering for sales, the situation is an invitation to assessee to explain as to how and from what source he held the amount of the commodity with regardsto its purchase before it was offered for sale. In absence of an explanation, the deeming provision of Sec. 69 is applicable [CIT *v.* Anandrajan (1997) 228 ITR 664 (Ker.)].

Secrete Dealings are Covered.

Where the sales were conducted by the assessee secretly and were not entered in his books of account, and the relevant dealings involved investments, additions could be made by invoking Sec. 69 [Himmatram Laxminarian *v.* CIT (1986) 161 ITR 7 (P&H)].

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.

Possession of Assets is Prima Facie Proof of Ownership.

The question whether the assessee is the owner of any money, bullion, jewellery or other valuable article, depends on the facts of each case. Section 110 of the Evidence Act presumes that possession is *prima facie* proof of ownership [Kantilal Chandulal *v.* CIT 136 TTR 889].
Thus, where an assessee is found in possession of wrist watches and he does not adduce any evidence to prove that the wrist watches do not belong to him, the value of wrist watches may be treated the income of the assessee [Chanharmal *v.* CIT 172 ITR 250 (SC)].

Date of Possession of Money and other Valuable Articles, Determines the Year of Assessment.

The date on which the assessee is found to be the owner of money, bullion, jewellery or other valuable article in search proceedings, determines the year of assessment. The date on which the search finding is concluded or recorded is not relevant. Thus, where search is conducted by custom authorities on 1-02-2004 but the finding of ownership is recorded on, 1-05-2005, deemed income would be assessable in the assessment vear 2004-2005 and not in the AY 2006-2007 [Patoa Bros. *v.* CIT (1982) 133 ITR 672 (Guj.)].

No Source of Income can be Assigned to Unexplained Money and other Assets.

Since source of income is not known, such deemed income will not fall even under the head "income from other sources." Therefore, the corresponding deductions which are applicable to the income under various heads will not be attracted in respect of deemed incomes, which are covered under Sees. 69, 69A, 69B, and 69C [Fakir Mohamed Hahi Hasan *v.* CIT (2001) 247 ITR 290 (Guj.)]. Thus, where the value of confiscated gold is treated deemed income of the assessee, no deduction can be allowed for the cost of gold in computing taxable income.

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.

Accounts Must be Maintained.

Where accounts are not maintained, additions made as unexplained investment would not be sustainable under Sec. 69B [Dr. Prakash Tiwari *v.* CIT (1984) 148 ITR 474 (MP)].

Burden of Proof is on the Revenue.

The burden to prove that the real investments exceed the investment shown in the books of accounts of the assessee is on the department and no addition can be made under Sec. 69B merely on the basis of fair market value. If on the basis of sufficient material on record, some reasonable inference can be drawn that the assessee has invested more amount in the purchase of plot than that shown in the account books, addition under Sec. 69B can be made [Smt. Amar Kumari Surana *v.* CIT (1996) 89 Taxman 544 (Raj.)].

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.

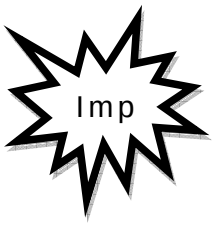
Meaning of hundi:

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:

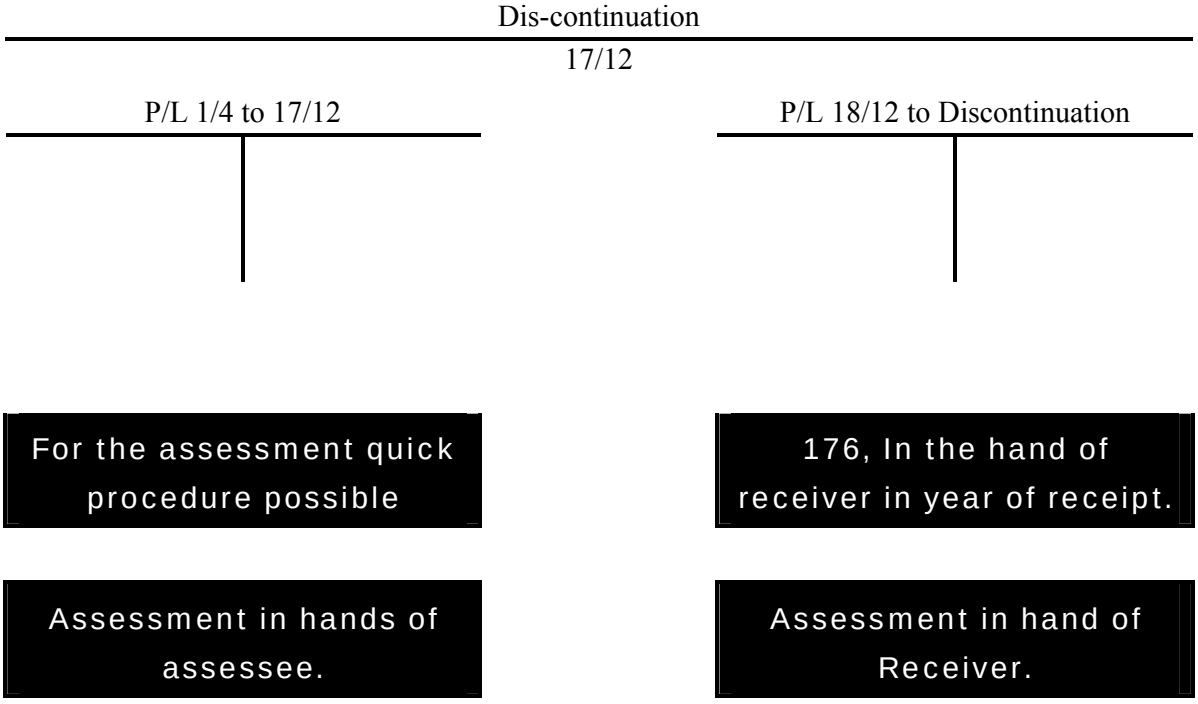
A hundi is payable to a specified person or order or negotiable without endorsement by the payee. A holder is entitled to sue on a hundi without an endorsement in his favour. A hundi accepted by the drawee could be negotiated without endorsement. If a hundi is lost, the owner could claim a duplicate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

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 recepient

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 wen 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)

Penalty Provisions			
Section	Nature of Default	Minimum penalty	Maximum Penalty
272A(2)	Failure to comply with a notice issued under section 94; to give notice to discontinuance of business/profession under section 176(3); to furnish returns/statements mentioned in section 133, 206, 206C or 285B; to allow inspection of register referred to in section 134 (or of any entry in such register or to allow copies of such register to be taken); to furnish return of income under section 139(4A) or 139(4C) or to deliver in due time a declaration mentioned in section 197A; to furnish a certificate as required in section 203 or 206C; to deduct and pay tax under section 226; to furnish a statement under section 192(2C); to deliver a copy of declaration referred to in section 206C(1A); to deliver within time a statement referred to in section 200(3) or 206C(3) or to deliver quarterly return under section 206A(1).	Rs. 100 for everyday during which default continues	Rs. 100 for everyday during which default continues

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)

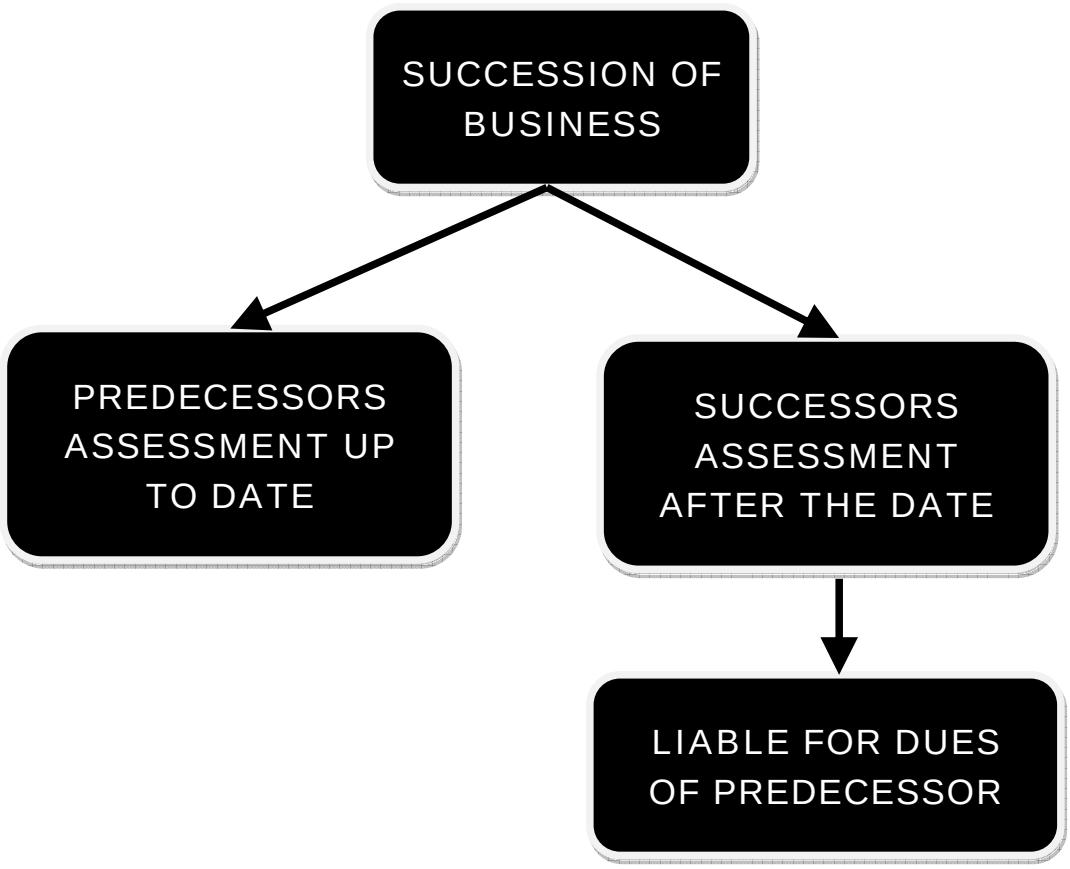
Where firm converted into company it amounts to succession of business of firm by company. Firm assessable for the period till it was succeeded by company. [1998] 230 ITR 0044- Motor Sales vs. Commissioner of Income-tax (Allahabad High Court)

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

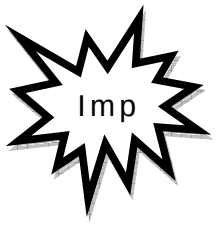
When the predecessor cannot be found, the assessment of the income of the previous year in which the succession took place up to the date of succession and of the previous year preceding that year shall be made on the successor in like manner and to the same extent as it would have been made on the predecessor.

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.



TAXATION OF GIFTS SEC. 56

where an individual or a Hindu undivided family receives, in any previous year, from any person or persons on or after the 1st day of October, 2009,



(a) any sum of money, without consideration, the aggregate value of which exceeds fifty thousand rupees, the whole of the aggregate value of such sum;

(b) any immovable property, without consideration, the stamp duty value of which exceeds fifty thousand rupees, the stamp duty value of such property.

(c) any property, other than immovable property,—

(i) without consideration, the aggregate fair market value of which exceeds fifty thousand rupees, the whole of the aggregate fair market value of such property;

(ii) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding fifty thousand rupees, the aggregate fair market value of such property as exceeds such consideration :



Non taxable gifts

(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 or donor, as the case may be; or

(e) from any local authority as defined in the Explanation to clause (20) of section 10; or

(f) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in clause (23C) of section 10; or

(g) from any trust or institution registered under section 12AA.

"property" means means the following capital asset of the assessee, namely—

(i) immovable property being land or building or both;

(ii) shares and securities;

(iii) jewellery;

(iv) archaeological collections;

(v) drawings;

(vi) paintings;

(vii) sculptures;

(viii) any work of art;

(ix) any bullion;

"relative" means

(i) spouse of the individual;

(ii) brother or sister of the individual;

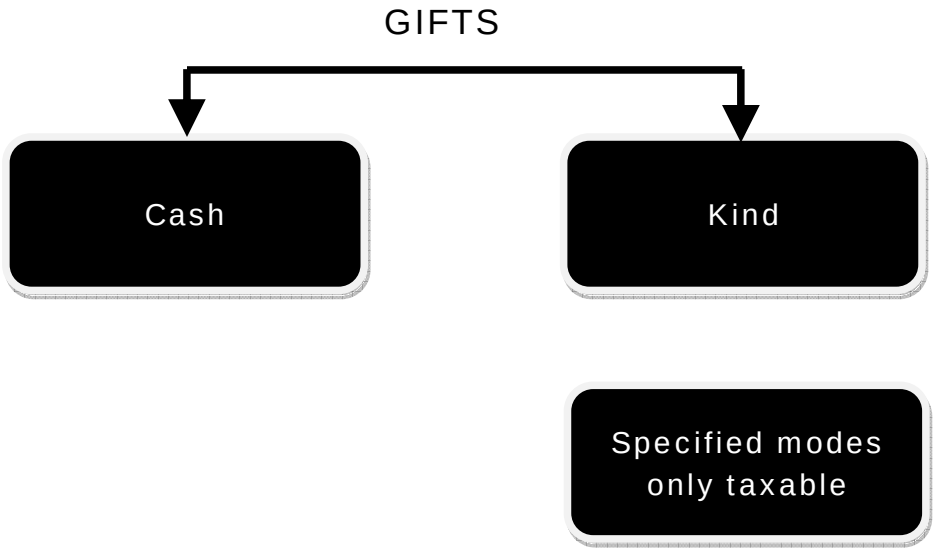
(iii) brother or sister of the spouse of the individual;

(iv) brother or sister of either of the parents of the individual;

(v) any lineal ascendant or descendant of the individual;

(vi) any lineal ascendant or descendant of the spouse of the individual;

(vii) spouse of the person referred to in clauses (ii) to (vi)



Gifts received by company 56(viia)



Where a firm or a company not being a company in which the public are substantially interested, receives, in any previous year, from any person or persons, on or after the 1st day of June, 2010, any property, being shares of a company not being a company in which the public are substantially interested,—

(i) without consideration, the aggregate fair market value of which exceeds fifty thousand rupees, the whole of the aggregate fair market value of such property;

(ii) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding fifty thousand rupees, the aggregate fair market value of such property as exceeds such consideration :

Provided that this clause shall not apply to any such property received by way of a transaction not regarded as transfer under clause (via) or clause (vic) or clause (vicb) or clause (vid) or clause (vii) of section 47.

Explanation.—For the purposes of this clause, "fair market value" of a property, being shares of a company not being a company in which the public are substantially interested, shall have the meaning assigned to it in the Explanation to clause (vii)

transactions undertaken in shares of a company not being a company in which the public are substantially interested where the recipient is a firm or a company not being a company in which the public are substantially interested.

"fair market value" of a property, other than an immovable property, means the value determined in accordance with the method as may be prescribed.

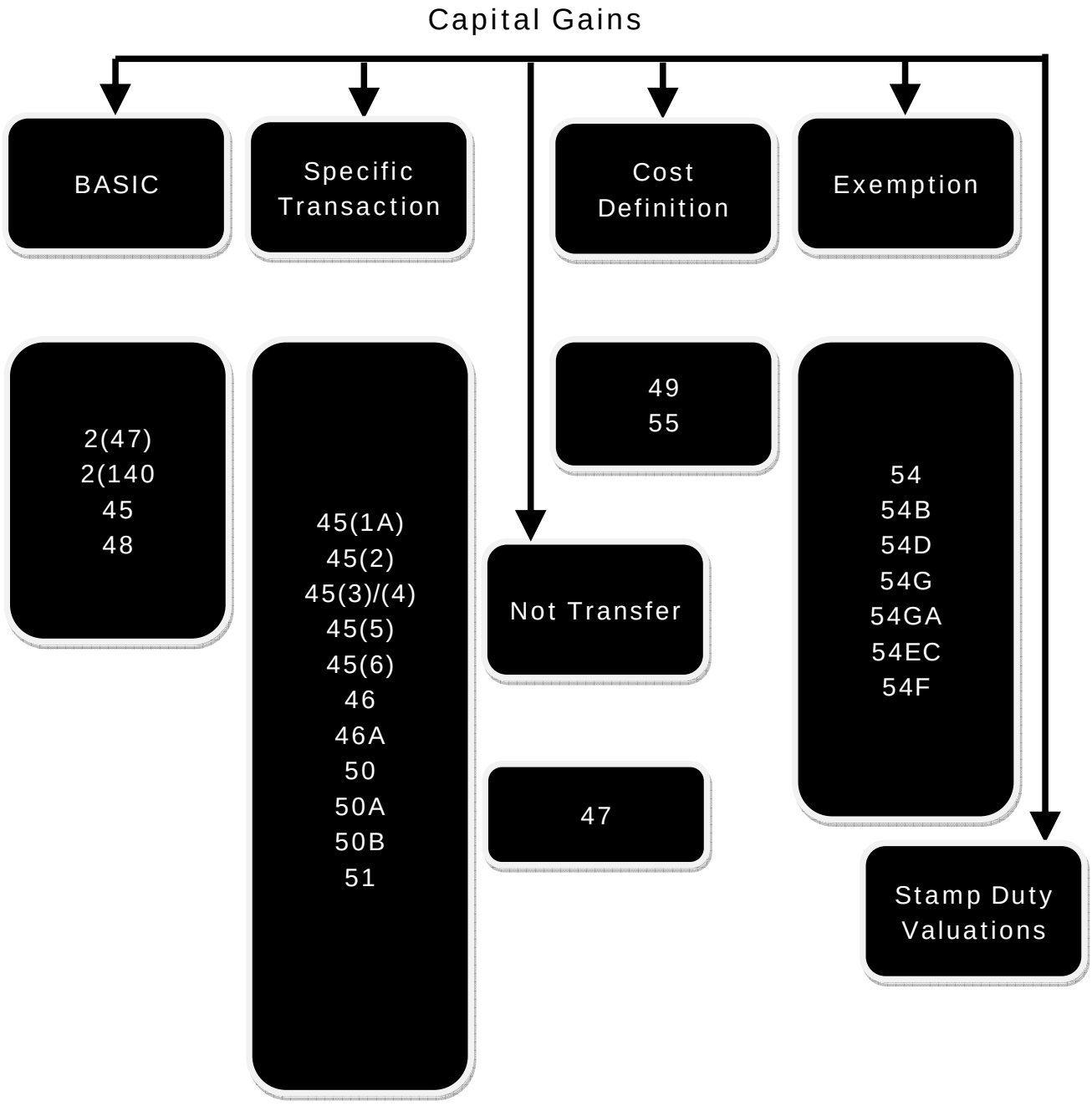
PART – D

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).

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2(14) "CAPITAL ASSET"

"Capital Asset" means property of any kind held by an assessee, whether or not connected with his business or profession, but does not include

(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, archaeological collections, drawings, paintings, sculptures and any work of art,) 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) INSURANCE COMPENSATION

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.

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.**

Manner of computation / Adjustments	Rs.
Full Value of Consideration (**FMV**) – 15/12/2009	3,50,000
Cost of acquisition – 1,25,000 (3.08.2000) (Date of Fire 15/2/2009)	
Indexed cost of acquisition [1,25,000*582/389]	1,87,020
Long Term Capital Gains	1,62,980

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.

Manner of computation / Adjustments		Rs.
Full Value of Consideration u/s 45(2) – Jewellery MV on date of conversion		27,85,000
Cost of acquisition		
Indexed cost of acquisition (assumed)		5,32,747
Long Term Capital Gains	(A)	22,52,253
Profits / Gains from B / P (37,85,000 - 27,85,000)	(B)	10,00,000
Total Income		32,52,253

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.

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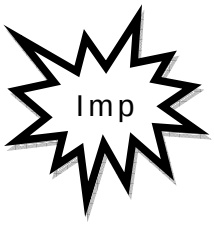
CONVERSION OF ASSETS IN TO PARTNERSHIP AND ITS DISSOLUTION SEC. 45 (3) AND (4)



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.)

Mr. X (partner of firm giving capital asset as contribution to firm) Manner of computation / Adjustments	Rs.
Full Value of Consideration (Book Value) u/s 45(3)	25,00,000
Indexed cost of acquisition (assumed)	16,99,780
Capital Gains	8,00,220

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.

Transfer to partner any immovable properties

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)

M/s XYZ (asset distributed upon dissolution) Manner of computation / Adjustments	Rs.
Full Value of Consideration (FMV as per sec 45(4))	32,50,000
Indexed cost of acquisition (assumed)	13,79,852
Long Term Capital Gains	18,70,148

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 enhance 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.

		AMOUNT	AMOUNT
Compensation Received			14,00,000
Less :			
Indexed Cost of Acquisition (assumed) (indexation will be allowed only up to the year of acquisition and not up to the year of receipt of compensation)			12,36,989
Long Term Capital Gains	(A)		1,63,011

Enhance compensation received			4,75,000
Less :			
Cost of Acquisition		Nil	
Cost of improvement		Nil	
Expenses of transfer		25,000	25,000
Long Term Capital Gains	(B)		4,50,000

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

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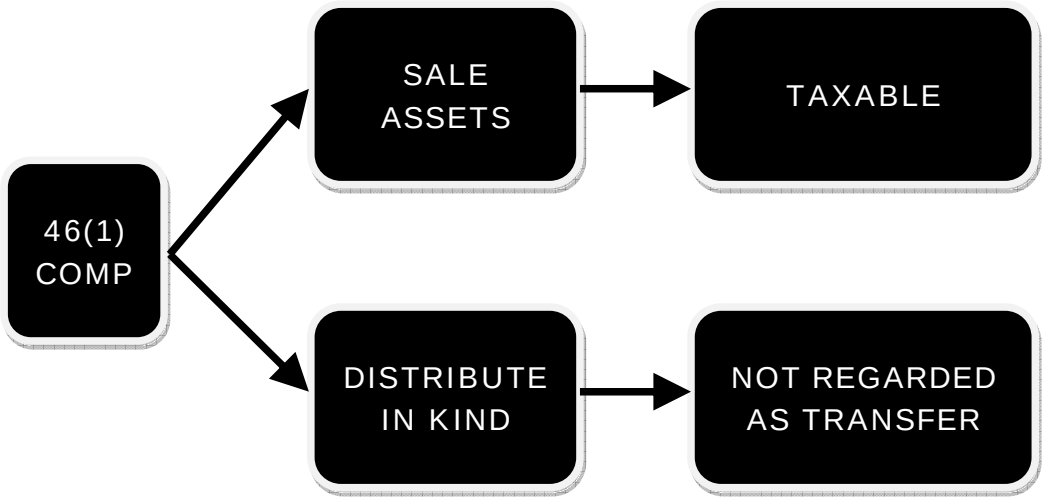
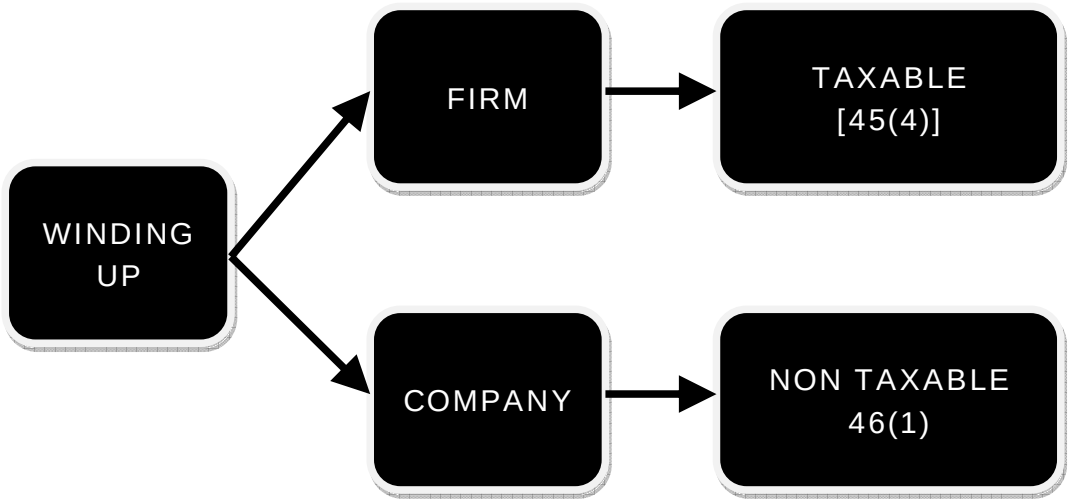


Where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as a transfer by the company for the purposes of section 45. Where a shareholder on the liquidation of a company receives any money or other assets from the company, he shall be chargeable to income-tax under the head "Capital gains".



Taxation of shareholders of company in liquidation

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.

Manner of computation / Adjustments	Rs.	Rs.
Full Value of Consideration (FMV on the date of distribution)		
Cash	2,75,000	
Market value of an asset (agricultural land, silver coin, car, etc.)	4,61,800	7,36,800
Less: Deemed dividend u/s 2(22)(c)		
Amount of Deemed Dividend (assumed)		52,737
Balance		6,84,063
Indexed cost of acquisition (assumed)		5,97,683
Long Term Capital Gains		86,380

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.

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

HOLDING AND 100 % SUBSIDIARY

Transfer by holding to subsidary 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.

X Ltd. – Holding Co. – Transferor Company. Y Ltd. – 100% Subsidiary Transferee Company.	Amt
(A) Capital Gains in case of X Ltd.	
Sale consideration	10,00,000
Less: Indexed Cost of Acquisition (assumed)	4,88,032
Long Term Capital Gains (not regarded as transfer and not taxable)	5,11,968
(B) Y Ltd. converts the asset into stock in trade & then sells the stock	
Capital Gains to X Ltd. (Transferor Co.) Rectification u/s 155	5,11,968
Consideration (Amt at which transferred to 3rd party.)	6,00,000
Less: cost of acquisition (assumed)	4,66,200
Short Term Capital Gains	1,33,800
(C) Capital Gains to X Ltd. (Transferee Co.)	
Full value of consideration (Market value as on date of conversion)	5,75,000
Less: Indexed cost of Acquisition	5,32,600
Long Term Capital Gains	42,400
Business Income	
Sale Price	10,00,000
Less: Market value on date of conversion	5,75,000
Business Income	4,25,000

AMALGAMATION

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 forieign 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 in case of business re-organisation of bank 47(vica) and 47(vicb)

Amalgamation / business re-organisation of banks ***would not be regarded as transfer*** for both the banks and its share holders.

DEMERGER

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 forieign 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.

BONDS / CONVERTIBLE DEBENTURES

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.

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.

Conversion of 115ac bonds in to shares or debentures 47 (xa)

Nothing contained in section 45 shall apply to any transfer by way of conversion of bonds referred to in section 115AC into shares or debentures of any company;

SPECIFIED TRANSACTION

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.

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.

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.

Reverse mortgage (xvi)

Any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government.

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.

Company or unlisted public company to LLP 47(xiiib)

Nothing contained in section 45 shall apply any transfer of a capital asset or intangible asset by a private company or unlisted public company (company) to a limited liability partnership or any transfer of a share or shares held in the company by a shareholder as a result of conversion of the company into a limited liability partnership in accordance with the provisions of section 56 or section 57 of the Limited Liability Partnership Act,

Provided that—

(a) all the assets and liabilities of the company immediately before the conversion become the assets and liabilities of the limited liability partnership;

(b) all the shareholders of the company immediately before the conversion become the partners of the limited liability partnership and their capital contribution and profit sharing ratio in the limited liability partnership are in the same proportion as their shareholding in the company on the date of conversion;

(c) the shareholders of the company do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of share in profit and capital contribution in the limited liability partnership;

(d) the aggregate of the profit sharing ratio of the shareholders of the company in the limited liability partnership shall not be less than fifty per cent at any time during the period of five years from the date of conversion;

(e) the total sales, turnover or gross receipts in business of the company in any of the three previous years preceding the previous year in which the conversion takes place does not exceed sixty lakh rupees; and

(f) no amount is paid, either directly or indirectly, to any partner out of balance of accumulated profit standing in the accounts of the company on the date of conversion for a period of three years from the date of conversion.

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 ;

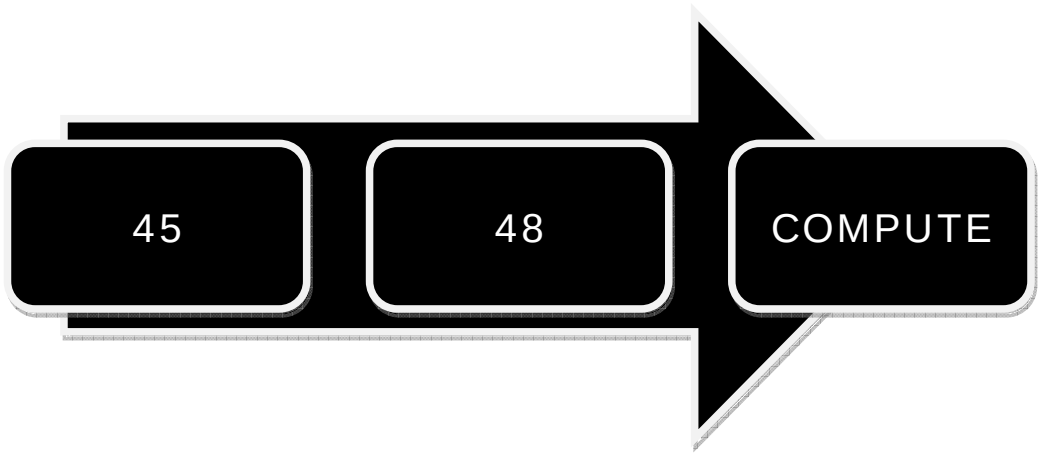
Withdrawal of exemption in case of violation 47A (3) / (4)

Where any of the conditions laid down in the proviso to clause (xiii) or (xiiia) or (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 shall be deemed to be the profits and gains chargeable to tax of the successor company for the previous year in which the requirements, are not complied with.'

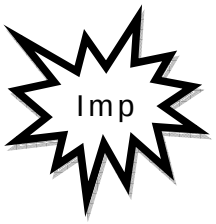
If the conditions stipulated regarding the succession of a proprietary concern or firm by a company whereby capital gains tax is not levied are not complied with, the amount of profits or gains arising from the transfer of such capital asset or intangible asset not charged under section 45 by virtue of conditions laid down in the proviso to clause (xiii) or (xiiia) or (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.

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



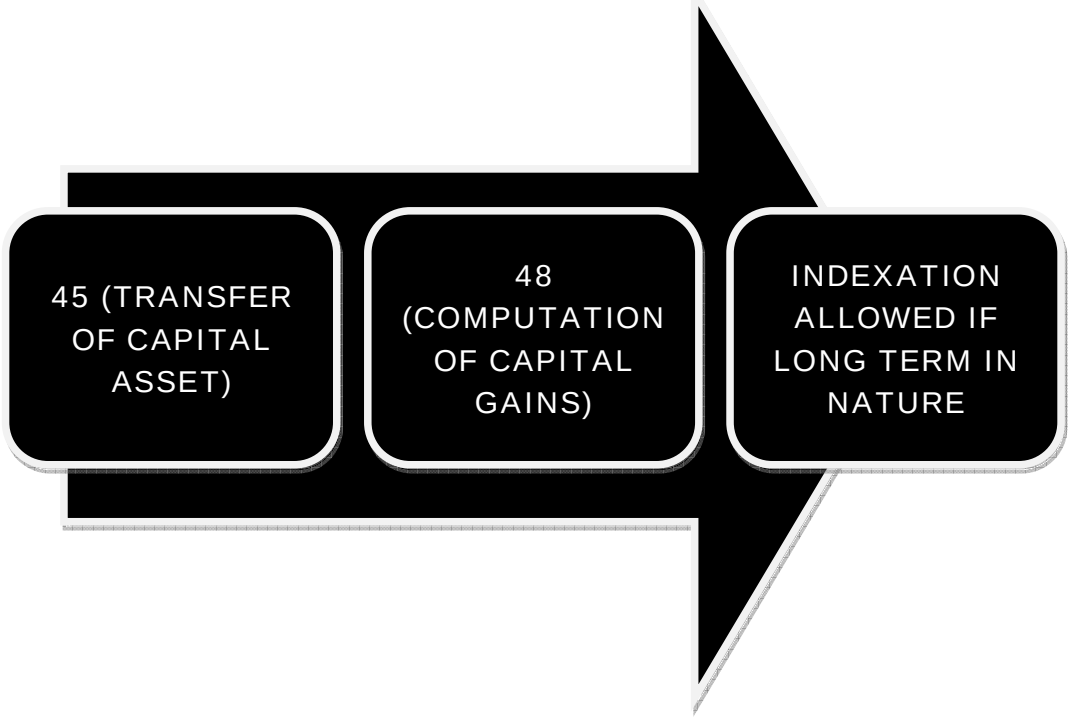
In the case of an assessee, who is a non-resident, capital gains arising from the transfer of a capital asset being shares in, or debentures of, an Indian company shall be computed by converting the cost of acquisition, expenditure incurred wholly and exclusively in connection with such transfer and 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:

	USD
(a) Shares not sold through RSE	
Sales consideration (4,27,500/45)	9,500
Less: Cost of Acquisition 1,42,500/25)	5,700
Long Term Capital Gains	3,800
Capital Gains in INR (3,800*43)	1,63,400
(b) If shares sold through RSE entire long term gains exempt u/s 10	

	Rates	Date
FVC	Average of Buying and Selling rate.	Transfer
Cost	--do--	Acquisition
Expense	--do--	Transfer
CG	Buying rate.	Transfer

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.



Manner of computation / Adjustments	Rs.	Rs.
Full Value of Consideration		26,98,700
Expense on account of transfer		2,500
Cost of Acquisition		
Cost of Acquisition (94-95)	5,69,000	
Cost of Improvement (2005-06)	3,15,000	
Indexed cost of acquisition		
Indexed cost of acquisition (cost * CII of year of transfer / CII of year of acquisition) (assumed)	13,88,478	
Indexed cost of improvement (cost * CII of year of transfer / CII of year of improvement) (assumed)	4,00,563	17,89,041
Long Term Capital Gains		9,07,159

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:

F.Y.	INDEX	F.Y.	INDEX
1981-82	100	1998-99	351
1982-83	109	1999-00	389
1983-84	116	2000-01	406
1984-85	125	2001-02	426
1985-86	133	2002-03	447
1986-87	140	2003-04	463
1987-88	150	2004-05	480
1988-89	161	2005-06	497
1989-90	172	2006-07	519
1990-91	182	2007-08	551
1991-92	199	2008-09	582
1992-93	223	2009-10	632
1993-94	244	2010-11	711
1994-95	259	2011-12	
1995-96	281		
1996-97	305		
1997-98	331		

Indexation for property inherited

The issue, which quite often arises, is what should be the cost inflation index to be adopted in the case of sale of a house property acquired through a will or any of the other modes stipulated in section 49(1)(ii) and (iii)(a). Should the cost inflation index pertaining to the financial year in which the property devolved on the assessee be adopted or is he entitled to take cost inflation index pertaining to the year in which the property was acquired by the previous owner ? For example an assessee acquired, under a will, a house property on the death of his mother on October 29, 2005, and the property was acquired by his mother prior to April 1, 1981. The assessee now proposes to transfer the property and is willing to invest in purchase of a residential property to avoid capital gains tax. The following issue arises :

"What should be the indexed cost of acquisition ? Should the index point of 100 relating to the financial year 1981-82 be adopted for working out capital gains or should it be the cost inflation index pertaining to the financial year 2005-06 when the assessee became the owner of the property ?"

There is no reported decision of any High Court touching this point. However an issue arose before the Chandigarh Bench of the Income-tax Appellate Tribunal in the case of Mrs. Pushpa Sofat v. ITO [2002] 81 ITD 1 (Chd.) (SMC) . In this case the house was acquired around the year 1972 by the assessee's father and the assessee inherited the property through a will left by her father. The assessee's father expired on February 17, 1991, and the assessee disposed of property during the assessment year 1993-94. The issue arose whether index point 223 pertaining to the accounting year 1991-92 (the year during which the father of assessee expired) should be adopted or index point of 100 pertaining to April 1, 1981 should be adopted. The Appellate Tribunal after referring to the provisions of sections 48 and 49(1) held that the cost of acquisition of the asset has to be deemed to be the cost for which the previous owner had acquired it. The Tribunal, therefore, ultimately held that point 100 pertaining to April 1, 1981 should be taken as the indexed cost of acquisition to work out capital gains and as the cost of property by applying the cost inflation index in terms of section 48(1)(a) was more than the sale consideration it was held that no taxable capital gain accrued to the assessee.

Conclusion

From the above, therefore, it could be inferred that the assessee who acquires the property through any of the modes stipulated in section 49(1)(ii) and (iii)(a) of the Income-tax Act, 1961, that is under a gift or will or by succession, inheritance or devolution is entitled to adopt the cost inflation index pertaining to the financial year in which the property was acquired by the previous owner.

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).

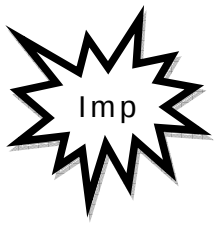
When computation is not possible

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).

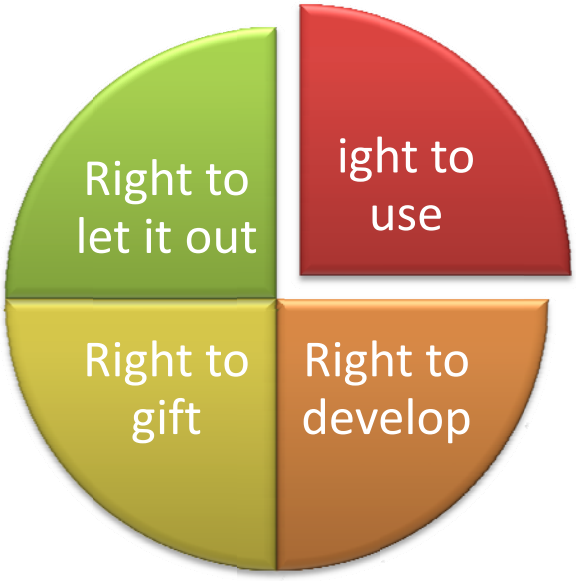
Capital gains in case of rights

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

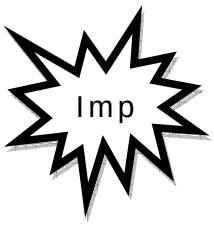


The appellant, a body of individuals, purchased two pieces of land in 1966 at a price of Rs. 27,600. In 1970 it granted a mining lease to a private company to extract clay for a period of 10 years at a premium of Rs. 5 lakhs in addition to payment of royalty. The grant of the mining lease was transfer 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)



PART OF CAPITAL ASSET IS ALSO A CAPITAL ASSET

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

I. 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

I. 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

I. Period of ***sweat equity*** shares shall be ***recognized from date of its allotment***.

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 DEFINITION 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) or (vica) or (vicb) or (xiiib) 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. Explanation - expression "previous owner of the property" in relation any capital asset owned by an assessee means the last previous owner of the capital asset.

Mr. Y - Manner of computation / Adjustments		Rs.
Full Value of Consideration		35,00,000
Cost of acquisition		
Cost to previous owner Mr. P	4,75,000	
Cost of improvement by Mr. Y	65,000	
	5,40,000	
Indexed cost of acquisition (assumed)		30,92,285
Long Term Capital Gains		4,07,715

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) or (xa) 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 under section 17, the cost of acquisition of such shares, debentures or warrants shall be the value under that clause.
49(2AAA)	Where the capital asset being rights of a partner referred to in section 42 of the Limited Liability Partnership Act, became the property of the assessee on conversion as referred to in clause (xiiib) of section 47, 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 company immediately before its conversion.
49(2AB)	When subsequently employee sells the ESOPs then ***FMV at time of his subscription*** would be the cost of acquisition.
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.
49(2E)	(2C) and (2D) would apply for business re-organisation of co-operative bank.

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.
49(4)	Where the capital gain arises from the transfer of a property, the value of which has been subject to income-tax under clause (*vii*) *or clause (*viia*)* of 56(2), the cost of acquisition of such property shall be deemed to be the value which has been taken into account for the purposes of that clause.

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;

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 generated	Initially acquired under the circumstances mentioned under section 49(1)		Initially purchased
		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

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 he 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.

Example 1

OPENING WDV	100
ADDITION	150
Total	250
SALE OF ASSETS	375
STCG	125

Example 2

OPENING WDV	100
ADDITION	150
Total	250
SALE OF ASSETS (ALL THE ASSETS SOLD)	175
STCL	75

Example 3

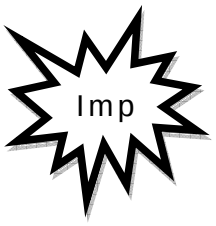
OPENING WDV	100
ADDITION	150
Total	250
SALE OF ASSETS (3 out of 4 assets in block sold)	175
WDV (there will not be any capital gains or loss, however assessee will continue to claim regular depreciation on this block of assets.)	75

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.

	OP 1.	OP.2	OP.3
FVC (UNIT)	100	100	132 100 + 32
COA			
ASSET WDV (DEPRECIABLE)	10	10	10
ASSET (NON-DEPR)	5	5	5
TOTAL	15	15	15
LIABILITY	3	32	--
COST OF BUSINESS	12	-17	15
CAPITAL GAINS	88	100	117

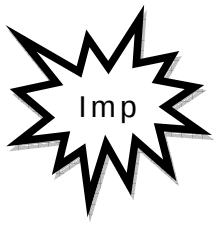
Note

(i) cost can not be negative.

(ii) liability taken over can not be treated as FVC in case of slump sale.

(iii) Option 3 is not to be followed.

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 or assessable by the "stamp valuation authority" for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed or assessable 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 or assessable 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 or assessable 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 or assessable by such authority shall be taken as the full value of the consideration received or accruing as a result of the transfer.

"assessable" means the price which the stamp valuation authority would have, notwithstanding anything to the contrary contained in any other law for the time being in force, adopted or assessed, if it were referred to such authority for the purposes of the payment of stamp duty.

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.

Example 1

FVC		100
COA	10	
ADVANCE MONEY (A'EE)	1	
ADVANCE MONEY (P.O.)	2	9
CAPITAL GAINS		91

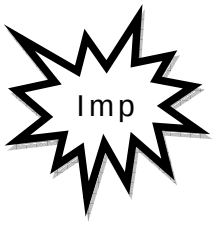
Note : adjustment is to be done from cost of acquisition and not from indexed cost of acquisiton.

Example 2

FVC		100
COA	10	
ADVANCE MONEY (A'EE)	15	Nil
CAPITAL GAINS		100
(- * - = +) LOGIC is not correct. Cost can not be negative.		

	Rs.	
Full value of consideration		25,00,000
Less: Expense on Transfer		25,000
Cost of Acquisition		
Cost to Previous Owner 5,00,000		
COI to Previous Owner 1,00,000		
FMV as on 1.4.81 5,50,000	5,50,000	
COI by Assessee	2,50,000	
Advance Money Forfeited		
By Previous owner 2,50,000	-	
By Assessee 2,00,000	(2,00,000)	
Cost of Acquisition	6,00,000	
Less:		
Indexed Cost of Acquisition/ Improvement		
Indexed COA (5,50,000 – 2,00,000) (assumed)	8,93,573	
Indexed COI (2,50,000) (assumed)	3,29,167	
Indexed COA & COI		12,24,740
Long Term Capital Gains		12,50,260

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 qualfying for benrfit ?	Individial 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 asseseee 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

Manner of computation / Adjustments	Rs.
Full Value of Consideration (Sale of Residential House)	32,00,000
Less: Expense on account of transfer	30,000
Less: Cost of acquisition (FMV as on 1.4.81 - 3,00,000)	
Indexed cost of acquisition (assumed)	18,96,000
Long Term Capital Gains	12,74,000
Less: **u/s 54** Investment in New Residential House	9,50,000
Taxable Capital Gains	3,24,000

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.).

Manner of computation / Adjustments		Rs.
Long Term Capital Gains		12,74,000
Less: **U/s 54** Purchase of Land	6,00,000	
Investment in Capital Gains A/c Scheme (for construction of house)	4,50,000	10,50,000
		2,24,000

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.

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)

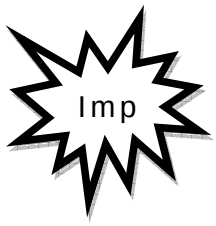
Agreement to sell entered in to advance

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)

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)

The controversy arises because the expression used in section 54(1) is "a residential house" and the stand usually adopted by the Revenue (Income-tax Department) is that the expression "a residential house" means only one residential house or one residential unit and hence if the assessee invests the amount of capital gain in more than one residential unit, exemption would not be available in full but

will be restricted to investment in one unit. The Mumbai Bench of the Income-tax Appellate Tribunal in the case of Mrs. Gulshanbanoo R. Mukhi v. Joint CIT [2003] 78 TTJ 768 (Mumbai), confirmed the view of the Revenue in the sense that the assessee was eligible to claim deduction for only one house. The Mumbai Bench in this case emphasized that the Legislature had not used the expression "residential house or houses" and "a new asset or new assets" to include or mean more than one unit. The Mumbai Bench laid more emphasize on the expression "a residential house" in the second part of section 54(1) and ultimately held in favour of the Revenue. This appears to be the only reported decision in favour of the Revenue and against the assessee and there are decisions rendered by different Benches of the Income-tax Appellate Tribunal at different times in favour of the assessee.

The Bangalore Bench of the Tribunal in D. Anand Basappa v. ITO [2005] 92 TTJ 597 (Bang) has not followed the above decision. It has instead followed the decisions in K. G. Vyas v. ITO [1986] 26 TTJ (Bom) 491 and Smt. Fulwanti C. Rathod v. ITO (I. T. A. No. 1092/Mum/1995, dated May 3, 2002). In this case, the assessee acquired two adjacent properties to meet his residential needs by investing the proceeds of one house sold by him. Both the properties were acquired simultaneously within the period stipulated in section 54. It was held that the assessee was entitled to exemption. It was observed that a house can contain more than one residential unit and yet it can be called "a residential house". If the intention of the Legislature was to restrict the deduction for only one house then instead of using the words "a residential house", the words "one residential house" would have been used. Under section 13 of the General Clauses Act, the singular includes the plural and vice versa - if the context does not otherwise intend and there is no such otherwise intention here.

In the case of K. G. Vyas v. ITO (supra) which has been relied on by the Bangalore Bench in the above case, the assessee had invested the relevant proceeds in purchase of four flats in the same building for the purpose of his own residence along with members of his big family and those flats were being used by him for that purpose only. It was held that the assessee was entitled to exemption under section 54. It was observed that the mere fact that the assessee had purchased those flats jointly either in the name of his wife or in the names of his sons would not materially affect or alter the factual position that he was the owner of all the four flats and he was living with the members of his family and that the fact that on a future date he may divide these properties among the members of his family is of no relevance or consequence for the purpose of allowing relief under section 54 when he had fulfilled all the conditions of investing in the purchase of these flats.

In Joint CIT v. S. K. Jasani [reported in BCAJ, August, 2005, at page 535], two flats purchased by the assessee on different floors were converted into a residential unit by providing an internal staircase. It was held that in view of the fact that the proceeds of transfer were invested within time in the purchase of two flats, exemption under section 54 was allowable. Thus, two flats were held to come within the scope of the expression "a residential house".

In Ratanlal Murarka's case [I. T. A. No. 4485/Mum/1999, reported in BCAJ, 2003] the assessee had purchased one house at Pune and the other at Thane by investing within the specified time the relevant proceeds arising out of transfer of his house and it was held that exemption under section 54 was allowable in respect of investment in acquiring both the houses. The expression "a residential house" in section 54(1) was held to include two houses.

In the case of P. S. Mogre [I. T. A. No. 4748/Mum/2001] the house that had been sold was approximately 1500 square feet in area and out of relevant proceeds, two flats were purchased of the area of about 750 square feet and 630 square feet in different localities within the stipulated time as the assessee was unable to acquire one big flat of about 1500 square feet and the Mumbai Bench of the Tribunal allowed the exemption following the decision in Ratanlal Murarka's case (supra).

The Delhi High Court in the case of CIT v. Smt. Sunita Aggarwal [2006] 284 ITR 20 held that the issue relating to whether two flats could be treated as one single residential unit does not give rise to a question of law and that the decision of the Tribunal in this regard on facts was binding on the court. In this case four different deeds were executed for two properties and even then it was held by the High Court that the assessee can claim benefit under section 54 of the Income-tax Act.

One of the outstanding issues in understanding reinvestment benefit under section 54 is whether it is possible for an assessee to get the benefit of investment in more than one residential house. Section 54F clearly permits investment in a single house. As for section 54, reinvestment is possible in "a residential house", so that it has been understood in some quarters, that the expression being singular can refer only to a single house. There were conflicting decisions on this point. The decision of the Bombay High Court in Kaushik (K. C.) v. P. B. Rane, Fifth ITO [1990] 185 ITR 499, is not an answer to the issue, because the dispute itself related to the issue, whether the assessee could claim relief with reference to the second property purchased by him. It was only this claim which was adjudicated in the taxpayer's favour. In the light of the object of promoting housing and the difference in language as between section 54 and section 54F, one would imagine that there is scope for a more liberal interpretation for section 54. The Special Bench of the Tribunal in ITO v. Ms. Sushila M. Jhaveri [2007] 292 ITR (AT) 1 (Mumbai), however, opted for a narrower interpretation on the comparison of these two provisions with other provisions, which would appear to be incorrect, since they are not comparable. So is the reliance of the Tribunal upon Kaushik's case (supra), which as pointed out did not deal with this issue. It referred to the decision in B. B. Sarkar v. CIT [1981] 132 ITR 150 (Cal), where again this issue was not directly involved.

It was in its view that the Tribunal held that the assessee could avail of the benefit for either of the two flats acquired by her at her choice in preference to the more liberal view based on the General Clauses Act, which would understand the singular to mean the plural and the policy of the Government to promote housing in enacting section 54. This is a matter pending in a large number of cases, which would have to await the final solution from the courts. It would be reasonable to expect that the Board would accept the more liberal view for section 54 in contrast with the limitation placed to section 54F itself, so as to avoid litigation instead of waiting for a final solution before the courts.

From the above therefore it could be inferred that the benefit of section 54 would not be lost merely because more than one residential unit is purchased. Of course there is no direct decision rendered by any High Court in this regard.

Whether the sale proceeds can be invested in purchase of a commercial property ?

In this connection the provisions of section 54 may be referred to. As per the provisions of section 54 the capital gain arising out of transfer of a long-term capital asset being a residential house owned by an individual or a Hindu undivided family should be invested in the purchase or construction of a residential house within the stipulated time. This section also stipulates that the income from that property should be chargeable under the head "Income from house property". So what the section clearly states is that the property which is being sold should be a residential house and the property which should be purchased or constructed within the stipulated time should also be a residential house. This clearly rules out purchase of a commercial property which cannot be stated to be used for residential purposes even though the income from letting out such commercial property may be assessed in the hands of the individual under the head "Income from house property".

Case law on this subject also would throw light with regard to the meaning of "a residential house". Though a residential house has not been defined in the statute, the issue as to whether the particular property is a residential house or not arises in the context of the concession for self-occupation for residential purposes under section 23(1) (this provision is repealed now) and exemption given under the Wealth-tax Act for one residential house. In Globe Theatres Ltd. v. Khan Saheb Abdul Gani, AIR 1956 Mys 57 [FB], the following extract from the English decision in Barlaw v. Smith [1892] TLR 57 was relied upon :

"The Act distinguishes between occupation and residence and requires that the person who occupies must reside in the borough . . . The party may occupy and not `reside' there . . . Residence . . . Under the enactment is different from occupation and means where the man lives and where he has his home. It has always been held that a man resides where he lives and has his home."

Stroud's Judicial Dictionary defines residence in the following words :

"The word `residence' signifies a man's abode or continuance in a place and where there is nothing to show that it is used in a more extensive sense. It denotes the place where an individual eats, drinks and sleeps or where his family or his servants eat, drink and sleep. The word `residence' has a variety of meanings according to the statute in which it is used. The term is flexible and must be construed according to the object and intent of the particular legislation where it may be found. Primarily `residence' or `place of abode' means the dwelling and home where a man is supposed usually to live and sleep ; they may also include a man's business abode, the place where he is to be found daily".

In Poonen v. Rathi Varghese, AIR 1967 Ker 1 [FB], it was held that it should constitute an abode or residence, though not for the purpose of the owner. Such residential use should not be casual as in the case of a hotel or choultry.

The hon'ble Supreme Court in the case of Tata Engineering and Locomotive Company Ltd. v. Gram Panchayat , AIR 1976 SC 2463, has clearly brought out the distinction between building and dwelling house. It has been held in the case of P. N. Shukla v. CIT [2005] 276 ITR 642 (All) that where the construction itself was for letting out for non-residential purpose to a public sector company, the assessee is not entitled to claim any relief under section 23(1) for self-occupation.

Hence from what has been stated above, it is quite clear that the investment made in commercial property out of the capital gains arising out of sale of residential property will not entitle the assessee to claim any deduction under section 54.

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.).

Manner of computation / Adjustments	Rs.
Full Value of Consideration (Agricultural Land)	66,50,000
Expense on account of transfer	50,000
	66,00,000
Cost of acquisition 8,00,000	
Indexed cost of acquisition (assumed)	50,56,000
Less: Exemption u/s 54B	
Agricultural Land Purchased	10,00,000
Taxable Long Term Capital Gains	5,44,000

	Particulars	SECTION 54D	SECTION 54G
1	Who is the assessee qualfying 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)

Manner of computation / Adjustments	Rs.
Full Value of Consideration (Bldg – Deprecial Assets)	12,00,000
Opening WDV	7,36,894
STC Gains u/s 50	4,63,106
Exemption u/s 54D. Cost of Bldg purchased 5,75,000 / amount of capital gain whichever is less	4,63,106
Taxable STC Gains	Nil

Manner of computation / Adjustments			Rs.
Full Value of Consideration			
Plant & Machinery		25,00,000	
Building		45,00,000	
Furniture & Fixtures		1,50,000	71,50,000
WDV of depreciable assets			
Plant & Machinery		14,00,000	
Building		18,25,000	
Furniture & Fixtures		1,38,000	33,63,000
Short Term Capital Gains u/s 50	**(A)**		37,87,000
Long Term Capital Gains on sale of industrial land			
Full value of consideration			31,50,000
Less: Indexed cost of acquisition (assumed)			22,12,000
Long Term Capital Gains	**(B)**		9,38,000
Total Capital Gains (A+B)			47,25,000
Less: **Exemption u/s 54G**			
Plant & Machinery		18,75,000	
Building		29,00,000	
Total Investment		47,75,000	
But restricted to capital gains on plant and machinery and building			47,13,000
Taxable Short Term Capital Gains (on furniture and fixtures not eligible for exemption u/s 54G, 1,50,000 – 1,38,000)			12,000

	Particulars	SECTION 54EC	SECTION 54GA
1	Who is the assessee qualfying for benrfit ?	Any Person	Any
2	What should be the asset transferred ?	Any asset	Building, Land, Plant and Machinery forming part of Industrial Undertaking in Urban Area.
3	What is the holding period of Transferred asset ?	Transfer of LTCA	- -
4	Any other condition	---	Shifting to Special Economic Zone.
5	Where should assessee invest Monies ?	Specified Bonds (redeemable after 3 years)	Similar assets in special economic zone.
6	What is time Limit for Acquisition ?	6 months after	1 year before or 3 years after
7	What is time Limit for Construction ?	---	1 year before or 3 years after
8	What is the amount of Investment ?	Capital Gains (investment in bonds does not exceed 50 lakhs of Rupees.)	Capital Gains
9	What is holding period of new asset ?	3 years from date of acquisiton	3 years from date of acquisition
10	What if there is violation in holding period ?	Deemed Capital gains	Cost Less (Same as 54G)
11	Which will be the year of consequence ?	Year of Violation.	- -
12	Is 54H applicable ?	Yes	No
13	Is CG scheme 1988 applicable ?	No	Yes

Note 6 – related to section 54EC

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**.

Manner of computation / Adjustments	Rs.
Full Value of Consideration (Gold)	3,75,700
Expense on account of transfer	1,700
Cost of acquisition (1,19,500)	
Indexed cost of acquisition (assumed)	1,94,149
Capital gains	1,79,851
Exemption u/s 54EC Investment in NHAI Bonds	1,60,000
Taxable LTC Gains	19,851

	Particulars	SECTION 54F	SECTION 115F
1	Who is the assessee qualfying for benrfit ?	Individual or HUF	Non Resident Indian
2	What should be the asset transferred ?	Any asset (Other then 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 acquisiton	3 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 ?	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.

Manner of computation / Adjustments	Rs.
Full Value of Consideration (Jewellery)	9,00,000
Expense on account of transfer	2,000
Cost of acquisition (1,15,000)	
Indexed cost of acquisition (assumed)	4,51,428
Capital gains	4,46,472
Less: Exemption u/s 54F investment in new residential house (4,46,472 * 8,50,000 / 8,98,000)	4,22,607
Taxable LTC Gains	23,864

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, amont 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 54H

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 extention 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 prayer 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 prayer.

The tax prayer 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 prayer 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.

CAPITAL GAINS - EXEMPT FROM TAX

10(33) TRANSFER OF UNITS

Any income arising from the transfer of a capital asset, being a unit of the Unit Scheme,1964 takes place on or after the 1st day of April, 2002.

10(37) URBAN AGRICULTURAL LAND COMPULSORY ACQUIRE

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, where

(i) such land is situate in any urban 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 under any law, or a transfer the consideration for which is determined or approved by the Central Government or the Reserve Bank of India ;

(iv) such income has arisen from the compensation or consideration for such transfer received by such assessee on or after the 1st day of April, 2004.

10(38) LISTED 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 where

(a) the transaction of sale of such equity share or unit; and

(b) such transaction is chargeable to securities transaction tax under that Chapter.

Provided that the income by way of long-term capital gain of a company shall be taken into account in computing the book profit and income-tax payable under section 115JB.

For the purposes of this clause, "equity oriented fund" means a fund

1) 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 ; and

2) which has been set up under a scheme of a mutual fund specified under clause (23D) :

Provided that the percentage of equity share holding of the fund shall be computed with reference to the annual average of the monthly averages of the opening and closing figures.

Computation of Total Income	AMT	AMT
(I) SALARIES		2,39,750
(II) INCOME FROM HOUSE PROPERTY (LETOUT PROPERTY)		1,41,500
(II) INCOME UNDER HEAD CAPITAL GAINS		
IV. STCG (on sale of shares)	31,500	
I. LTCG (on sale of unlisted shares)	21,200	52,700
(III) INCOME FROM OTHER SOURCES		
(i) Interest on FD with Banks	16,380	
(ii) Commission from LIC	4,750	21,130
		4,55,080
(IV) GROSS TOTAL INCOME (without LTC Gains & STC Gains on eq. shares)		
Less: Admissible Deduction under Chapter VIA		
80C + 80D + 80U		1,06,300
Total income		3,48,780
TAX LIABILITY		
(I) Tax on Total Income (excl. capital gains) (as per slab rates)		xxxx
(II) Tax on Long Term Capital Gain u/s 112		xxxx
(III) Tax on Short Term Capital Gains u/s 111A		xxxx
Total Tax due		xxxx
Less: TDS/Adv. Tax if any		xxxx
Self Assessment/(Refund)		xxxx

PART E

SET OFF

CLUBBING

TDS

TCS

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	35AD business loss.
3	Where the result of the computation made for any assessment year under sections 48 to 55 in respect of any capital asset (other than a short-term capital asset) is a loss, the assessee shall be entitled to have the amount of such loss set off against the income, if any, as arrived at under a similar computation made for the assessment year in respect of any other capital asset not being a short-term capital asset. 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.
4	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)
5	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
73A	35AD business	35AD business	ANY	
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.

SEC 72A SCOPE EXTENDED

This Section deals with carry forward and set-off of accumulated losses and unabsorbed depreciation in the case of amalgamation or demerger of a company. ***The benefit of this Section is now extended to amalgamation of one or more public sector companies engaged in the business of operation of aircraft.***

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) Fulfils 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.

Transfer to limited liability partnership

Where there has been reorganisation of business whereby a private company or unlisted public company is succeeded by a limited liability partnership fulfilling the conditions laid down in the proviso to clause (xiiib) of section 47, then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the predecessor company, shall be deemed to be the loss or allowance for depreciation of the successor limited liability partnership for the purpose of the previous year in which business reorganisation was effected and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.

Provided that if any of the conditions laid down in the proviso to clause (xiiib) of section 47 are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the successor limited liability partnership, shall be deemed to be the income of the limited liability partnership 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.

SEC 72AB DEMERGER OF BANK

This provisions are very similar to 72A amalgamation or demerger.

A new S. 72AB has also been added from A.Y. 2008-09 to provide for carry forward and set-off of accumulated losses and unabsorbed depreciation allowance in the case of amalgamation or demerger of co-operative banks. The Section provides that the accumulated business losses and unabsorbed depreciation of amalgamating or demerged co-operative banks will be allowed to be set off against the income of amalgamated/resulting co-operative banks, subject to the conditions specified in the Section. These conditions are more or less the same as provided in S. 72A dealing with carry forward and set-off of accumulated losses and absorbed depreciation in the case of amalgamation or demerger of limited companies.

It may be noted that these two Sections do not deal with a situation where a co-operative bank merges with any other nationalised bank or a private sector bank which is registered under the Companies Act.

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)

Merger of societies no eligible for 72A

Section 72 of the Income-tax Act, 1961, provides for carry forward and set off of business loss of an assessee. The word "assessee" has been used in section 72A. Under this section in case of merger of companies, the losses suffered by a company before amalgamation can be carried forward and set off after amalgamation against the profits of the amalgamated company, but no such provision has been made in the case of merger of societies. When there is no specific provision like section 72A for companies, that the Legislature has no intention to extend a similar benefit in the case of merger of societies. Section 78(2) also extends the benefit of carry forward or set off of losses only in the case of succession.

Where there is a merger of two co-operative societies, the carried forward loss of the merging society cannot be set off against profit of the merged society, because section 72A, which permits such set off for merger between two companies, will have no application for merger of two co-operative societies. However, the claim was made on the ground of succession under section 78(2). It was found in Rajasthan Rajya Sahakari Spinning and Ginning Mills Federation Ltd. v. ITAT [2003] 260 ITR 167 (Raj) that a merger cannot constitute succession, because after merger, a new federation came to be formed. The federation itself is merger of four societies. It is under these circumstances, the claim was found inadmissible.

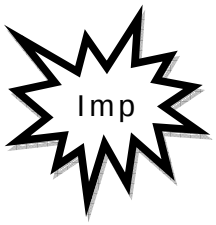
Succession by inheritance

Assessee as sole proprietor, carried on a speculation business. Within one month of his death, his heirs, who had succeeded to and carried on the business in the meanwhile, drew up a partnership deed, to carry on the same business, narrating these facts. The firm claimed carry forward and set off of the loss incurred by M in the business.

Held [2001] 247 ITR 0805- CIT VS. MADHUKANT M. MEHTA (SC) that the partners, as heirs, had succeeded to assesee's business and there was inheritance for the purposes of section 78(2) and firm entitled to carry forward loss of sole proprietor.

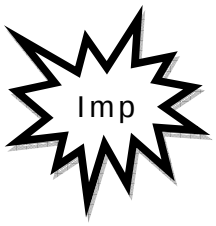
SPECIAL CASES OF FIRMS AND COMPANIES

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

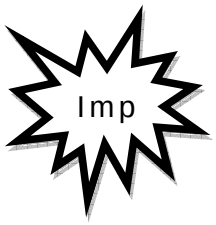
Provided further that nothing contained in this section shall apply to any change in the shareholding of an Indian company which is a subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company subject to the condition that fifty-one per cent shareholders of the amalgamating 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.

BOND WASHING TRANSACTION

SEC 94(7) DIVIDEND STRIPPING



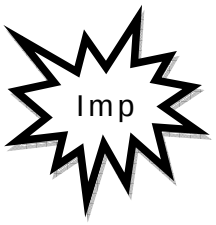
Where (a) Any person buys or acquires any securities or unit within a period of three months prior to the record date

(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.

CLUBBING OF INCOME

TRANSFER OF INCOME WITHOUT TRANSFER OF ASSETS [SEC. 60]

If any person transfers income without transferring ownership of the asset, such income is taxable in the hands of the transferor. If will not make any difference whether the transfer is revocable or irrevocable or it was effected before or after the commencement of the Act.

REVOCABLE TRANSFER OF ASSETS [SEC. 61]

Any income arising to any person by virtue of a revocable transfer of assets is chargeable to tax as the income of the transferor. This is subject to the following two exceptions laid down by section 62:
Where the income arises to any person by virtue of a transfer by way of trust which is not revocable during the lifetime of the beneficiary and, in the case of any other transfer, which is not revocable during the lifetime of the transferee.
Where the income arises to any person by virtue of a transfer made before April 1, 1961, which is not revocable for a period of six years or more.

REMUNERATION OF SPOUSE [SEC. 64(1)(II)]

An individual is chargeable to tax in respect of nay remuneration received by the spouse from a concern in which the individual has substantial interest.

When clubbing is not attracted

Remuneration solely attributable to the application of technical or professional knowledge and experience of the spouse is not clubbed, irrespective of the fact whether such remuneration is received from a firm or any other person.

When both husband and wife have a substantial interest in a concern –

Where both husband and wife have a substantial interest in a concern and both are in receipt of remuneration from such concern, remuneration will be included in the total income of husband or wife whose total income excluding such remuneration is greater.

Substantial interest

An individual is deemed to have substantial interest, if he (individually or along with his relatives) beneficially holds equity shares carrying not less than 20 per cent voting power in the case of a company or is entitled to not less than 20 per cent of the profits in the case of a concern other than a company at any time during the previous year. "Relative", in relation to an individual, means the husband, wife, brother or sister or any lineal ascendant or descendant of that individual [section 2(41)].

Income eligible for clubbing

Income to be clubbed in the hands of individual is limited to salary, commission, fees or any other remuneration received by the spouse, directly or indirectly, whether in cash or in kind. Any other income, not covered by the aforesaid categories is, however, outside the scope of this section even if it accrues to the spouse from a concern in which the individual has a substantial interest.

ASSETS TRANSFERRED TO SPOUSE [SEC. 64(1)(IV)]

Where an asset (other than house property) is transferred by an individual to his spouse directly or indirectly, otherwise than for adequate consideration or in connection with an agreement to live apart, any income from such asset is deemed to be the income of the transferor.

ASSETS TRANSFERRED TO SON'S WIFE [SEC. 64(1)(VI)]

If an individual, directly or indirectly, transfers assets after may 31, 1973, without adequate consideration to son's wife, income arising from such assets is included in the total income of the transferor.

TRF. TO A PERSON FOR BENEFIT OF SPOUSE [SEC. 64(1)(VII)]

Where an asset is transferred by an individual, directly or indirectly, without adequate consideration, to a person or an association of persons for the immediate or deferred benefit of his or her spouse, income arising from the transferred asset is included in the total income to the transferor to the extent of such benefit.

TRF. TO A PERSON FOR BENEFIT OF SON'S WIFE [SEC. 64(1)(VIII)]

Where an asset is transferred by an individual, directly or indirectly, on or after June 1, 1973, without adequate consideration, to a person or an association of persons for the immediate or deferred benefit of son's wife, income arising, directly or indirectly, from the transferred assets is included in the total income of the transferor to the extent of such benefit.

INCOME OF MINOR CHILD [SEC. 64(1A)]

All income which arises or accrues to the minor shall be clubbed in the income of his parent. However, the income derived by the minor from manual work or from any activity involving his talent or specialised knowledge and experience and income of minor child suffering from any disability of the nature specified in section 80U will not be included in the income of his parents.

The income of a minor will be included in the income of that parent whose total income [excluding the income includible under section 64(1A)] is greater and where the marriage of the parents does not subsist, the income of minor will be includible in the income of that parent who maintains the minor child in the relevant previous year. Where any such income is once included in the total income of either parent, any such income arising in any succeeding year shall not be included in the total income of the other parent, unless the Assessing Officer is satisfied (after giving that parent an opportunity of being heard) that it is necessary so to do.

In case the income of an individual includes the income of his minor child in terms of section 64(1A), such individual shall be entitled to an exemption of Rs. 1,500 in respect of each minor child if the income of such minor includible under section 64(1A) exceeds that amount. Where, however, the income of any minor so includible is less than Rs. 1,500, the aforesaid exemption shall be restricted to the income so included in the total income of the individual.

HUF AND PARTITION [SEC. 64(2)]

Where a member of a Hindu undivided family has converted his self-acquired property into joint family property after December 31, 1969, (or where a member transfers his property without consideration to his Hindu undivided family) income arising from the converted or transferred property will be dealt with as follows,

The entire income from the converted property or transferred property is taxable as the income of the transferor. If the converted property or transferred property is subsequently partitioned amongst the members of the family, the income derived from such converted property or transferred property as is received by the spouse of the transferor will be taxable in his hands.

POINTS TO BE NOTED.

Income from the accretion to assets

In the aforesaid cases, income arising to the transferee from the property is taxable in the hands of the transferor. However, income arising to the transferee from the accretion of such property or from accumulated income of such property is not includible in the total income of the transferor. For instance, where X transfers Rs. 1,00,000 to his wife without any consideration and Mrs. X deposits the money in a bank, interest received from the bank on such deposits is taxable in the hands of X. if, however, Mrs. X purchases debentures of a company from the accumulated interest income, interest received by Mrs. X on debentures is taxable in her hands and is not to be clubbed with the income of X.

Clubbing of negative income

Under section 64, the income of specified persons is liable to be included in the total income of the individual in the circumstances mentioned in above paras. For the purposes of including the income of specified persons in the income of the individual, the word "income" will include a loss.

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, principal officer or company does not deduct the whole or any part of the tax or after deducting fails to pay the tax as required by or under this Act, he or it shall be liable to pay simple interest,

(i) at one per cent for every month or part of a month on the amount of such tax from the date on which such tax was deductible to the date on which such tax is deducted; and

(ii) at one and one-half per cent for every month or part of a month on the amount of such tax from the date on which such tax was deducted to the date on which such tax is actually paid,

and such interest shall be paid before furnishing the statement.

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.

Penalty order for assessee in default

No order for penalty shall be made deeming a person to be an assessee in default for failure to deduct the whole or any part of the tax from a person resident in India, at any time after the expiry of

(i) two years from the end of the financial year in which the statement is filed in a case where the statement referred to in section 200 has been filed;

(ii) four years from the end of the financial year in which payment is made or credit is given, in any other case :

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.

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 / statements 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.

Section 206(1) is amended to do away with the requirement of furnishing of the annual return of tax deducted at source on or after the 1st day of April, 2005.

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 5,000 rupees by way of interest (for bank interest 10,000) (other than interest on securities), shall prepare such statements for such period as may be prescribedin 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	As per finance act, 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	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)	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.10,000 per branch in case of bank interest & deposit with housing finance companies. b) 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. 10,000	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. 5,000	30 %
194C(1)	Specified persons	Payment to Resident contractors by	Rs.30000 per contract OR Aggregate of sum during financial year is exceeding Rs. 75,000	1 % if payee is I / H Else 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. 20,000	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. 5000	10 %

194I	Any person (However Individual or HUF covered by 44AB are subject to TDS)	Rent paid to any resident person. (rent will include hiring of machinery, plant, equipment, furniture and fittings besides land and building, whether let separately or jointly)	Rs.180000 p.a.	2 % for use of mach / plant / equipment 10 % for use of L / B / LA
194J	Other than individual & HUF. (However Individual or HUF covered by 44AB are subject to TDS)	Fees for professional services or for technical services OR royalty and on sum referred to in 28(*va*) (non compete charges)	Rs.30000 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.”;	10 %
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)

PAYMENT DUE TO RECOMMANDATION OF PAY COMMISSION

CIRCULAR NUMBER: 756 [1997] 228 ITR (Stat) 0015-

As per section 192 of the Income-tax Act, 1961, the person responsible for paying any income under the head "Salaries" is required, at the time of payment, to deduct income-tax on the amount payable, at the average rate of income-tax computed on the basis of the rates in force for the financial year in which the payment is made, on the estimated income of the assessee for that financial year. All DDOs must, therefore, ensure that proper and adequate tax is deducted from the disbursement to employees of not only additional pay and allowances but also of arrears payable to Central Government employees as a result of the implementation of the revised pay scales.

CIRCULAR NUMBER: 758 [1997] 228 ITR (Stat) 0145-

However, it has come to notice that a large number of drawing and disbursing officers have not deducted the full quantum of tax liability on the arrears paid to Central Government employees as a consequence of the recently announced revision of the pay scales. The deductions have been made in an ad hoc manner. This is in gross violation of the provisions of the Income-tax Act, and is liable to attract penal consequences including prosecution.

All drawing and disbursing officers in the Central Government and various organisations under it are advised to recompute the correct tax liability of every employee, on the arrears drawn by him and immediately recover the full tax liability thereon.

NOTE FOR 194A

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 (***shall deduct income tax if interest payable on such Bonds exceeds ten thousand rupees during the financial year***.)
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 or scheduled bank

"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)

Payment to member of co-operative bank

[2002] 257 ITR (STAT) 0036- CIRCULAR NUMBER: 009

Representations have been received in the Board seeking clarification as to whether a member of a co-operative bank may receive without TDS interest on time deposit made with the co-operative bank. The Board has considered the matter and it is clarified that a member of a co-operative bank shall receive interest on both time deposits and deposits other than time deposits with such co-operative bank without TDS under section 194A by virtue of the exemption granted vide 194A(3)(v). The provisions of clause 194A(3)(viia) is applicable only in case of a non member depositor of the co-operative bank, who shall receive interest only on deposits other than time deposits without TDS under section 194A.

It is hereby clarified that the exemption is available only to such members who have joined in application for the registration of the co-operative society and those who are admitted to membership after registration in accordance with the bye-laws and rules. A member eligible for exemption under section 194A(3)(v) must have subscribed to and fully paid for at least one share of the co-operative bank, must be entitled to participate and vote in the general body meetings and/ or special general body meetings of the co-operative bank and must be entitled to receive share from the profits of the co-operative bank.

Arbitration award is in interest

[2002] 258 ITR 0337- GHAZIABAD DEVELOPMENT AUTHORITY VS. DR. N.K. GUPTA (NATIONAL CONSUMER DISPUTES REDRESSAL COMMISSION)

Where the purchaser of a flat from the DDA was found entitled to interest for deficiency and delay in handing over the flat under an order from the State Consumer Disputes Redressal Commission, the requirement for tax deduction under section 194A was not applicable because the character of the payment though described as interest fixed at 18 per cent. per annum, was only compensation measured with reference to the yardstick of interest.

It is held in case of Govinda Choudhury and Sons [1993] 203 ITR 881 (SC) if the amounts under a contract were not paid at the proper time and interest was awarded to the respondent for such delay, the interest was only an accretion to the respondent's receipts from the contract and was attributable to and incidental to the business carried on by it. The interest payable to the respondent partook of the same character as the receipts for the payment of which it was otherwise entitled under the contracts and which payment had been delayed as a result of disputes between the parties. The interest awarded could not be separated from the other amounts granted to the respondent under the

awards and treated as "Income from other sources". It is well-settled that interest can be assessed under the head "Income from other sources" only if it cannot be brought within one or the other of the specific heads of charge.

In case of B.N. Agarwala and Co. 259 ITR 754 (SC) The assessee entered into a contract with the Government for executing certain works. A dispute arose between the assessee and the Government and the dispute was referred to arbitration. The arbitrator awarded a certain amount by way of compensation for work done and also awarded interest. The question was whether the interest awarded by the arbitrator was income assessable tax. The High Court held that the interest was of capital nature and could not be assessed as income. On appeal to the Supreme Court Held, reversing the decision of the High Court, that the interest awarded by the arbitrator was income and it had to be assessed as a business receipt of the assessee.

Interest on delayed compensation by land acquisiton collector

[2003] 260 ITR 0284- SHANKAR VS. UNION OF INDIA (DEL)

In view of the decision of the Supreme Court in Bikram Singh v. Land Acquisition Collector [1997] 224 ITR 551 wherein it was held that the interest received on delayed payment of compensation under the Land Acquisition Act, 1894, was a revenue receipt exigible to tax and section 194A of the Income-tax Act, 1961. The person entitled to compensation would be entitled to a spread over of 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.

It is established law that interest on delayed compensation on compulsory acquisition arises from year to year as decided by the Supreme Court in CIT v. T. N. K. Govindarajulu Chetty [1987] 165 ITR 231. But where tax is deducted at the time of payment in one lump sum, there is usually a mismatch between the amount required to be deducted and what is actually deducted under section 194A of the Income-tax Act. A writ was filed in Shankar v. Union of India [2003] 260 ITR 284 (Delhi) questioning the deduction without considering the effect of spread-over of income. The High Court found that since the payment was taxable, tax deduction cannot be avoided as found by the Supreme Court in Bikram Singh v. Land Acquisition Collector [1997] 224 ITR 551. The manner in which it is assessable in the hands of the assessee cannot determine the amount of tax that is required to be deducted under the statute. However, it is open to the recipient to offer the income on year to year basis by filing returns and claiming refund for excess tax.

[2003] 262 ITR 0033- KRANTI KUMAR SAXENA, IN RE VS. (MADHYA PRADESH HIGH COURT)

Under 194A tax deduction at source is permissible in respect of interest on compensation on compulsory acquisition of land and also in respect of interest accrued on enhanced compensation of the Land Acquisition Act. This section has to be read in conjunction with section 204 which furnishes the meaning of "person responsible for paying". Where land is compulsorily acquired and the money to be paid as enhanced compensation, is deposited in the execution court and interest is awarded on such compensation, the court is not the person responsible for paying any income by way of interest to the assessee. In terms of sections 194A and 204 the real person responsible for paying income by way of interest is the Land Acquisition Officer/Collector who has money in his possession. The court acts only as a conduit for getting the payment made to the claimant in execution of a decree passed by the court. Since there is no liability of the court to deduct tax under section 194A, the court need not retain the amount of approximate tax and inform the concerned Income-tax Officer to collect it by means of voucher.

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)

Gratitous distribution of prize

[2004] 266 ITR 0027- COMMISSIONER OF INCOME-TAX VS. DEPUTY DIRECTOR OF SMALL SAVINGS (MADRAS HIGH COURT)

Before a scheme can be regarded as a lottery, there must be the element of distribution of prizes which should be by chance or lot and such distribution should be among those who had paid a price for participating in the scheme. Mere gratuitous distribution without any price having been paid by the participants for acquiring the chance and receiving a prize that is ultimately distributed, would not amount to a lottery. That appears to be the reason why the Explanation was added under section 2(24)(ix) of the Income-tax Act, 1961, with effect from April 1, 2002, to bring within the purview of section 194B, winnings from prizes awarded to any person by a draw of lots under any scheme or arrangement, whether or not the persons taking part in that arrangement, had paid a price for acquiring the chance of winning the prize. The Explanation lays emphasis on the winnings awarded by a draw of lots or chance.

Are prizes awarded by savings schemes operated by the Government, though chosen by lot, to be treated as winnings from lotteries ? The High Court in CIT v. Deputy Director of Small Savings [2004] 266 ITR 27 (Mad) held that the prizes are given with a view to encourage thrift and were in the nature of a gift for the same having been limited only to the investors. An investor was not paying for the prize of the coupon, since the prizes were awarded for the holder of lucky coupon, which was not so purchased and since what was given were goods in kind, the question of treatment of the same as liable for tax does not arise and consequently liability for tax deduction at source cannot also be inferred under the law. It was in this context that penalty levied under section 201(1A) on the officer of the State Government in CIT v. Deputy Director of Small Savings [2004] 266 ITR 27 (Mad) was found to be without jurisdiction.

Penalty was for the alleged default on the aggregate value of the prizes distributed to the extent of Rs. 73 lakhs during the year. Since the proviso to section 194B introduced with effect from June 1, 1997, had roped in distribution of lottery winnings in kind by requiring the distributor not to part with the winnings without ensuring that tax has been paid by the winner. The fact, that the payment was made in kind, could not have spared the distributor from liability though it could have applied only for the period beginning from June 1, 1997. Further it could have applied only in respect of amount exceeding Rs. 5,000 in value which could be treated as lottery winnings. The scheme was not one for the promotion of sale of any goods. The investor was not offered interest payable on a larger sum, even when a smaller sum is invested. When the investment was made the full amount was payable and interest was paid thereon for the specific period, the investment as also the interest being eligible for concessions/exemptions under the Income-tax Act. The chance given to the investor to win a prize was a free chance, and not a chance given in return for a price or contribution

paid. The scheme was not a lottery. No penalty could be imposed once it was found that there had been no violation of the law.

NOTE ON SECTION 194C

Where any sum is paid or credited for carrying out any work, tax shall be deducted at source

(i) on the invoice value excluding the value of material, if such value is mentioned separately in the invoice; or

(ii) on the whole of the invoice value, if the value of material is not mentioned separately in the invoice.

No individual or Hindu undivided family shall be liable to deduct income-tax on the sum credited or paid to the account of the contractor where such sum is credited or paid exclusively for personal purposes of such individual or any member of Hindu undivided family.

No deduction shall be made from any sum credited or paid or likely to be credited or paid during the previous year to the account of a contractor during the course of business of plying, hiring or leasing goods carriages, on furnishing of his Permanent Account Number, to the person paying or crediting such sum.

"specified person" shall mean,—

(a) the Central Government or any State Government; or

(b) any local authority; or

(c) any corporation established by or under a Central, State or Provincial Act; or

(d) any company; or

(e) any co-operative society; or

(f) any authority, constituted in India by or under any law, engaged either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages, or for both; or

(g) any society registered under the Societies Registration Act, 1860 (21 of 1860), or under any law corresponding to that Act in force in any part of India; or

(h) any trust; or

(i) any university established or incorporated by or under a Central, State or Provincial Act and an institution declared to be a university under section 3 of the University Grants Commission Act, 1956 (3 of 1956); or

(j) any Government of a foreign State or a foreign enterprise or any association or body established outside India; or

(k) any firm; or

(l) any person, being an individual or a Hindu undivided family or an association of persons or a body of individuals, if such person,—

(A) does not fall under any of the preceding sub-clauses; and

(B) is liable to audit of accounts under clause (a) or clause (b) of section 44AB during the financial year immediately preceding the financial year in which such sum is credited or paid to the account of the contractor;

work shall include—

(a) advertising;

(b) broadcasting and telecasting including production of programmes for such broadcasting or telecasting;

(c) carriage of goods or passengers by any mode of transport other than by railways;

(d) catering;

(e) manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer,

but does not include manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from a person, other than such customer.

NOTE ON SECTION 194H

No deduction of tax at source in respect of payments of commission or brokerage payable by ***BSNL or MTNL to their public call office (PCO) franchisees.***

Reverse transaction

[2002] 257 ITR 0202- AHMEDABAD STAMP VENDORS ASSOCIATION VS. UOI (GUJ)

Where the State Government supplies stamp papers at a discount to its vendors/agent, the Assessing Officers expected the agent to make good what the Government should have deducted at source under section 194-H by treating the discount on sale as commission. Licensed vendors of stamp paper pay a price at a discount and that it cannot be said that there is any commission received by them, since they only purchase the stamp paper at a discount acquiring ownership of such stamp papers and bearing any loss or destruction, etc. Though they may get a refund of outdated stamp papers, there is still a sale at a discount. It is not a case of an agency, where sale of stamp paper is made on behalf of the principal, so that it does not fall within the ambit of the definition of commission or brokerage. This decision points out the distinction between commission/brokerage and discount. Discount is an abatement of cost, where it is given at the time of sale. It is not for services rendered by the purchaser, so as to constitute commission or brokerage. Such discount even including cash discount for prompt payment has been treated consistently for sales tax purposes as abatement of cost, so that sales tax becomes leviable only on the net amount as was decided in Dy. CST v. Advani Oerlikon Pvt. Ltd. [1980] 45 STC 32 (SC) and Dy. CST v. Kerala Rubber and Allied Products [1993] 90 STC 170 (SC). Bonus, discount or rebate have been all understood as abatement of price. The discount made available to the licensed stamp vendors under the provisions of the Gujarat Stamps Supply and Sales Rules, 1987, does not fall within the expression "commission" or "brokerage" under section 194H of the Act.

NOTE ON SECTION 194I / J

Treatmnet of payment of advance rent

CIRCULAR NUMBER: 005 [2001] 248 ITR (STAT) 0241-

Problems were being faced by the assessees in getting due credit for tax deducted at source in respect of tax deducted in terms of section 194-I of the Act. Such problems in getting due credit for tax deducted at source mainly relate to the following situations :

Sometimes tax is deducted at source under the provisions of section 194-I of the Act on advance rent pertaining to more than one financial year to be adjusted against future rent. Difficulty in getting due credit for tax deducted arises because the entire amount of advance rent does not accrue to the assessees as income in one financial year since the income from the property is taxed on the basis of annual letting value whereas the tax is deducted at source on the entire amount of advance rent pertaining to more than one financial year. Therefore, credit for entire amount of tax deducted at source is not allowed in terms of section 199 of the Act because the credit is to be given for the assessment year for which such income is assessable. Thus, the assessees do not get credit for the entire amount of tax deducted at source in the first assessment year, in which part of the advance rent is offered as rental income, on the basis of the certificate furnished under section 203 of the Act. Further there is a difficulty in claiming the credit in the remaining assessment years to which balance of advance rent relates in the absence of the certificate for tax deducted at source for these years.	In such cases where advance rent is spread over more than one financial year and tax is deducted thereon, credit shall be allowed in the same proportion in which such income is offered for taxation for different assessment years based on the single certificate furnished for tax so deducted on the entire advance rent.
Sometimes subsequent to the deduction of tax at source on advance rent pertaining to one or more financial years. Rent agreement gets terminated/cancelled resulting into refund of balance amount of advance rent to the tenant, or Rented property is transferred by way of sale, lease, gift, etc., with tenant in occupation or otherwise resulting into refund of balance amount of advance rent to the transferee or the tenant, as the case may be. Difficulty in getting due credit for tax deducted at source arises because rental income ceases to accrue to the assessees on account of termination/cancellation of rent agreement or transfer of the rented property subsequent to the deduction of tax at source on advance rent pertaining to one or more financial years. The credit is not given in the hands of the assessees in whose names certificate for tax deduction at source stands because there is no relatable rental income and, further credit for tax is not allowed to any person other than the person in whose name certificate for tax deducted at source has been issued. Thus, in such cases, even though tax has been deducted at source and paid to the Government, due credit for such tax deducted is not allowed.	Credit for the entire balance of tax deducted at source, which has not been given credit so far, shall be allowed in the assessment year relevant to the financial year during which the rent agreement gets terminated/cancelled or rented property is transferred and balance of advance rent is refunded to the transferee or the tenant, as the case may be.

Property let by AOP

[2003] 264 ITR 0016- AMALENDU SAHOO VS. INCOME-TAX OFFICER (CAL)

Section 194-I of the Income-tax Act talks about a person as well as an individual. There appears to be a conscious decision to keep them separate. A person may be an individual and may be a body of individuals. While the liability under section 194-I is foisted the moment rent is to be paid to a person which as aforesaid may be an individual or a body of individuals. But the rate of tax to be deducted has been fixed for an individual at a separate rate and for a body of individuals at a separate rate. The proviso to the section deals with the payee. If the payee is an individual entitled to receive rent in excess of Rs. 1,20,000 per annum then the payer is obliged to deduct 15 per cent. thereof as tax deducted at source. If the payee is a body of individuals and if the rent payable exceeds Rs. 1,20,000 per annum, the payer is required to deduct 20 per cent. thereof as tax deducted at source.

Where the assessee as undivided joint owners had let out the property to the bank the bank correctly deducted tax at source while agreeing to pay a balance sum to the petitioners jointly as and by way of rent.

Where the assessee individually had let out specified areas of the property to the bank, the rent payable was required to be apportioned and accordingly if upon such apportionment the assessee were not individually entitled to receive a sum in excess of Rs. 1,20,000 per annum the bank was not entitled to make any deduction of tax at source.

Where a property is let out to a body of individuals, the limit should be a collective one. But if it is let out to each member of such body, the limit has to be a split one. It was so decided in Amalendu Sahoo v. ITO [2003] 264 ITR 16 (Cal).

Cellular services are not technical services

[2001] 251 ITR 0053 SKYCELL COMMUNICATIONS LTD. VS. DCIT (MAD)

Section 194J provides for tax deduction at source at 5% on payments exceeding Rs.20,000 for fees for professional and technical services. The provision of cellular mobile telephone facility to subscribers cannot be treated as technical service and that it does not fall under any other listed services nor has it been notified. Merely because the service is linked to science and technology as are found in most of the gadgets now in use in every day life, every such instrument or gadget to make life easier cannot be treated as involving provision of technical service. [However, the issue may still arise whether it is liable for TDS at the lesser rate of 2% under section 194C or not]

"Technical service" contemplates rendering of a "service" to the payer for the fee. Mere collection of a "fee" for use of a standard facility provided to all those willing to pay for it does not amount to the fee having been received for technical services.

TDS if no pan is furnished

Any person who is entitled to receive any sum or income or amount on which tax is deductible under Chapter XVIIB (hereinafter referred to as the deductee) shall furnish his Permanent Account Number to the person responsible for deducting such tax (hereinafter referred as the deductor), failing which tax shall be deducted at the rate mentioned in the relevant provisions of the Act or at the rate in force or at the rate of twenty per cent, whichever is higher.

Declaration filed under section 197A shall not be valid unless the person filing the declaration

furnishes his Permanent Account Number in such declaration.

In case any declaration becomes invalid, the deductor shall deduct the tax at source in accordance with the above provisions.

No certificate under section 197 shall be granted unless it contains the Permanent Account Number of the applicant.

Deductee shall furnish his Permanent Account Number to the deductor and both shall indicate the same in all correspondence, bills, vouchers and other documents which are exchanged between them.

Where the Permanent Account Number provided by the deductee is invalid or it does not belong to the deductee, then it shall be deemed that Permanent Account Number has not been furnished to the deductor and tax shall be deducted as per this provisions.

NOTE ON SECTION 195 (TDS FOR NON RESIDENT)

It has been observed that with the growth of the economy of the country the number of transactions of the taxpayers in India with non-residents has been increasing. Such transactions may relate to supply of plant and machinery from abroad, technology transfers, provision of technical and consultancy services by non-residents, etc. In respect of all the sums payable to non-residents, for the purpose of the aforesaid transactions, tax is required to be deducted at source.

Section 195 of the Act, which falls under Chapter XVII-B, casts a duty upon a person to deduct tax at source on payments to non-residents or foreign companies, but such payments must be chargeable to tax under the provisions of the Act. In this context, therefore, it becomes an important issue as to what types of payments fall within the purview of the provisions of section 195 of the Act. There may be certain payments which are not liable to tax in India on the basis of the relevant provisions of the Act, viz. sections 5(2), 9(1), 115A, etc. If the said payments are not liable to tax under the provisions of the Act, the matter ends there and no tax is required to be deducted at source in respect of such payments. However, if such payments are liable to tax under the Act, then one has to examine the provisions of the Double Taxation Avoidance Agreement (DTAA) between India and the country of residence of the non-resident. There may be a number of payments which may not be liable to tax in India in view of the provisions of the relevant tax treaty between India and the country of residence of the non-resident.

Supreme Court has rendered a landmark judgment, dated January 4, 2007, in the case of Ishikawajima-Harima Heavy Industries Ltd. v. DIT [2007] 288 ITR 408 (SC) .

The Supreme Court has thrown new light in respect of the meanings of the terms "business connection" and "permanent establishment". The apex court has provided a totally different interpretation regarding the tax-treatment of fees for technical services, as per the provisions of section 9(1)(vii) of the Act. The apex court has also provided some other valuable insights as regards the provisions of Double Taxation Avoidance Agreements (DTAA), particularly the Double Taxation Avoidance Agreement between India and Japan.

The aforesaid company provided services to persons resident in India. It is a non-resident company incorporated in Japan. It formed a consortium along with five other enterprises. The consortium was awarded by Petronet, a turnkey project for setting-up a liquefied natural gas (LNG) receiving, storage and re-gasification facility in Gujarat. The aforesaid company was to develop, design, engineer, procure equipment, materials and supplies to erect and construct storage tank including marine facility (jetty and island breakwater) for transmission and supply of LNG to purchasers, to test and commission the facilities, etc. The contract involved : (i) off shore supply, (ii) off shore services, (iii) on shore supply, (iv) on shore services and (v) construction and erection.

In the aforesaid judgment, the Supreme Court has considered in detail the provisions of sections 5(2) and 9(1) of the Act and also the provisions of the Double Taxation Avoidance Agreement between India and Japan. The significant part of the aforesaid judgment may be briefly summarized as follows :

1. The provisions of section 9(1)(vii) of the Act, relating to fees for technical services, must be read with section 5, thereof, which takes within its purview the territorial nexus on the basis whereof tax is required to be levied, namely (a) resident ; and (b) receipt or accrual of income.

What is relevant is receipt or accrual of income as would be evident from a plain reading of section 5(2) of the Act. In a case of this nature, interpretation with reference to the nexus to tax territories will assume significance. Territorial nexus for the purpose of determining the tax liability is an internationally accepted principle. It may, therefore, not be possible to give an extended meaning to the words, "Income deemed to accrue or arise in India", as expressed in section 9 of the Act.

Whatever is payable by a resident to a non-resident by way of fees for technical services, thus, would not always come within the purview of section 9(1)(vii) of the Act. It must have sufficient territorial nexus with India so as to furnish a basis for imposition of tax. Whereas a resident would come within the purview of section 9(1)(vii) of the Act, a non-resident would not, as services of a non-resident to a resident utilized in India may not have much relevance in determining whether the income of the non-resident accrues or arises in India. It must have a direct live link between the services rendered in India. When such a link is established, the same may again be subjected to any relief under the Double Taxation Avoidance Agreement. A distinction may also be made between rendition of services and utilization thereof.

It is evident that section 9(1)(vii), read in its plain language, envisages the fulfilment of two conditions : services which are the source of income sought to be taxed in India must be (i) utilized in India, and (ii) rendered in India. In the present case, both these conditions have not been satisfied simultaneously.

So far, the normally accepted view in this regard has been that if the technical or consultancy services in the context of section 9(1)(vii) of the Act, are utilized in India, then the same are liable to tax in India, irrespective of the place where such services are rendered. Thus, such services are considered to be liable to tax in India, even if they are rendered outside India.

The apex court has totally reversed the aforesaid view and has clearly held that in the context of section 9(1)(vii), fulfilment of two conditions is envisaged. The services which are the source of income sought to be taxed in India must be utilized in India and also rendered in India. Both the aforesaid conditions must be satisfied simultaneously.

Therefore, if the technical or consultancy services, though utilized in India, are rendered outside India, the same will not be liable to tax in India within the provisions of section 9(1)(vii) of the Act.

2. The fact that the contract was signed in India is of no material consequence, since all the activities in connection with the off-shore supply were outside India and therefore, cannot be deemed to accrue or arise in India. So far, the Income-tax Department has been clinging to the view that if a contract is signed in India, then the income generated in India as a result thereof, will be liable to tax in India.

3. There exists a distinction between a business connection and a permanent establishment. As the permanent establishment cannot be said to be involved in the transaction, the aforementioned provision will have no application. The permanent establishment cannot be equated to a business connection, since the former is for the purpose of assessment of income of a non-resident under a

Double Taxation Avoidance Agreement, and the latter is for the application of section 9 of the Income-tax Act.

4. Once a transaction is excluded from the scope of taxation under the Income-tax Act, the question of application of the provisions of Double Taxation Avoidance Agreement would not arise.

5. Sufficient territorial nexus between the rendition of services and territorial limits of India is necessary to make the income taxable in India.

6. The location of the source of income within India would not render sufficient nexus to tax the income from that source.

7. The existence of a permanent establishment would not constitute sufficient "Business connection" and the permanent establishment would be the taxable entity. The fiscal jurisdiction of a country would not extend to taxing the entire income attributable to the permanent establishment. There exists a difference between the existence of a business connection and the income accruing or arising out of such business connection.

8. A legal fiction in a taxing statute should be construed on the basis of the object sought to be achieved.

The aforesaid judgment also covers a number of other issues connected with the issue of tax liability of non-residents in India. Therefore, it will always prove useful while ascertaining a tax-liability of a non-resident in India.

Impact of amendment by the Finance Act, 2007, on this judgment.

The aforesaid judgment of the apex court, is sought to be nullified by the amendment of section 9 of the Act, by the Finance Act, 2007. An Explanation has been inserted in section 9 stating that for the removal of doubts, for the purposes of the said section, where income is deemed to accrue or arise in India under clauses (v), (vi) and (vii) of sub-section (1), such income shall be included in the total income of the non-resident, whether or not the non-resident has residence or place of business or business connection in India.

The aforesaid purpose will not be achieved by the insertion of the aforesaid Explanation in section

9. The reasons for the same are as follows :

"Section 9 raises a legal fiction; but having regard to the contextual interpretation and furthermore in view of the fact that we are dealing with a taxation statute the legal fiction must be construed having regard to the object it seeks to achieve. The legal fiction created under section 9 of the Act must also be read having regard to the other provisions thereof. (see Maruti Udyog Ltd. v. Ram Lal [2005] 2 SCC 638)"

"What is relevant is receipt or accrual of income, as would be evident from a plain reading of section 5(2) of the Act. The legal fiction created although in a given case may be held to be of wide import, but it is trite that the terms of a contract are required to be construed having regard to the international covenants and conventions. In a case of this nature, interpretation with reference to the nexus to tax territories will also assume significance. Territorial nexus for the purpose of determining the tax liability is an internationally accepted principle. An endeavour should, thus, be made to construe the taxability of a non-resident in respect of income derived by it. Having regard to the internationally accepted principle and Double Taxation Avoidance Agreement, it may not be possible to give an extended meaning to the words `income deemed to accrue or arise in India' as expressed in section 9 of the Act. Section 9 incorporates various heads of income on which tax is sought to be levied by the Republic of India. Whatever is payable by a resident to a non-resident by way of fees for technical services, thus, would not always come within the purview of section 9(1)(vii) of the Act. It must have sufficient territorial nexus with India so as to furnish a basis for imposition of tax. Whereas a resident would come within the purview of section 9(1)(vii) of the Act, a non-resident would not, as services of a non-resident to a resident utilized in India may not have much relevance in determining whether the income of the non-resident accrues or arises in India. It must have a direct live link between the services rendered in India. When such a link is established, the same may again be subjected to any relief under the Double Taxation Avoidance Agreement. A distinction may also be made between rendition of services and utilization thereof."

Section 9 of the Act, is itself a deeming provision or a provision which raises a legal fiction. The proposed Explanation to be inserted in section 9, is also a deeming provision or a provision which raises a legal fiction. Thus, the aforesaid Explanation will be a fiction raised upon another fiction.

The basic provision under section 5(2) of the Act, which deals with "Scope of total income" in respect of non-residents and which has been heavily relied upon by the apex court in the aforesaid judgment, has remained unchanged.

In view of the aforesaid reasons, the insertion of the aforesaid Explanation in section 9, by the Finance Act, 2007, may not achieve the desired objective and besides, it may give rise to a lot of litigation. Only time will tell as to what would be the fate of the aforesaid amendment at the hands of the judicial authorities.

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 (excluding ***mining and quarrying of mineral oil***), 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 Govern- ment, 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)

TCS on what amount ?

[2004] 266 ITR 0364- HARVANSH AND SONS VS. UNION OF INDIA (MADHYA PRADESH HIGH COURT)

A perusal of the M. P. Excise Act, 1915, makes it clear that when liquor is purchased from a warehouse, payment of excise duty is to be made at the rate of duty in force on the date of issue. Excise duty is to be paid separately to the State. Hence, tax has to be collected at source on the cost price of liquor excluding the amount paid towards excise duty.

Any license fees are not coverfed

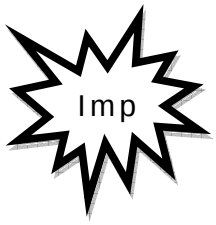
[2001] 248 ITR 0105 UOI VS. OM PRAKASH S.S. AND COMPANY (SC)

To licence fees paid for licences issued by the Government permitting the licensee to carry on liquor trade, the provisions of section 206C, for collection of tax at source are not attracted, as the licensee does not fall within the concept of "buyer" referred to in that section. The payment made by the

licensee by way of licence fee does not ipso facto entitle the licensee to lift goods. For obtaining the goods mentioned in the Table appended in the section, the licensee has to place an order on the manufacturer or supplier of the goods and it is at that point of time that section 206C would get attracted. "Buyer" means a person who, by virtue of the payment, gets a right to receive specific goods and not one who is merely allowed/permitted to carry on business.

Penalty Provisions			
Section	Nature of Default	Minimum penalty	Maximum Penalty
271C	Failure to deduct the whole or any part of tax as required under section 192 to 196C or if any person fails to pay tax on dividends under section 115-O or under second proviso to section 194B	Amount of tax which such person has failed to deduct or pay	-
271CA	Penalty for failure to collect tax at source	Amount of tax which a person has failed to collect	

Penalty Provisions			
Section	Nature of Default	Minimum penalty	Maximum Penalty
272BB(1A)	Failure to quote tax deduction or collection number	Rs. 10,000	-



PART – F

MAT

FIRMS

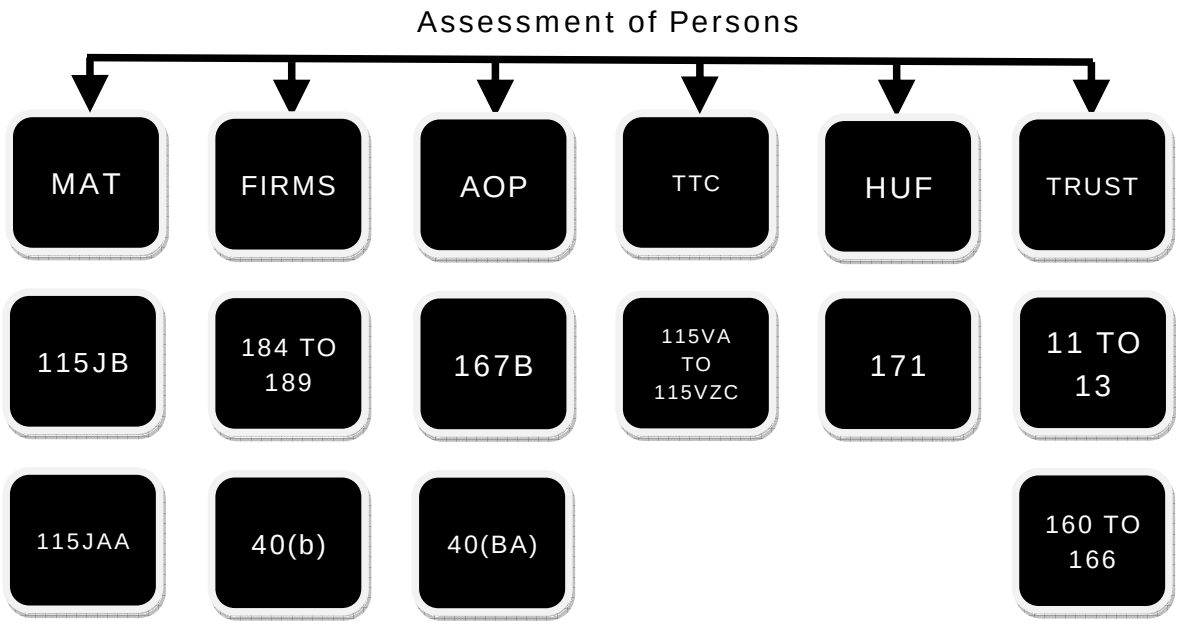
AOP

CHARITABLE TRUST

HUF

POLITICAL PARTY

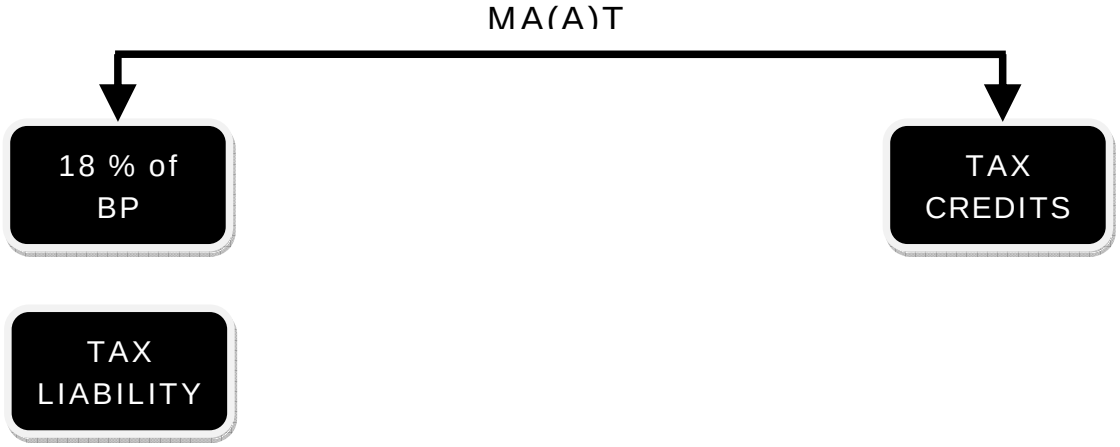
CO-OPERATIVE SCT.


Assessment of Persons
MAT
FIRMS
AOP
TTC
HUF
TRUST
115JB
184 TO 189
167B
115VA TO 115VZC
171
11 TO 13
115JAA
40(b)
40(BA)
160 TO 166

MININUM ALTERNATE TAX

ASSESSMENT OF COMPANIES

A company is a juristic person. It is separate and distinct from its shareholders. A company is assessable on its total income. However, if tax on its book profits exceeds the tax on its total income, it is assessed on its book profits. A domestic company is further liable to pay additional income tax on the amount of dividends declared, distributed or paid. Different provisions, relating to company, governing its assessment and tax liability, are explained as in the following sections.



SEC. 115JB MINIMIMUM 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 is less than 18 %. 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 18 %..

Company	Rate of income-tax (per cent)
In case of a domestic company	30
In case of a foreign company Royalty received from Government or Indian concern in pursuance of an agreement made by it with the Indian Concern after March 31, 1961, but before April 1, 1976, or fees for rendering technical services in pursuance of an agreement made by it after February 29, 1964 but before April 1, 1976 and where such agreement has, in either case, been approved by the Central Government	50
Other income	40

	If net income does not exceed Rs. 1 crore	If net income exceeds Rs. 1 crore
Domestic company	Nil	7.5%
Foreign company	Nil	2.5%

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:

a)	The amount of income-tax paid or payable, and the provision therefore [income tax means any tax on distributed profits under section 115-O or on distributed income under section 115R; ((i) dividend tax (ii) any interest charged under this Act; (iii) surcharge, if any, as levied by the Central Acts from time to time; (iv) Education Cess on income-tax, if any, as levied by the Central Acts from time to time; and (v)Secondary and Higher Education Cess on income-tax, if any, as levied by the Central Acts from time to time.]	X
b)	The amounts carried to any reserves, by whatever name called other than a reserve specified under section 33AC	X
c)	The amount or amounts set aside to provisions made for meeting liabilities, other than ascertained liabilities	X
d)	The amount by way of provision for losses of subsidiary companies	X
e)	The amount or amounts of dividends paid or proposed	X
f)	The amount or amounts of expenditure relatable to any income to which section 10 [other than the provisions contained in clause (23G) / (38) thereof] or section 11 or section 12 apply	X
g)	The amount of depreciation debited to the profit and loss account.	
h)	the amount of deferred tax and the provision therefor	
i)	the amount or amounts set aside as provision for diminution in the value of any asset	

		X

Less:

if any amount referred is credited to the profit and loss account,

a)	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. 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.	X
b)	The amount of income to which any of the provisions of section 10 [other than the provisions contained in clause (23G) / (38) thereof] or section 11 or section 12 apply, if any such amount is credited to the profit and loss account	X
c)	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
d)	The amount of profits eligible for deduction under section 80HHC	X
e)	The amount of profits eligible for deduction under section 80HHE	X
f)	The amount of profits eligible for deduction under section 80HHF	X
g)	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
h)	The amount of depreciation claimed in the profit and loss account, excluding the claim of depreciation on account of revaluation of assets, shall be reduced from the book profit.	
i)	The amount withdrawn from revaluation reserve and credited to the profit and loss account to the extent it does not exceed the amount of depreciation on account of revaluation of assets shall be reduced from the book profit.	
j)	the amount of deferred tax, if any such amount is credited to the profit and loss account	

		X

Set off under income tax act ifdifferent

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 10 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)

No fresh inquiry

[2002] 255 ITR 0273 APOLLO TYRES LTD. VS. CIT (SC)

While so looking into the accounts of the company, the Assessing Officer has to accept the authenticity of the accounts with reference to the provisions of the Companies Act, which obligate the company to maintain its accounts in a manner provided by that Act and the same to be scrutinised and certified by statutory auditors and approved by the company in general meeting and thereafter to be filed before the Registrar of Companies who has a statutory obligation also to examine and be satisfied that the accounts of the company are maintained in accordance with the requirements of the Companies Act. Sub-section (1A) of section 115J does not empower the Assessing Officer to embark upon a fresh enquiry in regard to the entries made in the books of account of the company.

Generally accepted accounting principle.

[2003] 262 ITR 0330- KINETIC MOTOR CO. LTD. VS. DEPUTY CIT (BOM)

The assessee was a public limited company engaged in the business of manufacture and sale of two wheelers. For the previous year in the books of account maintained the assessee debited an amount of Rs. 6,32,65,430 on account of depreciation. This depreciation was calculated on the written down value method, which is one of the permissible methods under the Companies Act as well as under the Income-tax Act, although the assessee earlier used to provide the depreciation on the straight line method in its corporate accounts. The above change in treatment resulted in a book loss of Rs. 1,64,49,937. These accounts were certified to be true and fair by the auditors. The Assessing Officer took the view that there was no justification for the assessee to change the basis of providing

depreciation. The Assessing Officer re-worked the depreciation and arrived at a revised figure of book profit. Held, that it was not in dispute that under the Companies Act both the straight line method and written down value method are recognised. Therefore, once the amount of depreciation actually debited to the profit and loss account was certified by the auditors, it was not permissible for the Assessing Officer to make book adjustments.

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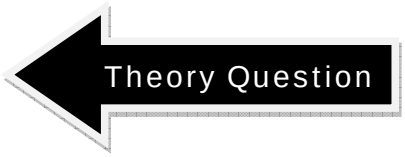
ASSESSMENT OF FIRMS

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.

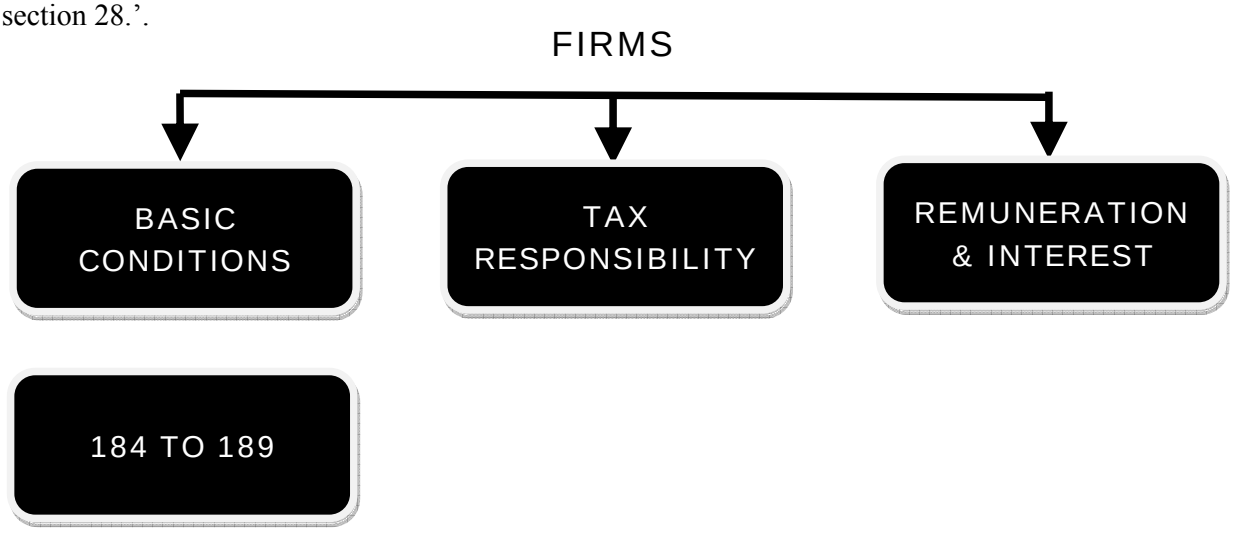
Sec. 184(5) consequence when firm is within scope of 144

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.

Theory Question

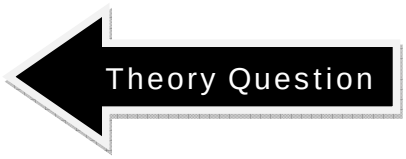
Where a firm does not comply with the provisions of section 184 for any assessment year, the firm shall be so assessed that no deduction by way of any payment of interest, salary, bonus, commission or remuneration, by whatever name called, made by such firm to any partner of such firm shall be allowed 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 interegnum 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.

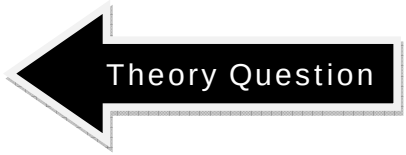
Succession connotes a change of ownership from one entity to another, the former coming to an end and the latter taking over the business in continuity as a going concern. In other words, the successor-business must be a continuation of the original business. For succession to take place, it is essential 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.

DISSOLUTION OF FIRM

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 assessees 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)

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)

Stock valuation

[2004] 265 ITR 0466- CIT VS. TAMIL NADU SUGAR CORPORATION LTD. (MAD)

Valuation of closing stock has to be made as on the last day of the accounting year. Where market rate becomes relevant either because the assessee follows valuation at market rate or at cost or market rate whichever is lower, the market rate prevailing on the last day of the accounting year has to be taken. In CIT v. Tamil Nadu Sugar Corporation Ltd. [2004] 265 ITR 466 (Mad), a lesser value prevailing 25 days later than that date was adopted. The Assessing Officer insisted on substitution of the market value as on the last day of the accounting year. It was argued on behalf of the assessee that the accounting standards permit even the value occurring after the balance-sheet. The High Court, however, found that even if the system of accounting followed by the assessee were such as to treat the value after the relevant date, it would not be a proper system of accounting, so that the Assessing Officer can discard the same following the rationale of the decision in CIT v. British Paints India Ltd. [1991] 188 ITR 44 (SC). The adoption of such accounting would not reflect the true profits of the accounting year and was, therefore, not justified. In fact, the argument that events after the end of the accounting year could be taken into consideration would be acceptable only in the case of extraordinary events occurring after the close of the accounting year and before the accounts are finalised, such as earthquake, fire or such other events, which would clearly indicate that the balance sheet without considering such loss of such magnitude, though after the last day of the accounting year, would give a wrong picture of the true net worth of the enterprise. Hence, the accounting standards for taking into account events after the last day of the accounting year cannot possibly cover instances of fluctuation in market rates in inventory valuation.

[2001] 250 ITR 0871- SAKTHI TRADING CO. VS. CIT (SC)

It was so observed in A. L. A. Firm v. CIT [1991] 189 ITR 285 (SC) There can be no manner of doubt that, in taking accounts for purposes of dissolution, the firm and the partners, being commercial men, would value the assets only on a real basis and not at cost or at their other value appearing in the books. The real rights of the partners cannot be mutually adjusted on any other basis. That the partners of the assessee firm having revalued the stock-in-trade for the purposes of mutual adjustment which was the only basis on which the real rights of the partners had to be adjusted, it was untenable for them to contend that the valuation should be on some other basis for income-tax purposes. The stock-in-trade had been valued at market price, the surplus had to be reflected in the profits of the firm and had to be charged to tax.

The assessee in Sakthi Trading's case was a registered firm. As a result of death of one of its partners the firm was dissolved and reconstituted with remaining partners. As the business of the firm was never discontinued but was taken over on succession by another firm, the closing stock of the assessee firm had to be valued at cost or market price whichever was lower. In other words, since there was no cessation of business, the closing stock had to be valued at cost or market price, whichever was lower.

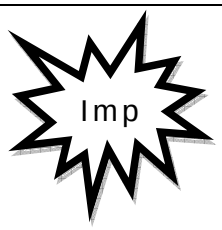
This decision of the Court will have application even after section 45(4) requiring the market value to be adopted for distribution of assets to partners because section 45(4) has application only for distribution of capital assets for purposes of capital gains and not stock in trade.

Liability of partners of limited liability partnership in liquidation 167C.

Notwithstanding anything contained in the Limited Liability Partnership Act, 2008 (6 of 2009), where any tax due from a limited liability partnership in respect of any income of any previous year

or from any other person in respect of any income of any previous year during which such other person was a limited liability partnership cannot be recovered, in such case, every person who was a partner of the limited liability partnership 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 limited liability partnership.

Taxation of firms

<table>
<tr><td>Rate of tax</td><td>Flat rate of 30 % on the total income after deduction of interest and remuneration to partners at the specified rates.</td></tr>
<tr><td>Interest to partners</td><td>Not exceeding 12 % p.a. (simple interest)</td></tr>
<tr><td>Remuneration to partners</td><td>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><td>Book Profit/Loss</td><td>% Or amount of deduction</td></tr><tr><td>Up to Rs.300000</td><td>90 % or BP
Or
150,000
which ever is higher</td></tr><tr><td>Balance profit</td><td>60%</td></tr></table></td></tr>
<tr><td>Conditions for allowance of remuneration & interest to partners</td><td>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</td></tr>
<tr><td>Conditions for assessment as a firm</td><td>1. The partnership should be evidenced by an instrument in writing specifying individual shares of the partners
2. A certified copy of the instrument signed by all the partners (not being</td></tr>
</table>

	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.

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).

ASSESSMENT OF AOP

- For resident woman (who is below 65 years on the last day of the previous year)-

Net income range	Income tax rates	Education cess	Secondary and higher education
Upto Rs. 1,90,000	Nil	Nil	Nil
Rs. 1,90,000 – Rs. 5,00,000	10% of (total income minus Rs. 1,90,000)	2% of income-tax	1% of income-tax
Rs. 5,00,000 – Rs. 8,00,000	Rs. 31,000 + 20% of (total income minus Rs. 5,00,000)	2% of income-tax	1% of income-tax
Rs. 8,00,000	Rs. 91,000 + 90% of (total income minus Rs. 8,00,000)	2% of income-tax	1% of income-tax

- For resident senior citizen (who is 65 years or more at any time during the previous year)-

Net income range	Income tax rates	Education cess	Secondary and higher education
Upto Rs. 2,40,000	Nil	Nil	Nil
Rs. 2,40,000 – Rs. 5,00,000	10% of (total income minus Rs. 2,40,000)	2% of income-tax	1% of income-tax
Rs. 5,00,000 – Rs. 8,00,000	Rs. 26,000 + 20% of (total income minus Rs. 5,00,000)	2% of income-tax	1% of income-tax
Rs. 8,00,000	Rs. 86,000 + 90% of (total income minus Rs. 8,00,000)	2% of income-tax	1% of income-tax

- For any other individual, every HUF/AOP/BOI/artificial juridical person-

Net income range	Income tax rates	Education cess	Secondary and higher education
Upto Rs. 1,60,000	Nil	Nil	Nil
Rs. 1,60,000 – Rs. 5,00,000	10% of (total income minus Rs. 1,60,000)	2% of income-tax	1% of income-tax
Rs. 5,00,000 – Rs. 8,00,000	Rs. 34,000 + 20% of (total income minus Rs. 5,00,000)	2% of income-tax	1% of income-tax
Rs. 8,00,000	Rs. 94,000 + 90% of (total income minus Rs. 8,00,000)	2% of income-tax	1% of income-tax

Notes:

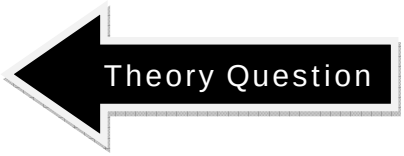
1. Surcharge – Nil
2. Education cess – it is 2 per cent of income-tax.
3. Secondary and higher education cess – it is 1 per cent of income-tax.

'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).

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.

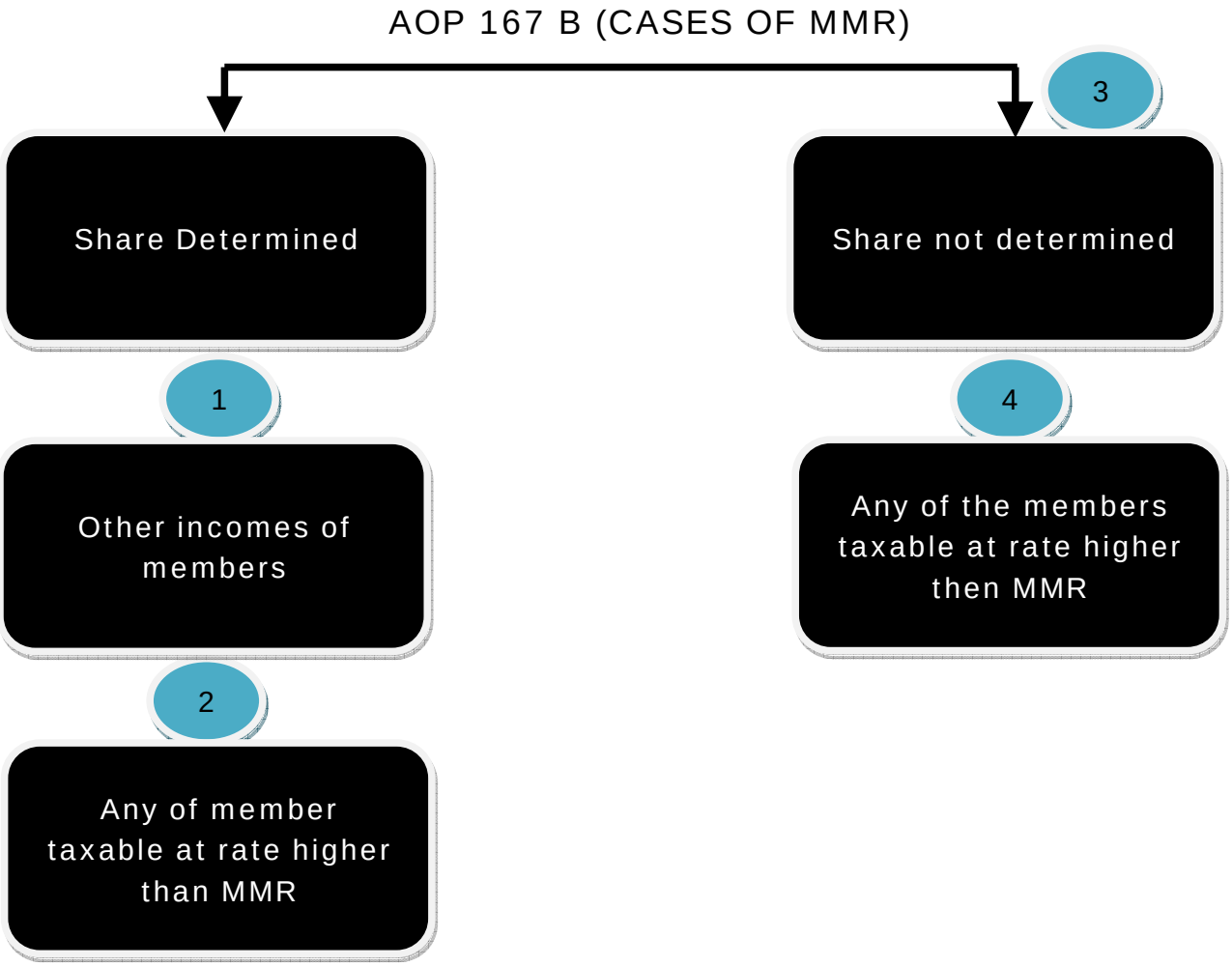
Body of individuals



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 the association or body shall be taxed at the maximum marginal rate.	NO as per sec. 86
When share is NOT determined	Maximum marginal rate	NO as per sec. 86


AOP 167 B (CASES OF MMR)
Share Determined
Share not determined
3
1
Other incomes of members
2
Any of member taxable at rate higher than MMR
4
Any of the members taxable at rate higher then MMR

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 ;

Rebate as per average rate of tax 110

Where there is included in the total income of an assessee any income on which no income-tax is payable under the provisions of this Act, the assessee shall be entitled to a deduction, from the amount of income-tax with which he is chargeable on his total income, of an amount equal to the income-tax calculated at the average rate of income-tax on the amount on which no income-tax is payable.

2(10) "average rate of income-tax" means the rate arrived at by dividing the amount of income-tax calculated on the total income, by such total income.

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.

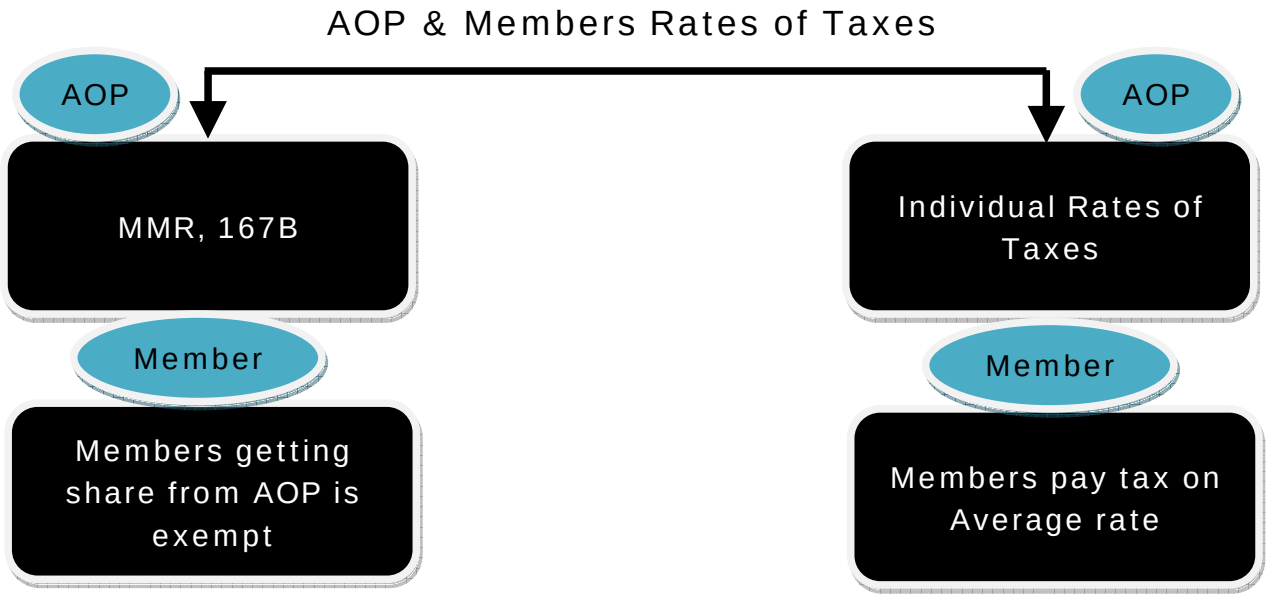
Joint investment v/s charge on investment

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)

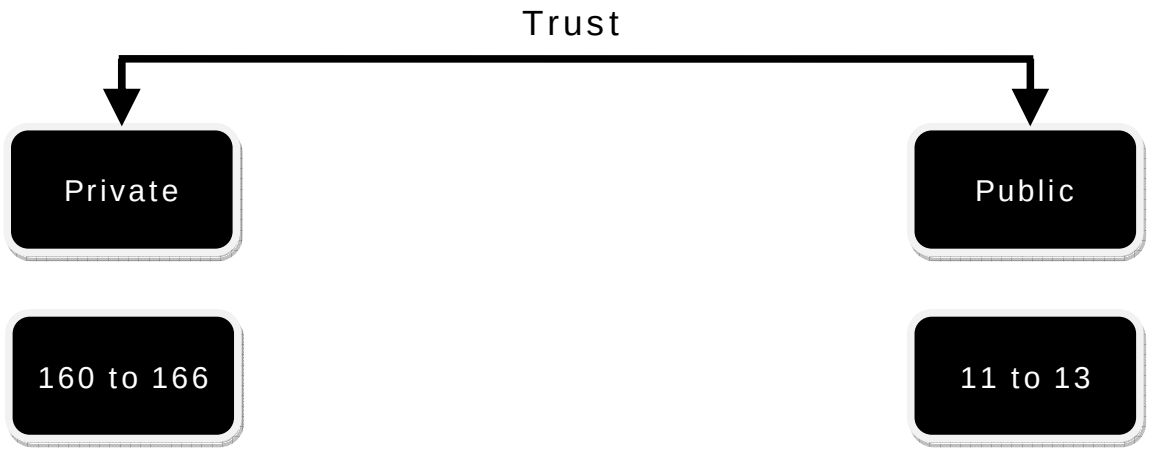
No option to officer to make the assessment in status of individual

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. Atchaiah (Ch.) (Supreme Court of India)



TRUSTS



Types of the Trusts

Trust may be broadly of two types: public trust and private trust. The income of public trust enjoys exemption and the income of private trust is chargeable to tax.

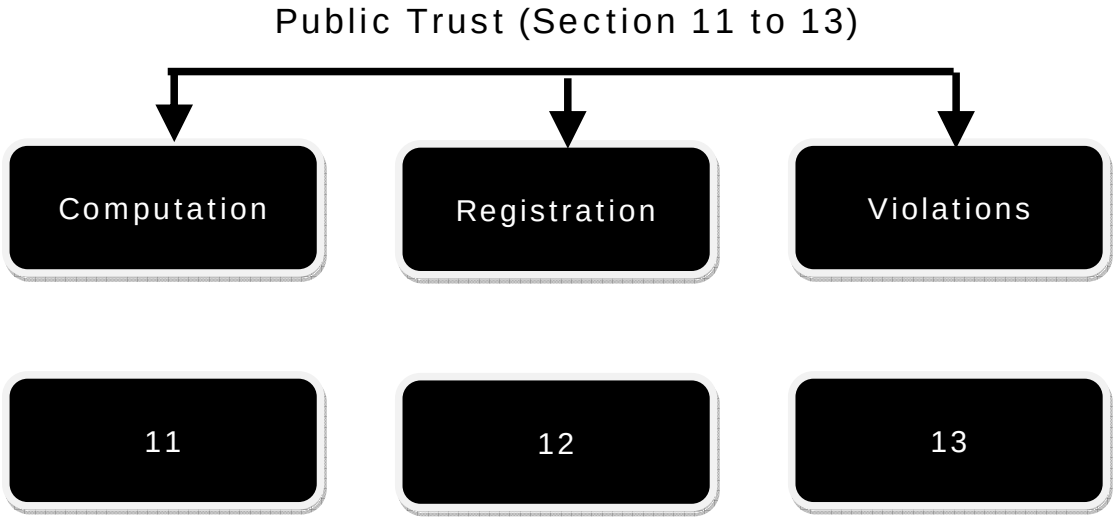
Public trust: A public trust may be of charitable or religious nature and tends to promote the benefit of the public. Thus, public are always the beneficiary under a public trust.

Private trust: A private trust tends to promote the welfare of specified persons and hence the beneficiaries are always specified individuals. Sometimes, the shares of the beneficiaries are defined by the author of the trust or may even be indeterminate or unknown. Trust where the trustee is vested with the power to determine the mode of distribution of the trust income among the beneficiaries is also called a discretionary trust.

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.



Charitable purpose [sec. 2(15)]

"charitable purpose" includes relief of the poor, education, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest, and the advancement of any other object of general public utility:

Provided that the advancement of any other object of general public utility shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity.

Above provisions shall not apply if the aggregate value of receipts from the activities referred to in the first proviso is ten lakh rupees or less in the previous year.

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 is 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.

An Object, Beneficial to a Section of the Public, is an Object of General Public Utility.

The word Public need not be understood as the general public and it is sufficient if a section of the public is benefited [CIT v. Andhra Pradesh Riding Club (1987) 168 ITR 393 (AP)]. 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 (SC)]. Acts which would be useful to a particular community to promote unity and brotherhood among its members and bring about complete development of all aspects of life of members of the community are charitable purposes. [CIT v. Ahmedabad Rana Caste Association (1983) 140 ITR 1(SQ]

Primary Object of the Trust is Determinative of its Character and not the Ancillary Objects.

Advancement of any other activity of general public utility are words of wide import. If the objects or purposes of the trust or institution are wholly religious or charitable, there would be no difficulty in holding that the trust has been created for advancement of the object of general public utility and is entitled to exemption from tax. However, if some of the objects or purposes of the trust are charitable while some others are not charitable, the dominant or primary object or objects are the determining factors. If the primary or dominant object of the trust or institution is charitable, other objects which are merely ancillary or incidental to the primary or dominant purpose, even if they are non-charitable, would not prevent the trust or institution from being a valid charity qualifying for exemption from tax. [CIT v. Adarsh Gram Trust (1986) 159 ITR 41 (Raj.)].

If there are several (main) objects of a trust or institution, some of which are charitable and some non-charitable and the trustees or the managers in their discretion are to apply the income or property < to any of those objects, the trust or institution would not be liable to be regarded as charitable and no part of its income would be exempt from tax. In other words, where the main or primary objects are distributive, each and every one of the objects must be charitable in order that the trust or institution might be upheld as a valid charity. The test which has, therefore, to be applied is whether the object which is said to be non-charitable is a main or primary object of the trust or institution or it is ancillary or incidental to the dominant or primary object which is charitable. [Namazie (M.A.) Endowment v. CIT (1988) 174 ITR 58 (Mad.)]. If the primary or dominant purpose of a trust or institution is charitable, the other objects of the trust which by themselves may not be charitable, but are merely ancillary or incidental to the primary or dominant purpose, would not prevent the trust or institution from being a valid charity. However, if the main or primary objects are distributive, each and every one of the objects must be charitable in order that the trust or institution may be upheld as a valid charity [ACIT v. Surat Art Silk Cloth Manufacturers Association (1980) 121 ITR 1 (SC)].

Promotion of, or Encouragement in, Activities which are Calculated to Contribute to Health and Well-being of public would be Advancement of any Other Object of General Public Utility.

For example, equestrian games indisputably contribute to physical well-being and health. Therefore, imparting training in the art of horsemanship is intended for the benefit of the general public. The word public need not be understood as the general public and it is sufficient if a section of the public is benefited [CIT v. Andhra Pradesh Riding Club (1987) 168 ITR 393 (AP)].

Promotion of Sports and Games is Considered to be a Charitable Purpose.

Therefore, an association or institution engaged in the promotion of sports and games can claim exemption under Sec. 11 even if such association or institution is not approved under Sec. 10(23). An object of general public utility may be of charitable purpose if the object is not invested with profit motive. For example, where

Assessment of Charitable Trusts

the object of a trust or institution is to promote sports with a view to make profit, the object is non-charitable as it is invested with profit-making motive. Where the object of general public utility is not invested with profit-motive but some profit arises in the accomplishment of the object it would not lose its character as a charitable object merely because some profit arise from that object.

The relief to poor people may be a relief to the poor public at large or relief to a particular section of the poor public, for example, relief to poor coffee or tea planters, brick-kiln workers, and so on. The relief to poor does not necessarily mean giving them free doles or alms; it may take some other shape like seeking better reward for labour. Raising of moral, intellectual, economic, social and political conditions of people in general is an object of general public utility. An object of general public utility does not mean that it should be beneficial to the whole of mankind or to all persons living in a particular country or province; it is sufficient if the intention is to benefit a section of the public as distinguished from specified individuals.

The Aim and Object of the Trust have to be Determined by Reference to the Manner in which the Surplus Derived from the Activity could be Disposed of.

Even if all the objects of an assessee are charitable, the claim of the assessee for exemption will fail if there is no trust or legal obligation compelling the assessee to utilise its income only for charitable purposes. For example, where a stock exchange is established for conducting stock exchange business and thus to promote and regulate the business in stocks, shares, debentures and other securities, though the running of a stock exchange may be an object of general public utility, the income of the assessee stock exchange cannot be said to have been derived from property held under trust wholly for religious or charitable purposes merely because of the object. Therefore, in the absence of any prohibition for dividend to the shareholders and specific provisions for creating funds for the benefit of shareholders, employees or their relations, the stock exchange will be considered as carrying on the activity for the benefit of the shareholders, employees or their relations and cannot be treated as charitable purpose. Accordingly, the stock exchange will not be entitled to exemption under Sec. 11 read with Sec. 2(15) of the Act [Delhi Stock Exchange Association Ltd. v. CIT (1997) 225 ITR 235 (SC)].

Religious purposes

Religious purpose includes the advancement and propagation of a religion and its tenets. The distinction between a charitable trust and a religious trust is that a charitable trust is always public but a religious trust may be public or private [CIT v. Jamal Mohammad Sahib (1941) 9 ITR 375 SC]. For

example, feeding of Brahmins on specified religious occasions is a private religious purpose [CIT v. Ahmedabad Rana Caste Association (1983) 140 ITR 1(SC)].

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(l)(a) of the Act. [1987] 164 ITR 0439A Commissioner of Income-tax vs. Maharana of Mewar Charitable Foundation (Rajasthan High Court)

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 amounted 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)

Only Real Income is to be Considered.

The exemption from tax granted by Sec. **11** must be confined to the real income of the trust. For example, the amount of income which is taken away by deduction at source under Sec. 194 is not available to the trust for application to charitable purposes and cannot be considered as income of the trust. Though Sec. 198 provides that the amounts deducted by way of income tax is deemed to be "income received", what is deemed to be income can neither be spent nor accumulated for charitable purposes. The immunity from taxation that has been granted to the income of a charitable trust cannot be denied on the ground that the deemed income under Sec. 198 has not been actually spent for the purpose of charity [CIT v. Jayashree Charity Trust (1986) 159 ITR 280 (Cal.)]

Depreciation to be allowed on the assets

[2003] 264 ITR 0110- COMMISSIONER OF INCOME-TAX VS. INSTITUTE OF BANKING (BOM)

Normal depreciation can be considered as a legitimate deduction in computing the real income of the assessee on general principles or under section 11(1)(a) of the Income-tax Act, 1961. Income of a charitable trust derived from building, plant and machinery and furniture is liable to be computed in a normal commercial manner although the trust may not be carrying on any business and the assets in respect whereof depreciation is claimed may not be business assets. In all such cases, section 32 of the Act providing for depreciation, for computation of income derived from business or profession is not applicable. However, the income of the trust is required to be computed under section 11 on commercial principles after providing for allowance for normal depreciation and deduction thereof from the gross income of the trust. Income derived from the trust property has also got to be computed on commercial principles and if commercial principles are applied then adjustment of expenses incurred by the trust for charitable and religious purposes in the earlier years against the income earned by the trust in the subsequent year will have to be regarded as application of income of the trust for charitable and religious purposes in the subsequent year in which adjustment had been made having regard to the benevolent provisions contained in section 11 of the Act and such adjustment will have to be excluded from the income of the trust under section 11(1)(a).

Any Voluntary Contributions are also deemed to be Income derived from Property held under Trust (Sec. 12).

However, where any voluntary contribution is given by the donor with a specific direction that it should form part of the corpus of the trust or institution, such voluntary contributions is not to be included in the total income of the trust or institution [Sec. 11(1)(d)].

Payment of Taxes amounts to Applications.

The expenditure incurred by way of payment of tax out of the current vear's income has to be considered as an application for charitable purposes because the payment is made to preserve the

corpus, the existence of which is absolutely necessary for the trust [CIT v. Janki Ammal Ayya Nadar Trust (1985) 153 ITR 159 (Mad.)].

Repayment of Loans, taken for the Purpose of the Trust, amounts to Applications [Circular No. 100 dated 24.1.1973].

The repayment of loan, originally taken to fulfil one of the objects of the trust will amount to an application of the income for charitable and religions purposes.

If the object of the trust is advancement of education, granting of educational loans, even if interest bearing, will amount to applications of the income for charitable purposes. As and when the loans are returned to the trust, it will be treated as income of the trust for that year.

Income of the Trust should be applied for Charitable and Public Religious Purposes.

The application of the income can be for revenue or capital purposes. So long as the expenditure is incurred out of the income of the trust, even if such expenditure is for capital purposes on the objects of the trust, income would be exempt. It is, in fact, the application of the income which is material. Income which is actually applied for whollv charitable purpose is exempt from income tax, no matter that it is derived from property which is held under a trust which is charitable in part only. [Additional Commissioner of Income tax v. Sherwani Charitable Trust (1975) 99 ITR 284 (All.)].

Application of Income for Charitable of Religious Purposes

Exemption under Sec. 11 (1) is available onlv for income that is applied for charitable or religious purposes unless such income is accumulated or set aside for charitable or religious purposes in accordance with the provisions of Sec. 11 and the conditions thereof are satisfied.

Application of Income vs. Spending:

The word application should be distinguished with the word spent. Thus, where a charitable trust passes a resolution to donate certain amounts to other charitable trusts, debits the same in books of accounts and shows the recipient trusts as creditors in its balance sheet, it is treated as application of income even though donations are actually disbursed in next accounting year [CI I v. Trustees of H.E.H. the Nizam's Charitable Trust (1981) 131 ITR 497 (AP)]. So long the income is applied for charitable purposes, the exemption will apply even if the spending is contrary to the terms of the trust deed [Trustees of H.E.H. the Nizam's Pilgrimage Money Trust v. CIT (1987) 65 CTR290(AP)|.

Similarly, repayment of the loan originally taken to fulfil one of the objects of the trust is deemed to be an application of the income for charitable or religious purposes. If the object of the trust is advancement of education and granting of scholarship loans is only one of the activities carried on for the fulfilment of the objectives, granting of loans 'even interest bearing' is deemed to be an application of the income for charitable purposes. However, if the only object of the trust is to give interest bearing loans for higher studies, it will amount to carrying on money lending business [Circular No. 100 dated 24 January 1973].

Where a trust makes donation to other charitable or religious trust, it is also application of income. The donor trust is entitled to the exemption [CIT v. Thanthi Trust (1999) 239 ITR 502 (SC.)]. Where such income is accumulated in excess of the allowable limits, it is only the excess amount accumulated, and not the entire trust income, which becomes disentitled to exemption [CIT v. Krishan Chand Charitable Trust (1975) 98 ITR 387 court].

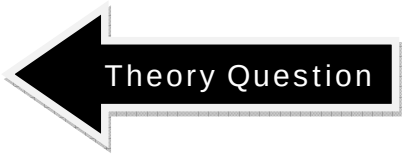
Depreciation is an Allowable Expense and is deemed to be applied for the Purpose of the Trust or Institution.

Since the income derived from property held in trust is determined in accordance with the print iples of commercial accounting, depreciation will be an allowable expense in determining the income or the trust. It cannot be argued that depreciation being a notional expense cannot be applied for the purpose of the trust because in the absence of such deduction, there is no way to preserve the corpus of the trust for deriving the income [CIT v. Society of The Sisters of St. Anne (1984) 146 ITR 28 (Kar.)].

It is Immaterial whether the Application of Income for Charitable and Religious Purposes may be of a Revenue or Capital Nature.

The word "applied" is wider in import than the word "expenditure". The money or amount may not go irretrievably when it is "applied" to a purpose. Therefore, even capital expenditure incurred for charitable or religious purposes will be considered as application of income and will qualify for exemption under Sec. 11 [CIT v. St. George Forana Church (1988) 170 ITR 62 (Ker.)].

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. If 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.

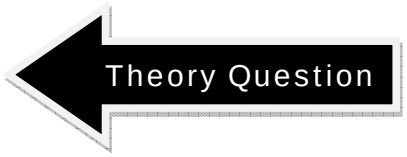
Format of computation for charitable trust	Rs.
VOLUNTARY DONATION (Non Corpus)	40
VOLUNTARY DONATION (Corpus)	-
Interest / Dividend	30
OTHER INCOME (Income – Expense – Depreciation - Tax)	30
Total Commercial Income	100
Accumulation @ 15 %	15
Income To Be Applied	85
Actually Applied	70
Expl. to 11 Amount Not Received (to be applied in year of receipt or year next)	5
11 (2) Over Accumulated (To be invested in modes referred to in 11(5))	7
Taxable Income (Individual Rate Of Tax)	3

CAPITAL GAINS FOR TRUST 11(1A)

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(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 [2]which 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 [2]which 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.

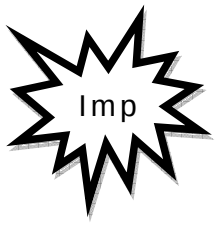
(xi) investment in immovable property. "Immovable property" does not include any machinery or plant or plant (other than machinery or plant installed in a building for the convenient occupation of the building) even though attached to, or permanently fastened to, anything attached to the earth;

(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.

VIOLATION SECTION 13

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 ;

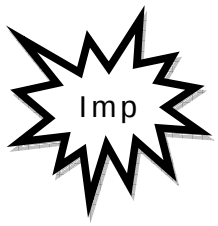
(c) Where such author, founder or person is a Hindu undivided family, a member of the family ;

(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.

12(2) R.W. 13(6)



Special treatment for educational or medical institution or a hospital 12(2) r.w. 13(6)

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

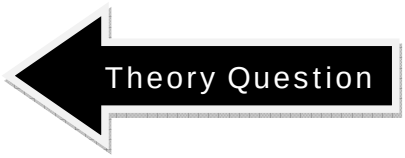
The value of any services, being medical or educational services, made available by any charitable or religious trust running a hospital or medical institution or an educational institution, to any specified person [Excluding (e) above], shall be deemed to be income of such trust or institution derived 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.

REGISTRATION OF TRUST

[Sec. 12A(a) and Sec. 12AA]

The trust or institution should be a registered one.

(I) Application for Registration [Sec. 12A(a)].



The person in receipt of the income has to make an application for registration of the trust or institution in the prescribed form (Form No.lOA, Rule 17A) and in the prescribed manner to the Commissioner.

No time-limit applies in respect of any application made on or after 1 June 2007.

(ii) Procedure for Registration [Sec. 12AA].

On receipt of the application for registration of the trust or institution, the Commissioner may call for documents and information and hold enquiries to satisfy himself about the genuineness of the trust or institution and its activities. If he is satisfied, he may pass an order in writing, registering the trust or institution. If he is not satisfied, he may pass an order refusing to register the trust or institution. A trust or institution cannot be refused registration without giving a reasonable opportunity to the applicant of being heard.

(iii) Order of Registration [Sec. 12A(a)].

A copy of the order of registration or refusal for registration will be sent to the trust or institution. In the case of a belated application made prior to 1 June, 2007, if the Commissioner is satisfied about the reasons for the delay, he may grant exemption with retrospective effect, that is, the date when the trust/institution was created/set-up. If the Commissioner is not satisfied about the reasons for the delay, the exemption is applicable only from the first day of the financial year in which the application is made.

(iv) Time-limit for Passing the Order of Registration [Sec. 12AA].

Every order granting or refusing registration shou Id be passed before the expiry of six months from the end of the month in which the application was received for registration under Sec. 12AA(a).

(v) power of de-registration

Where a trust or an institution has been granted registration and subsequently the Commissioner is satisfied that the activities of such trust or institution are not genuine or are not being carried out in accordance with the objects of the trust or institution, as the case may be, he shall pass an order in writing cancelling the registration of such trust or institution. Provided that no order shall be passed unless such trust or institution has been given a reasonable opportunity of being heard.

Audit of Accounts [Sec. 12A(b)]

If the total income of the trust or institution, as computed under this Act without giving effect to the exemption provisions of Sec. 11 and Sec. 12, exceeds the maximum amount which is not chargeable to income tax in any previous year, the accounts of the trust or institution for that year should be audited by a qualified accountant and the report of such audit should be filed along with the return of income in the prescribed form (Form No. 10B under Rule 17B) duly signed and verified by such accountant.

HINDU UNDIVIDED FAMILIES

Dual status is permissible in tax laws

The Hindu law is applicable not only to the Hindus but also the Jains, the Sikhs and the Buddhists, as also converts or reconverts to these religions. Hence the tax shelter provided by the Hindu law is available to a large section of the Hindus. Arya Samajists, Brahmos, Lingayats, Radhaswamis, Satsang is, Swayamariyathais, self-respecters as opposed to Purohit cult have all been treated as movements in Hinduism and not outside it. To be a Hindu it is not necessary that a person should undergo any ritual. (The Supreme Court in the case of Perumal v. Ponnus wamy held that any person can become a Hindu after expressing his intention that he lives as a Hindu and that the community or caste into the fold of which he is ushered has accepted him as a member of that community or caste. A non-Hindu can become a Hindu also by undergoing the formality of conversion prescribed by a caste or community to which he converts.)

When one of the parents is a Hindu and he is brought up as a Hindu, he will be a Hindu. It is possible for non-Hindus like Khojhas, Cutchi Memons, the Bohras, Moplas and the Holai Memons who are Muslims to follow Hindu law of inheritance and succession subject to the provisions of the Shariat Act, 1937. Some Christian communities also follow the Hindu law of succession, but the status of a Hindu joint family cannot be claimed by them even if Hindu law of succession is followed.

Even a Hindu who declares for the purposes of Special Marriage Act, 1872 that he is not a Hindu does not cease to be a Hindu for purpose of succession as held in the case of CIT v. Partap Chand Son born of a family married under Special Marriage Act, even where one of them is a Christian, can be a Hindu, if brought up as a Hindu as held in the case of CWT v. R. Sridharan (SC)

Basic conditions for huf

In the case of P. C. Balasanjanna it was pointed out that a joint family is a creature of law and not of contract. An ancestral nucleus is the pre-requisite. The ancestral asset received even on family arrangement can be treated only as joint family property as was held in the case of Arvind Chandulal v. CIT. However, there should be at least two members to constitute a Hindu joint family as held in the case of C. Krishna Prasad v. CIT. Even if there be one male member along with family members, it can be a Hindu joint family either by survivorship as held in the case of Gowli Buddanna v. CIT or even on partition as held in N. V. Narendranath v. CWT.

Ancestral property

Ancestral property, however small it may be, can form a nucleus of a Hindu undivided family, where the income is separately got nurtured. Where the income is nil or insignificant, it will be better if such property is realised and deployed in revenue yielding avenues so as to have a separate taxable entity. Joint family nucleus has greatly helped to establish the status of joint family however small such nucleus might have-been compared to the total outlay on investments. It has to be remembered that a joint family property cannot become individual property, since the rights of other members of the family are involved. The karta is only a manager of the joint family and he cannot appropriate the assets or income for his individual benefit. On the other hand, nothing prevents him from blending his individual income and treating his individual investments as joint family assets.

Effect of blending / gifting of property

When an individual stamps his personal property with joint family character, blends or throws into common hotchpotch, the property belongs The hence forward to the joint family. No registered instrument is necessary for this purpose has held in the case of CIT v. Kanhaiya Lal.

A female member cannot blend her personal property with the joint family property as held in the case o Pushpa Devi v. CIT But she can gift her property so as to constitute it as HUF property as held in CITv. M. Balasubramanian.

Though generally a gift from a female is a gift of her individual property, where the gift is specifically for the joint family, the gifted amount has to be treated as joint family property. Even in a case where there was no specific direction by the lady to this effect, but she gave money for conduct of business to the senior-most member of the family for the benefit of all her sons, such gifted amount can be treated as joint family property as has been held in CIT v. K. Satyendra Kumar.

If an individual, who is the sole coparcener in the family, blends his individual property, such property Will become the joint family property, but it will continue to be assessed in individual hands, since he continues to exercise absolute power of alienation as sole coparcener as held in the case of Surjit Lal Chhabda v. CIT. Blending, however, now statutorily invites application of aggregation provisions under section 64.

There is a belief that there should be something in hotchpotch before a Hindu joint family could be recognised. It was in this context that it was thought that by mere act of blending individual property, a joint family cannot be created. The Supreme Court in the case of Surjit Lal Chhabda v. CIT had an occasion to deal with such a situation. The result was rather disappointing for the taxpayer, though the Supreme Court held that a joint family status can be created by the act of blending individual property or throwing it in the common hotchpotch (even when it is empty) and there by vesting it with joint family character. But all the same the Supreme Court held that in view of the absolute right of alienation which such individual continues to command in cases where there is no other male member, the Department is entitled to continue to assess the income from such blended property as individual property. Section 64(2) has now recognised the principle in the statute itself. It is, however, recognised that an act of blending can create a joint family without anything in the common hotchpotch. The joint family created by blending serves no immediate purpose since the income will continue to be assessed in the hands of the person who blends his property. It is now recognised that a property devised by will or gift with clear intention that the beneficiary should hold the property as karta of his joint family can only be treated as joint family property.

Gift can be mode of creation of joint family

It is possible for a joint Hindu family to receive gifts as long as the intention of the donor to benefit the Hindu joint family and not the individual is patent and clear. In the case *of M.P.Periakaruppan Chettiar* the Supreme Court found that a mere statement in the gift deed to the effect that the gift was in favour of the donees and their respective heirs, executors, administrators and assigns did not evidence any intention to make a gift to the joint family. All the same this decision recognised that there could be a gift to the joint family, if appropriately worded. Ordinarily, the presumption in any gift is that the intention is for personal benefit of the doness. The Supreme Court has recognised the principle that there can be a gift in favour of a Hindu Undivided Family, if such intention is clearly expressed, as held in the case*ofC.M. Arunachala* v. *Muruganatha6* in following words.

Gift by will

The same reasoning which enables the gift in favour of a Hindu joint family would justify creation of HUF by a will. In the case of CIT v. Radhambal Ammal, a will made by adoptive father in favour of his adopted son with a provision that the benefit will be for the donee and any son born to him after the marriage, it was held, indicated the intention to benefit the Hindu joint family. This decision is approved later by the Full Bench of the same High Court in the case of CWT v/s. M. Balasubramaniam where a statement that the gift in favour of the son was for the benefit of him self, his wife and children was treated as sufficiently indicative of the intention that the income should be assessed in the hands of the Hindu joint family so that immediately on marriage the property was assessable for wealth-tax and income-tax as joint family property.

Salary to karta

The splitting up of the income as between joint family and individual is a possibility inherent in dual status. While individual assets can get pooled with joint family assets by blending, the HUF income may also get diverted into individual hands where, for example, the karta gets salary from HUF for services rendered by him to the joint family. Such salary income is assessable in individual hands.

Remuneration when belongs to HUF

Remuneration drawn as a managing director of a company may well be assessable in the hands of the joint family, if such remuneration has been given not because of the contribution of the managing director as an individual but because of the investment (family fund) in the company and such directorship is a reward for such investments. It was so held in the case of CTTv. Kalu Babu Lal Chand. Even where there may be a personal exertion, it may still be income of the family, if such income is earned by detriment to the family fund as held in the case of P.N. Krishna lyer v.CIT. Hence there may be many borderline cases, where it may be capable of being offered as joint family income without controversy, if care is taken to present the facts in the proper perspective even at the first instance. The Supreme Court has again held that if salary is part of return of the investment on the family, it is in come of the HUF as held in CIT v. Trilok Nath Mehrotra

Can huf be a partner in partnership firm

Though a Hindu joint family as such cannot enter into a partnership, the *karta* can do so. In such a case, the partnership share will be assessable in the hands of HUF of which he is the *karta.* It was so held in the case *of CIT v. Seth Govindram SugarMills.* Any member of a joint family can enter into a partnership on behalf of the HUF. It is possible for a Hindu Joint Family to enter into a partnership with its members in their individual capacity even without a partition as between them.

In *Bagyalakshmi & Co.* it was pointed out that the status of a person, who becomes a partner in his capacity as karta is that of trustee as regards partnership law, which recognises only an individual as a partner. In such a case, he has a dual capacity, that of an individual functioning in his personal capacity under partnership law vis a vis his co-partners and third parties and that of a joint family under Hindu law vis a vis other members of the family and direct tax laws.

Effect of death of coparcener

On the death of the last coparcener, it is no longer assessable as a Hindu joint family. The decision of the Supreme Court in the case *of CIT v. RMARAR Veerappa Chettiar* to the contrary should,

therefore, be treated as confined to the preexisting law. It is because all the female members under the Hindu Succession Act became absolute owner of their respective rights.

Where the karta has died and the widow and minor son have inherited the property, income is to be assessed as joint family property in the absence of an actual partition as held in *CIT v. Maharani Raj Lakshmi Devi.*

Partition also may help tax planning

Ordinarily, dual capacity, helps to reduce tax. But where the HUF has a large income with many coparceners, the liability of the HUF will be such that it can be effectively reduced only by a full may help where all the members have not reached the maximum slab rate. There may be even instances where the liability could become a small fraction of former liability on partition. Where, however, the largeness of income is in respect of capital gains, on which a flat rate is applicable, a partition would not help. But even in such a case, the sale of the asset after partition may enable the reinvestment benefit for such of those members who do not have a house to avail of the benefit of section54F and even otherwise under section 54EC and 54ED.

Section 171 of the Income-tax Act requires that a Hindu joint family hitherto assessed should continue to be assessed as such unless a partition has been recognised. It was once possible to have a partial partition. But an amendment to section171 by the Finance (No.2) Act, 1980 by way of insertion of sub-section (9) to the said section has derecognised any partial partition made after 31st day of December, 1978, "Partial partition" for this purpose has been defined in the Explanation there to as a partition which is partial as regards the persons constituting the HUF or the properties belonging to the HUF or both.

Partial partitions had helped multiple joint families, but with partial partition not being possible, one can still have three interests, firstly, as a member of larger Hindu Undivided Family with his sons, secondly, with himself and his wife as smaller joint family after partition with his sons and thirdly his own individual assessment. Partial partition is now not recognised by law under section 171(9).

The most important point to be noted for recognition of a partition in a joint family which has been hitherto assessed is the condition that there should be a partition by metes and bounds. There should be a physical division of the property. While the Hindu law will be content to recognise partition by mere severance of status without a physical division, the tax laws, whether of income tax or wealth-tax, would require such physical division. The argument that it was not possible to physically divide the property among the coparceners and that, therefore, the property continues to be joint would be no answer to the requirement of physical division.

Potential family

An individual may acquire joint family property by survivorship or on partition. He has to be assessed only as an individual till his marriage, since a joint family implies plurality of membership. In the case of T.S. Srinivasan v. CIT. It was held that it cannot be held that a joint family comes into existence merely on a male child being conceived as presumed under the Hindu law, but only on the birth of a son, as HUF is not in existence prior to this date. But the question as to whether the HUF comes into existence on marriage itself was not raised in this case.

The generally accepted view is that the sole surviving coparcener on marriage holds the property as potential joint family, which comes into existence on marriage. It was so held in the case of Prem Kumar v. CIT But in the case of CIT v. Shanker Lal Budhia and CIT v. Vishnukumar Bhaiy HUF it

has been held that a marriage by it self will make no difference and that till a son is born, the status will only be that of an Individual. But the Madras High Court in the case of S. Periannan v. CIT agreed with the more liberal view of the Allahabad High Court that the HUF comes into existence on marriage. Same view was taken in CITv. Arun Kumar Jhunjhun-wala & Sons.

Reunion of family after partition

Is it possible for a family after having partitioned or partially partitioned to bring back to the HUF where a tax or other considerations would make such reunion advisable ? The Hindu law certainly permits the parties, who have effected partition, to reunite. Such an agreement need not necessarily be in writing. An oral agreement with clear intention of the parties to reunite would bring back a joint family. At the same time, there are certain disabilities in the sense that where one of the parties is a minor, it is not possible for a reunion since even the guardian or the parent cannot give consent for such reunion.

Even if only some of the parties reunite pooling with the assets allotted to them, there is no bar to a reunion as was held in the case of Godavarthy Venkamma v. G. Venkatanarayana. As long as all the properties subjected to partition are brought back by the erstwhile coparceners willing for reunion, there is a reunion as was held by the Madras High Court in the case of CIT v. A.M. Vaiyapuri Chettiar.

TONNAGE TAX – FOR SHIPPING COMPANIES

Section 115V TO 115VZC tax tonnage scheme (TTS) for shipping companies

The Finance Minister has stated in the budget speech that the shipping industry has demanded the levy of tonnage tax to make it internationally competitive. Tonnage Tax will induce more ships to fly Indian Flag. Therefore, the Income-tax Act is amended by the introduction of a new Chapter XIIG [S. 115VA to S. 115VZC] to provide an alternative scheme of tonnage tax. It may be noted that, at present, shipping companies are assessed under the normal provisions of the Income-tax Act dealing with computation of profits and gains of business or profession. With the introduction of tonnage tax scheme, (TTS) the companies will have to exercise the option to be assessed under TTS or under the normal provisions of the Income-tax Act in Chapter IV-D. The Chapter is to be understood in following parts and subparts.

A.	**Nature Of Income**		
	1	Nature Of Income	**115VA**
	2	Tonnage Income	**115VF**
	3	Relevant Shipping Income	**115VI**
B	**Qualification And Procedure**		
	1	Procedure For TTS	**115VP**
	2	Operating Ships.	**115VB**
	3	Qualifying Ship.	**115VD.**
	4	Qualifying Company	**115VC**
C	**Computation Of Income**		
	1	Manner Of Computation Of Income.	**115VE**
	2	Computation Of TTS.	**115VG, X**
	3	Capital Gains From Transfer Of Tonnage Tax Assets.	**115VN**
	4	Exclusion Of Loss.	**115VM**
	5	General Exclusion Of Deduction And Set Off, Etc.	**115VL**
	6	Treatment Of Common Costs.	**115VJ**
	6	Calculation In Case Of Joint Operation, Etc.	**115VH**
	7	Depreciation.	**115VK**
C	**Conditions Of Tonnage Tax Scheme**		
	1	Maintenance And Audit Of Accounts.	**115VW**
	2	Minimum Training Requirement For Tonnage Tax Company.	**115VU**
	3	Transfer Of Profits To Tonnage Tax Reserve Account.	**115VT**
D	**Period of the scheme**		
	1	Period For Which Tonnage Tax Option To Remain In Force.	**115VQ**
	2	Renewal of scheme	**115VR**
	3	Prohibition to scheme	**115VS**
E	**Provisions of this Chapter not to apply in certain cases**		
	1	Avoidance of tax.	**115VZB**
	2	Exclusion from scheme	**115VZC**
F	***Miscellaneous***		
	1	Temperory cessation	**115VZA**

Nature of income 115VA

The income from the business of operating qualifying ships, may, at its option, be computed in accordance with the provisions of this Chapter and such 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".

Tonnage income. 115VF.

The tonnage income shall be computed in accordance with section 115VG and the income so computed shall be deemed to be the profits chargeable under the head "Profits and gains of business or profession" and the relevant shipping income referred to in 115V-I shall not be chargeable to tax.

Relevant shipping income. 115V-I.

The relevant shipping income of a tonnage tax company means—

(i)Its profits from core activities ((a) its activities from operating qualifying ships and (b) other ship-related activities)

(ii)Its profits from incidental activities

Where the aggregate of all such incomes specified in clause (ii) exceeds one-fourth per cent of the turnover from core activities, such excess shall not form part of the relevant shipping income for the purposes of this Chapter and shall be taxable under the other provisions of this Act.

The incidental activities shall be the activities which are incidental to the core activities and which may be prescribed for the purpose.

Where a tonnage tax company operates any ship, which is not a qualifying ship, the income attributable to operating such non-qualifying ship shall be computed in accordance with the other provisions of this Act.

Where any goods or services held for the purposes of tonnage tax business are transferred to any other business carried on by a tonnage tax company, or where any goods or services held for the purposes of any other business carried on by such tonnage tax company are transferred to the tonnage tax business and, in either case, the consideration, if any, for such transfer as recorded in the accounts of the tonnage tax business does not correspond to the market value of such goods or services as on the date of the transfer, then, the relevant shipping income under this section shall be computed as if the transfer, in either case, had been made at the market value of such goods or services as on that date:

Powers of the officer 115V-I.

Where, in the opinion of the Assessing Officer, the computation of the relevant shipping income in the manner hereinbefore specified presents exceptional difficulties, the Assessing Officer may compute such income on such reasonable basis as he may deem fit.

Where it appears to the Assessing Officer that, owing to the close connection between the tonnage tax company and any other person, or for any other reason, the course of business between them is so arranged that the business transacted between them produces to the tonnage tax company more than the ordinary profits which might be expected to arise in the tonnage tax business, the Assessing Officer shall, in computing the relevant shipping income of the tonnage tax company for the purposes of this Chapter, take the amount of income as may be reasonably deemed to have been derived therefrom.

For the purposes of this Chapter, in case the relevant shipping income of a tonnage tax company is a loss, then, such loss shall be ignored for the purposes of computing tonnage income.

Qualifying company 115VC

A company is a qualifying company if—

(a) It is an Indian company;
(b) The place of effective management of the company is in India;
(c) It owns at least one qualifying ship (defined in 115VD); and
(d) The main object of the company is to carry on the business of operating ships (defined in 115VB).

Qualifying ship. 115VD.

A ship is a qualifying ship if—

(a) It is a sea going ship or vessel of fifteen net tonnage or more;
(b) It is a ship registered under the merchant shipping act, 1958 (44 of 1958), or a ship registered outside india in respect of which a licence has been issued by the director-general of shipping under section 406 or section 407 of the merchant shipping act, 1958 (44 of 1958); and
(c) A valid certificate in respect of such ship indicating its net tonnage is in force,

but does not include

(i) A seagoing ship or vessel if the main purpose for which it is used is the provision of goods or services of a kind normally provided on land;
(ii) Fishing vessels;
(iii) Factory ships;
(iv) Pleasure crafts;
(v) Harbour and river ferries;
(vi) Offshore installations;
(vii) A qualifying ship which is used as a fishing vessel for a period of more than thirty days during a previous year.

Operating ships. 115VB

A company shall be regarded as operating a ship if it operates any ship whether owned or chartered by it and includes a case where even a part of the ship has been chartered in by it in an arrangement such as slot charter, space charter or joint charter :

Provided that a company shall not be regarded as the operator of a ship which has been chartered out by it on bareboat charter-cum-demise terms or on bareboat charter terms for a period exceeding three years.

Procedure for TTS 115VP

METHOD AND TIME OF OPTING FOR TONNAGE TAX SCHEME. 115VP

MUST MAKE AN APPLICATION FOR TTS

Category	Time Limit
Existing qualifying companies	Any time after the 30th day of September, 2004 but before the 1st day of January, 2005, The initial period.
A company incorporated after the initial period	May make an application within three months of the date of its incorporation

A qualifying company incorporated before the initial period but which becomes a qualifying company for the first time after the initial period	May make an application within three months of the date on which it became a qualifying company.

Processing of Application

On receipt of an application for option for tonnage tax scheme the Joint Commissioner may call for such information or documents from the company as he thinks necessary in order to satisfy himself about the eligibility of the company and after satisfying himself about such eligibility of the company to make such option for tonnage tax scheme, he

(i) Shall pass an order in writing approving the option for tonnage tax scheme; or

(ii) Shall, if he is not so satisfied, pass an order in writing refusing to approve the option for tonnage tax scheme, (provided that no order under this clause shall be passed unless the applicant has been given a reasonable opportunity of being heard.)

and a copy of such order shall be sent to the applicant:

Every order granting or refusing the approval of the option for tonnage tax scheme shall be passed before the expiry of one month from the end of the month in which the application was received.

Where an order granting approval is passed the provisions of this Chapter shall apply from the assessment year relevant to the previous year in which the option for tonnage tax scheme is exercised.

Computation of tts 115VG

The tonnage income of a tonnage tax company for a previous year shall be the aggregate of the tonnage income of each qualifying ship computed as follows.

The tonnage income of each qualifying ship = the daily tonnage income of each such ship multiplied by the number of days in the previous year or the number of days in part of the previous year in case the ship is operated by the company as a qualifying ship for only part of the previous year, as the case may be.

The daily tonnage income of a qualifying ship having tonnage will be as follows:

Qualifying ship having net tonnage (as per certificate referred to in 115VX)	Amount of daily tonnage income
(1)	(2)
Up to 1,000 exceeding 1,000 but not more than 10,000 exceeding 10,000 but not more than 25,000 exceeding 25,000	*Rs. 46 for each 100 tons* Rs. 460 plus Rs. 35 for each100 tons exceeding 1,000 tons Rs. 3,610 plus Rs. 28 for each100 tons exceeding 10,000 tons Rs. 7,810 plus Rs. 19 for each 100 tons exceeding 25,000 tons.

The tonnage shall be rounded off to the nearest multiple of hundred tons and for this purpose any tonnage consisting of kilograms shall be ignored and thereafter if such tonnage is not a multiple of hundred, then, if the last figure in that amount is fifty tons or more, the tonnage shall be increased to the next higher tonnage which is a multiple of hundred and if the last figure is less than fifty tons, the tonnage shall be reduced to the next lower tonnage which is a multiple of hundred; and the tonnage so rounded off shall be the tonnage of the ship for the purposes of this section.

No deduction or set off shall be allowed in computing the tonnage income under this Chapter.

Manner of computation of income. 115VE.

(1) A tonnage tax company engaged in the business of operating qualifying ships shall compute the profits from such business under the tonnage tax scheme.

(2) The business of operating qualifying ships giving rise to income shall be considered as a separate business (The tonnage tax business) distinct from all other activities or business carried on by the company.

(3) The profits shall be computed separately from the profits and gains from any other business.

(4) The tonnage tax scheme shall apply only if an option to that effect is made in accordance with the provisions of section 115VP.

(5) Where a company engaged in the business of operating qualifying ships is not covered under the tonnage tax scheme or, has not made an option to that effect, as the case may be, the profits and gains of such company from such business shall be computed in accordance with the other provisions of this Act.

Calculation in case of joint operation, etc. 115VH.

Where a qualifying ship is operated by two or more companies by way of joint interest in the ship or by way of an agreement for the use of the ship and their respective shares are definite and ascertainable, the tonnage income of each such company shall be an amount equal to a share of income proportionate to its share of that interest.

Where two or more companies are operators of a qualifying ship, the tonnage income of each company shall be computed as if each had been the only operator.

Treatment of common costs.115VJ.

Where a tonnage tax company also carries on any business or activity other than the tonnage tax business, common costs attributable to the tonnage tax business shall be determined on a reasonable basis.

Where any asset, other than a qualifying ship, is not exclusively used for the tonnage tax business by the tonnage tax company, depreciation on such asset shall be allocated between its tonnage tax business and other business on a fair proportion to be determined by the Assessing Officer, having regard to the use of such asset for the purpose of the tonnage tax business and for the other business.

General exclusion of deduction and set off, etc. 115VL.

In computing the tonnage income of a tonnage tax company for any previous year in which it is chargeable to tax as follows

(i) Sections 30 to 43B shall apply as if every loss, allowance or deduction referred to therein and relating to or allowable for any of the relevant previous years, had been given full effect to for that previous year itself;

(ii) No loss referred to in 70, 71, 72, or 72A, in so far as such loss relates to the business of operating qualifying ships of the company, shall be carried forward or set off where such loss relates to any of the previous years when the company is under the tonnage tax scheme;

(iii) No deduction shall be allowed under Chapter VI-A in relation to the profits and gains from the business of operating qualifying ships; and

(iv) In computing the depreciation allowance under section 32, the written down value of any asset used for the purposes of the tonnage tax business shall be computed as if the company has claimed and has been actually allowed the deduction in respect of depreciation for the relevant previous years.

Exclusion of loss. 115VM.

(1) Section 72 shall apply in respect of any losses that have accrued to a company before its option for tonnage tax scheme and which are attributable to its tonnage tax business, as if such losses had been set off against the relevant shipping income in any of the previous years when the company is under the tonnage tax scheme.

(2) The losses referred to in sub-section (1) shall not be available for set off against any income other than relevant shipping income in any previous year beginning on or after the company exercises its option under section 115VP.

(3) Any apportionment necessary to determine the losses shall be made on a reasonable basis.

Capital gains from transfer of tonnage tax assets. 115VN.

Any profits or gains arising from the transfer of a capital asset being an asset forming part of the block of qualifying assets shall be chargeable to income-tax in accordance with the provisions of section 45, read with section 50, and the capital gains so arising shall be computed in accordance with the provisions of sections 45 to 51

Provided that for the purpose of computing such profits or gains, the provisions of section 50 shall have effect as if for the words "written down value of the block of assets", the words "written down value of the block of qualifying assets" had been substituted.

Explanation.—For the purposes of this Chapter, "written down value of the block of qualifying assets" means the written down value computed in accordance with the provisions of sub-section (2) of section 115VK.

Depreciation. 115VK.

A company opting for the scheme is not allowed any set-off of loss nor is any depreciation allowed. However, both loss and depreciation are deemed to have been allowed and notional adjustments are made against the relevant shipping income. Although depreciation is not allowed, it is necessary to bifurcate the qualifying ships and non-qualifying ships at the time a company joins the scheme. Section 115VK lays down the method for allocating the written down value amongst qualifying and non-qualifying ships. Any income from transfer of qualifying assets is treated in the same manner as for any other business asset in terms of section 115VN.

For the purposes of computing depreciation, the depreciation for the first previous year of the tonnage tax scheme shall be computed on the written down value of the qualifying ships as the written down value of the block of assets, being ships, as on the first day of the first previous year, shall be divided in the ratio of the book written down value of the qualifying ships and the book written down value of the non-qualifying ships. The block of qualifying assets as determined shall constitute a separate block of assets for the purposes of this Chapter.

Where an asset forming part of a block of qualifying assets begins to be used for purposes other than the tonnage tax business, an appropriate portion of the written down value allocable to such asset shall be reduced from the written down value of that block and shall be added to the block of other assets and vice a versa.

For the purposes of computing depreciation under section 115VL, depreciation computed for the previous year shall be allocated in the ratio of the number of days for which the asset was used for the tonnage tax business and for purposes other than tonnage tax business.

Period for which tonnage tax option to remain in force. 115VQ.

(1) An option for tonnage tax scheme, after it has been approved, shall remain in force for a period of ten years from the date on which such option has been exercised and shall be taken into account from the assessment year relevant to the previous year in which such option is exercised.

(2) An option for tonnage tax scheme shall cease to have effect from the assessment year relevant to the previous year in which

(a) the qualifying company ceases to be a qualifying company;

(b) a default is made in complying with the provisions contained in section 115VT (Transfer of profits to Tonnage Tax Reserve Account.) or section 115VU (Minimum training requirement for tonnage tax company.) or section 115VV (Limit for charter in of tonnage.);

(c) the tonnage tax company is excluded from the tonnage tax scheme under section 115VZC (Specific Exclusion from tonnage tax scheme) ;
(d) the qualifying company furnishes to the Assessing Officer, a declaration in writing to the effect that the provisions of this Chapter may not be made applicable to it, and the profits and gains of the company from the business of operating qualifying ships shall be computed in accordance with the other provisions of this Act.

Renewal of tonnage tax scheme. 115VR.

An option for tonnage tax scheme approved may be renewed within one year from the end of the previous year in which the option ceases to have effect.
The provisions of sections 115VP and 115VQ shall apply in relation to a renewal of the option for tonnage tax scheme in the same manner as they apply in relation to the approval of option for tonnage tax scheme.

Prohibition to opt for scheme in certain cases. 115VS.

A qualifying company, which, on its own, opts out of the tonnage tax scheme or makes a default in complying with the provisions of section 115VT or section 115VU or section 115VV or whose option has been excluded from tonnage tax scheme in pursuance of an order made under section 115VZC, shall not be eligible to opt for tonnage tax scheme for a period of ten years from the date of opting out or default or order, as the case may be.

Transfer of profits to tonnage tax reserve account. 115VT.

A tonnage tax company shall, be required to credit to a reserve account an amount not less than twenty per cent or more of the book profit in each previous year to be utilised in the manner laid down. “book profit” shall have the same meaning as in 115JB the so far as it relates to the income derived from the activities
Where the company has book profit from the business of operating qualifying ships and book loss from any other sources, and consequently, the company is not in a position to create the full or any part of the reserves the company shall create the reserves to the extent possible in that previous year and the shortfall, if any, shall be added to the amount of the reserves required to be created for the following previous year and such shortfall shall be deemed to be part of the reserve requirement of that following previous year. To the extent the shortfall in creation of reserves during a particular previous year is carried forward to the following previous year the company shall be considered as having created sufficient reserves for the first mentioned previous year.
Benefit of creation of reserve in subsequent year shall not apply in respect of the second year in case the shortfall in creation of reserves continues for two consecutive previous years.
The amount credited to the Tonnage Tax Reserve Account shall be utilised by the company before the expiry of a period of eight years next following the previous year in which the amount was credited
(a) for acquiring a new ship for the purposes of the business of the company; and
(b) until the acquisition of a new ship, for the purposes of the business of operating qualifying ships other than for distribution by way of dividends or profits or for remittance outside India as profits or for the creation of any asset outside India.

Where any amount credited to the Tonnage Tax Reserve Account —

(a) has been mis-utilised or
(b) has not been utilised or
(c) has been utilised for the purpose of acquiring a new ship as specified in clause (a) of sub-section (3), but such ship is sold or otherwise transferred, other than in any scheme of demerger by the company to any person at any time before the expiry of three years from the end of the previous year in which it was acquired,

an amount which bears the same proportion to the total relevant shipping income of the year in which such reserve was created, as the amount out of such reserve so utilised or not utilised bears to the total reserve created during that year shall be taxable under the other provisions of this Act

(i) in a case referred to in (a), in the year in which the amount was so utilised; or
(ii) in a case referred to in (b), in the year immediately following the period of eight years or
(iii) in a case referred to in (c), in the year in which the sale or transfer took place

Provided that the income so taxable under the other provisions of this Act shall be reduced by the proportionate tonnage income charged to tax in the year of creation of such reserves.

Where the amount credited to the Tonnage Tax Reserve Account is less than the minimum amount required to be credited, an amount which bears the same proportion to the total relevant shipping income, as the shortfall in credit to the reserves bears to the minimum reserve required to be credited shall not be taxable under the tonnage tax scheme and shall be taxable under the other provisions of this Act.

If the reserve required to be created is not created for any two consecutive previous years, the option of the company for tonnage tax scheme shall cease to have effect from the beginning of the previous year following the second consecutive previous year in which the failure to create the reserve had occurred.

"new ship" includes a qualifying ship which, before the date of acquisition by the qualifying company was used by any other person, if it was not at any time previous to the date of such acquisition owned by any person resident in India.

Minimum training requirement for tonnage tax company. 115VU.

A tonnage tax company, after its option has been approved shall comply with the minimum training requirement in respect of trainee officers in accordance with the guidelines framed by the Director-General of Shipping and notified in the Official Gazette by the Central Government.

The tonnage tax company shall be required to furnish a copy of the certificate issued by the Director-General of Shipping along with the return of income under section 139 to the effect that such company has complied with the minimum training requirement in accordance with the guidelines.

If the minimum training requirement is not complied with for any five consecutive previous years, the option of the company for tonnage tax scheme shall cease to have effect from the beginning of the previous year following the fifth consecutive previous year in which the failure to comply with the minimum training requirement had occurred.

Maintenance and audit of accounts.115VW.

An option for tonnage tax scheme by a tonnage tax company shall not have effect in relation to a previous year unless such company

(i) maintains separate books of account in respect of the business of operating qualifying ships; and

(ii) furnishes, along with the return of income for that previous year, the report of an accountant, in the prescribed form duly signed and verified by such accountant.

Avoidance of tax. 115VZB.

The tonnage tax scheme shall not apply where a tonnage tax company is a party to any transaction or arrangement which amounts to an abuse of the tonnage tax scheme.

A transaction or arrangement shall be considered an abuse if the entering into or the application of such transaction or arrangement results, or would but for this section have resulted, in a tax advantage being obtained for (i) a person other than a tonnage tax company or (ii) a tonnage tax company in respect of its non-tonnage tax activities.

Exclusion from tonnage tax scheme. 115VZC.

Where a tonnage tax company is a party to any transaction or arrangement referred to in of section 115VZB, the Assessing Officer shall, by an order in writing, exclude such company from the tonnage tax scheme.

An opportunity shall be given by the Assessing Officer by serving a notice calling upon such company to show cause, on a date and time to be specified in the notice, why it should not be excluded from the tonnage tax scheme:

Provided further that no order shall be passed without the previous approval of the Chief Commissioner.

No order shall be passed where the company shows to the satisfaction of the Assessing Officer that the transaction or arrangement was a bona fide commercial transaction and had not been entered into for the purpose of obtaining tax advantage under this Chapter.

Where an order has been passed by the Assessing Officer excluding the tonnage tax company from the tonnage tax scheme, the option for tonnage tax scheme shall cease to be in force from the first day of the previous year in which the transaction or arrangement was entered into.

Effect of temporarily ceasing to operate ships 115VZA.

A temporary cessation (as against permanent cessation) of operating any qualifying ship by a company shall not be considered as a cessation of operating of such qualifying ship and the company shall be deemed to be operating such qualifying ship for the purposes of this Chapter.

Where a qualifying company continues to operate a ship, which temporarily ceases to be a qualifying ship, such ship shall not be considered as a qualifying ship for the purposes of this Chapter.

13A. POLITICAL PARTIES

Any income of a political party which is chargeable under the head "Interest on securities", "Income from house property" or "Income from other sources" or "Capital gains" 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 Income-tax Officer to properly deduce its income therefrom ;
b. in respect of each such voluntray contribution in excess of twenty 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 (CA)

Provided further that if the treasurer of such political party or any other person authorised by that political party in this behalf fails to submit a report of the Representation of the People Act, for a financial year, no exemption under this section shall be available for that political party for such financial year.

For the purposes of this section, “political party” means a political party registered under section 29A of the Representation of the People Act.

13B. ELECTORAL TRUST.

Any voluntary contributions received by an electoral trust shall not be included in the total income of the previous year of such electoral trust, if

a) such electoral trust distributes to any political party, registered under section 29A of the Representation of the People Act, 1951 (43 of 1951), during the said previous year, ninety-five per cent. of the aggregate donations received by it during the said previous year along with the surplus, if any, brought forward from any earlier previous year ; and

b) such electoral trust functions in accordance with the rules made by the Central Government.

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. The provisions of this section shall not apply in relation to any co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank.	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, In any other case,	100,000 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 any income by way of interest on securities or any income from house property chargeable under section 22.	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 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.

MUTUAL CONCERN / ORGANISATION

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.

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.

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.

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.

Trivandrum Club (Kerala High Court)

The real contributors of income by availing of the facilities of the marriage hall were not the members but non-members. In order to enable them to avail of the facilities of the club, non-members were to be given temporary membership only for the purpose of availing of this benefit. The Trivandrum Club's case [1989] 177 ITR 550 (Ker) was decided on the basis of the admitted

factual position that no non-member was enjoying the facilities of the club. The facts in this case were different. The marriage hall was admittedly being rented out to non-members making them temporary members only for the purpose of letting out the marriage hall from non-members. The principle of mutuality would not apply. Rental income received from non-members was taxable.
A club may be exempt on its receipts from members on the mutuality principle. As decided in CIT v. Bankipur Club Ltd. [1997] 226 ITR 97 (SC), there could be some latitude in respect of some miscellaneous income from transactions with outsiders, if such income arises from transactions without a "taint of commerciality". Income from interest on fixed deposits could be exempt on the same reasoning as was found in CIT v. Cawnpore Club Ltd. [2004] 140 Taxman 378 (SC). But then, an activity, which is tainted with commerciality, cannot qualify for exemption on the grounds of mutuality under the rule in Bankipur Club's case. It is what was decided in CIT v. Trivandrum Club [2006] 282 ITR 505 (Ker) in respect of income from letting out a marriage hall, because such letting out constituted a trade or a business and the income was from transactions with outsiders.

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.

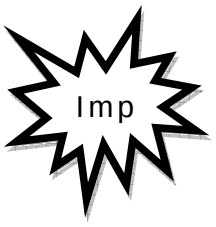
Points to be noted for mutual concern

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.

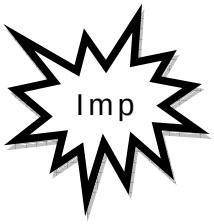
5) If the object is charitable, a mutual association like a trade association can claim exemption under section 11 where the surplus was to use only for public benefit and not to be distributed to its members. If the surplus is to be shared between members, it could claim exemption on grounds of mutuality, if other conditions like participants and contributors are both members with no dealings with outsiders.

SEC 44A. DEDUCTION FOR 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.



PART G

INTERNATIONAL TAXATION

DTAA

AAR

TRANSFER PRICING

ASSESSMENT OF NR / NRI

NR SHIPPING / AIR CRAFTS

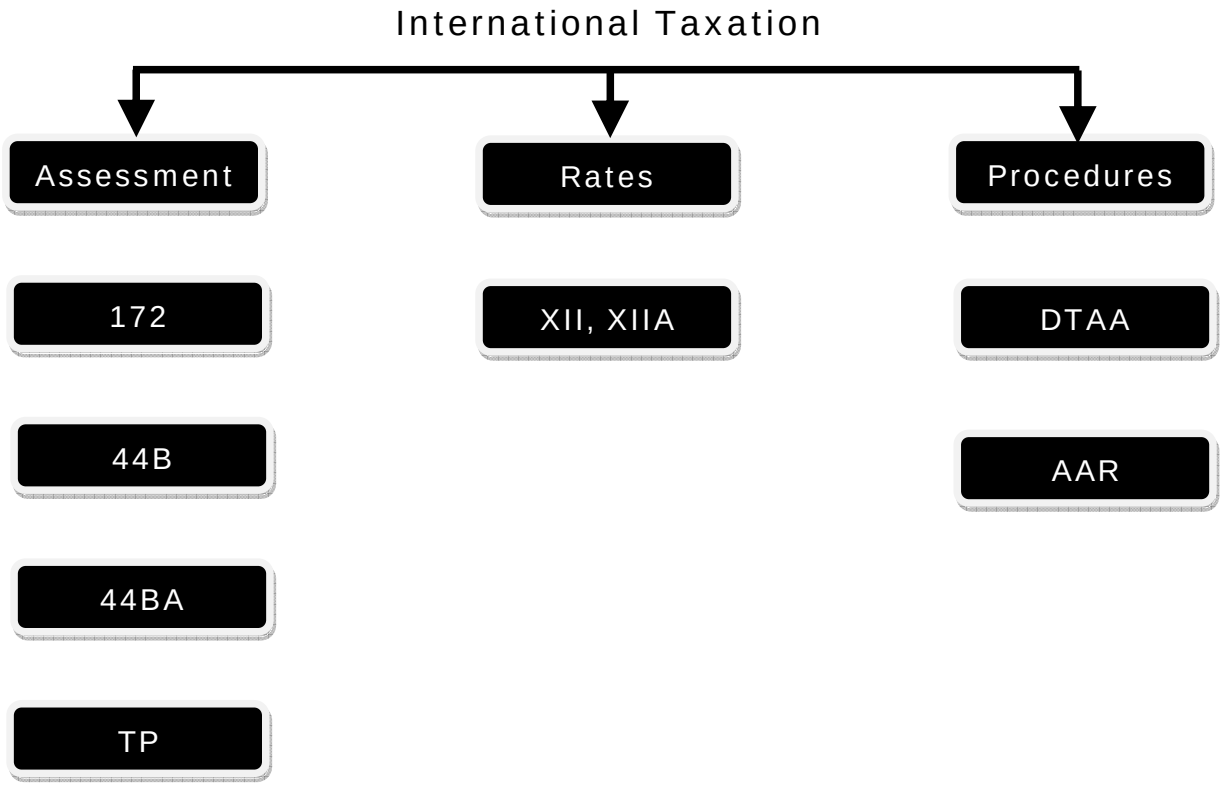
H.O. EXPENSE

OIL EXPLORATION

DOUBLE TAXATION AVOIDANCE AGREEMENTS -- DTAA

What is DTAA?

An individual who earned income has to pay income-tax in the country in which the income is earned and also in the country in which such person is resident. As such, the liability to tax on the aforesaid income does arise in the country of source and the country of residence. In order to avoid the hardship of double taxation, the Government of India has entered into DTAAs with several countries. DTAAs take care of technical know-how and service fees and reduce rates of tax on dividend, interest, and royalties received by residents of one country from other. When the rate of tax is higher in the Income-tax Act, 1961 than the rate prescribed in the DTAA, then the rate prescribed in the DTAA shall be applied, i.e., the rate which is better suited to the taxpayer would be applied.



Aim of DTAAs

The need and purpose of tax treaties were indicated by the Organization for Economic Co-operation and Development in the 'Model Tax Convention on Income and on Capital' as standardization and common solutions for cases of double taxation to the taxpayers who are engaged in industrial, financial or other activities in other countries. Firstly, treaties must help in avoiding and alleviating the burden of double taxation prevailing in the international arena. The tax treaties must clarify and help the taxpayer to know with certainty his potential tax liability in other country where he is carrying on industrial or other activities. Tax treaties must ensure that there is no discrimination

between foreign taxpayers who has PE in the source countries and domestic taxpayers of such countries. Treaties are made with the aim of allocation of taxes between treaty nations and the prevention of tax avoidance and/or tax evasion. The treaties must also ensure equal and fair treatment of taxpayers having different residential status, resolving differences in taxing the income and exchange of information and other details among treaty partners.

Classification of DTAAs

DTAAs may be classified into 'Comprehensive agreements' and 'Limited agreements' based on the scope of such agreements. Comprehensive DTAAs provide for taxes on income, capital gains and capital investments whereas limited DTAAs denote income from shipping and air transport or legacy and gifts. Comprehensive agreements ensure that the taxpayers in both the countries would be treated on equitable manner in respect of the problems relating to double taxation.

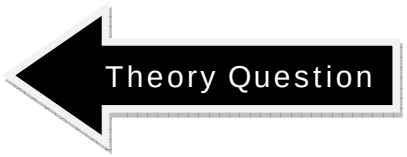
Treaty Benefits

To avail the benefits of tax treaty, an individual must be a resident of a contracting country and corporate entity should have a PE in a contracting State. In such a case only the benefits like lower withholding tax would accrue to those taxpayers on interest, dividend or royalty receipts.

Residence

Residential status of a person is important in determining tax liability both under domestic tax laws and under international tax laws. Normally, tax treaty clarifies how to determine a residential status of a person to tax him as a resident under the respective taxation laws of the Contracting State. A relief from double taxation may be sought only by the resident of that Contracting State. The term 'resident of Contracting State' means a person either an individual or a corporate, which is liable to tax under the laws of a particular country on account of domicile, place of permanent business establishment and, residence or any other similar criteria.

Permanent Establishment



One of the important terms that transpires in all the DTAAs is the term 'Permanent Establishment'. It had not been defined in the Income-tax Act. However, as per the DTAAs, PE includes a wide variety of arrangements. DTAAs usually restrict the jurisdiction of the Contracting States to taxing income of a foreign enterprise only if such enterprise carries on business in another country through PE. It is a fixed place of business through which business activities of enterprise are wholly or partially conducted in that country for generation of income.

Section 92F of the Income-tax Act explains the term 'Permanent Establishment' as a fixed place of business through which the business of the enterprise is wholly or partly carried out. OECD and UN Model Conventions also provide for definition of the term 'Permanent Establishment' as it includes a place of management, a branch, an office, a factory, a workshop, etc. There is an international accord on the attribution of profits earned by PE on the basis of 'Separate enterprises' concept and the relevance of the 'arm's length principle'.

Business Income

The business income of a non-resident is taxable in India under the provisions of the Act, when it accrues either directly or indirectly, through any business connection in India, or source of income or

assets located in India or through the transfer of an Indian capital asset. Only the residents of a Contracting State can avail of the benefits of the relevant treaty. Moreover, terms and conditions of all the treaties entered into by a State are not uniform. By and large, DTAAs assign jurisdiction with respect to a right to tax a particular income. The principle underlying tax treaties is to share the revenues between two countries.

AGREEMENT WITH FOREIGN COUNTRIES OR SPECIFIED TERRITORIES SEC. 90.

(1) The Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India,

(a) for the granting of relief in respect of—

(i) income on which have been paid both income-tax under this Act and income-tax in that country or specified territory, as the case may be, or

(ii) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory, as the case may be, to promote mutual economic relations, trade and investment, or

(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory, as the case may be, or

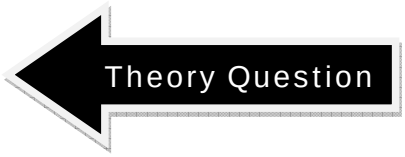
(c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory, as the case may be, or investigation of cases of such evasion or avoidance, or

(d) for recovery of income-tax under this Act and under the corresponding law in force in that country or specified territory, as the case may be,

and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

(2) Where the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India, as the case may be, for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.

ADOPTION BY CENTRAL GOVERNMENT OF AGREEMENT BETWEEN SPECIFIED ASSOCIATIONS FOR DOUBLE TAXATION RELIEF SEC. 90A.



(1) Any specified association in India may enter into an agreement with any specified association in the specified territory outside India and the Central Government may, by notification in the Official Gazette, make such provisions as may be necessary for adopting and implementing such agreement

(a) for the granting of relief in respect of—

(i) income on which have been paid both income-tax under this Act and income-tax in any specified territory outside India; or

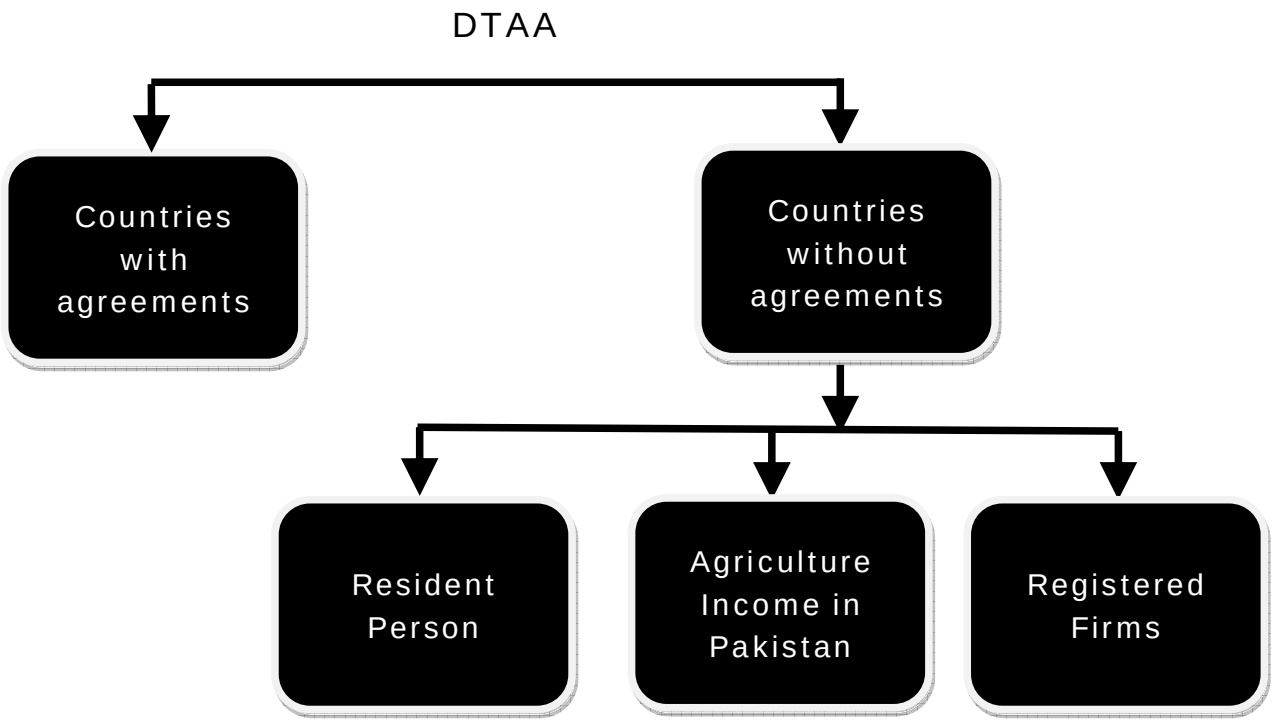
(ii) income-tax chargeable under this Act and under the corres-ponding law in force in that specified territory outside India to promote mutual economic relations, trade and investment, or

(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that specified territory outside India, or

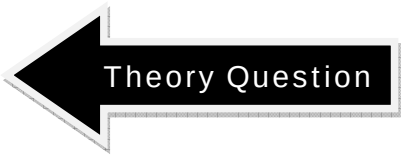
(c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corres-ponding law in force in that specified territory outside India, or investigation of cases of such evasion or avoidance, or

(d) for recovery of income-tax under this Act and under the corres-ponding law in force in that specified territory outside India.

(2) Where a specified association in India has entered into an agreement with a specified association of any specified territory outside India and such agreement has been notified, for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.


DTAA
Countries with agreements
Countries without agreements
Resident Person
Agriculture Income in Pakistan
Registered Firms

COUNTRIES WITH WHICH NO AGREEMENT EXISTS SEC. 91.



(1) If any person who is resident in India in any previous year proves that, in respect of his income which accrued or arose during that previous year outside India (and which is not deemed to accrue or arise in India), he has paid in any country with which there is no agreement under section 90 for the relief or avoidance of double taxation, income-tax, by deduction or otherwise, under the law in force in that country, he shall be entitled to the deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said country, whichever is the lower, or at the Indian rate of tax if both the rates are equal.

(2) If any person who is resident in India in any previous year proves that in respect of his income which accrued or arose to him during that previous year in Pakistan he has paid in that country, by deduction or otherwise, tax payable to the Government under any law for the time being in force in that country relating to taxation of agricultural income, he shall be entitled to a deduction from the Indian income-tax payable by him—

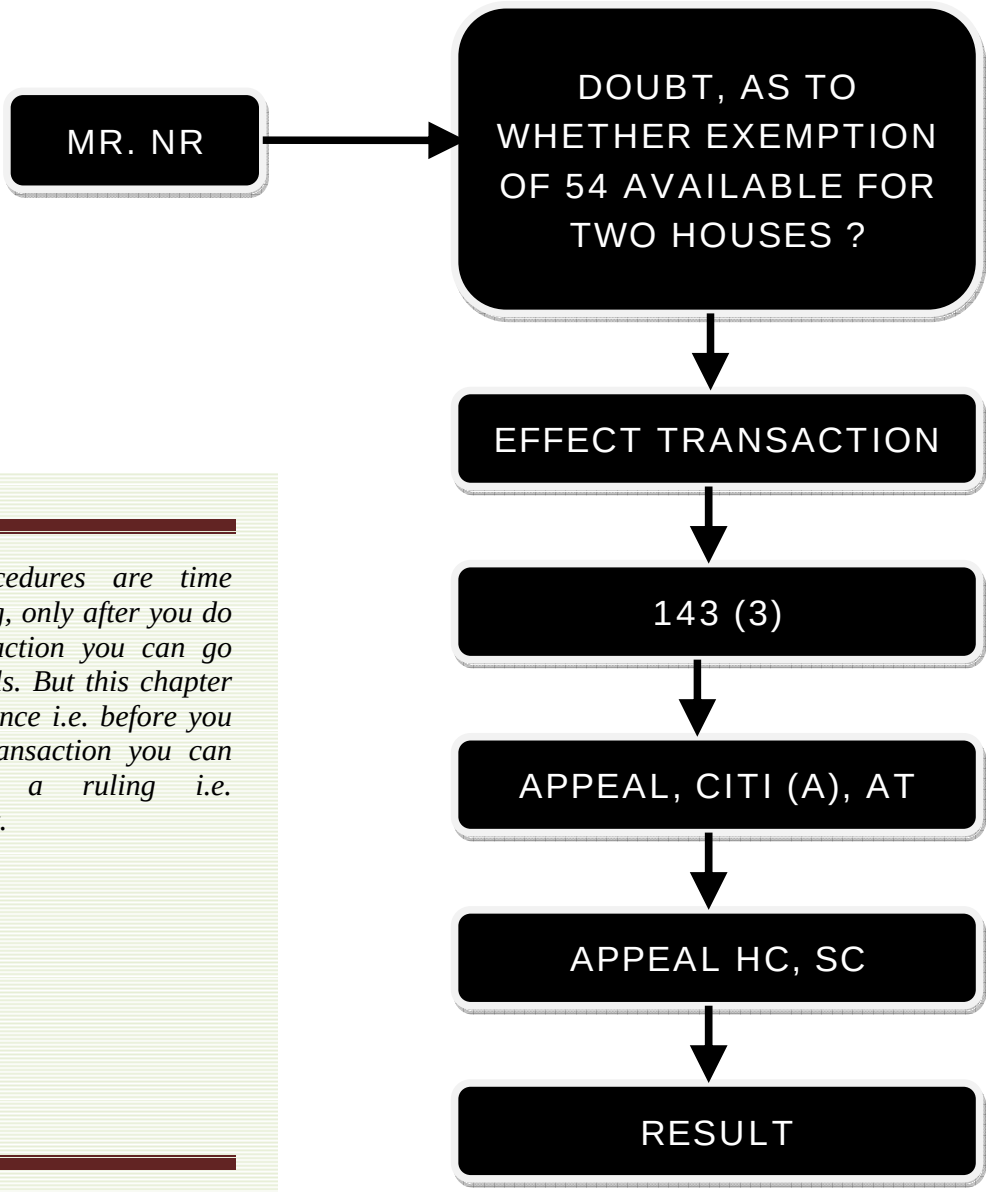
(a) of the amount of the tax paid in Pakistan under any law aforesaid on such income which is liable to tax under this Act also; or

(b) of a sum calculated on that income at the Indian rate of tax;

whichever is less.

(3) If any non-resident person is assessed on his share in the income of a registered firm assessed as resident in India in any previous year and such share includes any income accruing or arising outside India during that previous year (and which is not deemed to accrue or arise in India) in a country with which there is no agreement under section 90 for the relief or avoidance of double taxation and he proves that he has paid income-tax by deduction or otherwise under the law in force in that country in respect of the income so included he shall be entitled to a deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income so included at the Indian rate of tax or the rate of tax of the said country, whichever is the lower, or at the Indian rate of tax if both the rates are equal.

ADVANCE RULING



Our procedures are time consuming, only after you do the transaction you can go for appeals. But this chapter is in advance i.e. before you do the transaction you can ask for a ruling i.e. judgement.

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)

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Membership Type	1	2	3
Membership Name	**Free**	**DT**	**IDT**
Description	***Wealth Tax (excluding valuation rules and questions / answers.)***	***Direct Taxes for CA final (Includes membership type 3) (also included 130 + Class work problems and solution)***	***Indirect taxes of CA final. (included +100 Class work problems and solution)***
Hours of video access Granted	5 Hrs	100 Hrs	75 Hrs
Membership commence (May 2011 Exam)	16th May	16th May	16th May
Fair Usage of Hours for attending all lectures for given subject once. *(approximately in this many hours once all lectures can be attended, some extra time is given considering revision of any chapters that may be required. Particularly for DT if students attend basic topics of IPCC lectures also when we post from time to time then students will have to buy more hours at additional cost.)*	5 Hrs	100 Hrs	65 Hrs
Time of Access / Viewing *(You can access the lectures any time with user name and password. Subject to your membership expiry date and hours of usage.)*	24/7	24/7	24/7
Download of video files *(Video files are copy right protected, It is not allowed to be downloaded. User must not copy or distribute it any manner what so ever, audio or video or both.)*	Yes (Selected Files Only)	No	No
Viewing online *(You must be connected to internet with at least broadband connection. You can also access these lectures with help of smart mobile phone if it supports Java and gives you speed of 384 kbps minimum.)*	Yes	Yes	Yes
Web meeting with professor *(From time to time it will be scheduled for solving doubt and important discussion.)*	No	Yes	Yes
E-mail support for handling queries *(generally accepted response time of 48 hours.)*	No	Yes	Yes
Maximum time each video can be Logged in. *(This limit is kept for security purposes. Video Logged in for less then 3 min is not counted for this purpose.)*	10	10	10
Fees (Including taxes if any) ***(Not Refundable in any circumstances.)***	Rs. Nil	Rs. 15,500	Rs. 12,500
Charges for additional hours (if required).	Not available	100 P/hr	100 P/hr

Membership Activation time. *(You can Commence online lectures any time, you are never too late for classes.)*	automatic	48 Hours of payment.	48 Hours of payment.
Study notes in softcopy provided for download. *(*likely to be provided.)*	No	Yes	No*
Membership expiry for May 2011 exam (Respective hours or this date whichever is earlier.)	No	18th May	18th May
New Batch for Nov 2011 Online lectures commence for May 2011 students of CA final.	20th May	20th May	20th May
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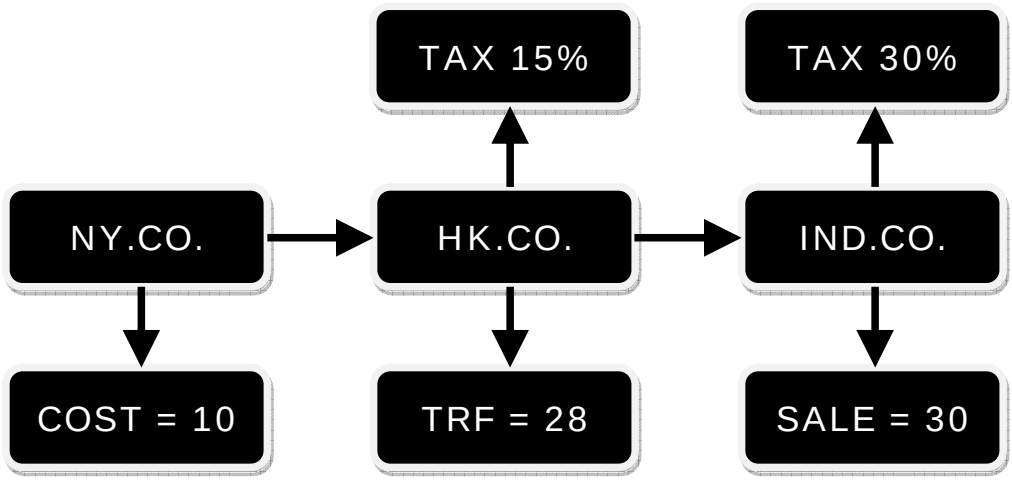
TRANSFER PRICING

Transfer pricing is the commercial transaction between the different parts of multinational groups which may not be subject to the same market forces shaping relations between the two Independent firms. It is used as an instrument to control tax avoidance by manipulating price charges on intra group cross border transactions in such a way as to maximize the taxable profits in low tax jurisdictions and minimise such profits in high tax countries. It relates to the pricing of transactions that take place within related associate of a group company in different tax jurisdictions. This write-up presents an overview of transfer pricing from an indian perspective. According to the authors, undoubtedly transfer pricing is very important both for tax base of the countries and taxpayers so it should be made at par with the countries having developed tp legislations and rules. They are of view that sony india (p.) Ltd. V. Dy. Cit [2008] 114 itd 448 (delhi) sets the pace for the gradual evolution of indian transfer pricing jurisprudence and it will be instrumental in solving relevant transfer pricing issues.

There is uneven distribution of economic resources between different countries which leads to international trade. Due to globalization, there is increasing participation of multi-national groups in economic activities in the country and has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multi-national group. To deal with such problems, the finance act, 2001 substituted section 92 with a new section and introduced new sections 92A to 92F in the income-tax act, relating to computation of income from an international transaction having regard to the arm's length price, meaning of associated enterprise, meaning of information and documents by persons entering into international transactions and definitions of certain expressions occurring in the said section. Transfer-pricing is used as an instrument to control tax avoidance by manipulating price charges on intra-group cross border transactions in such a way as to maximise the taxable profits in low tax jurisdictions and minimise such profits in high tax countries. Transfer pricing is the commercial transacttion between the different parts of the multi-national groups which may not be subject to the same market forces shaping relations between the two independent firms. One party transfers to another goods or services, for a price. The price involved is the transfer price.



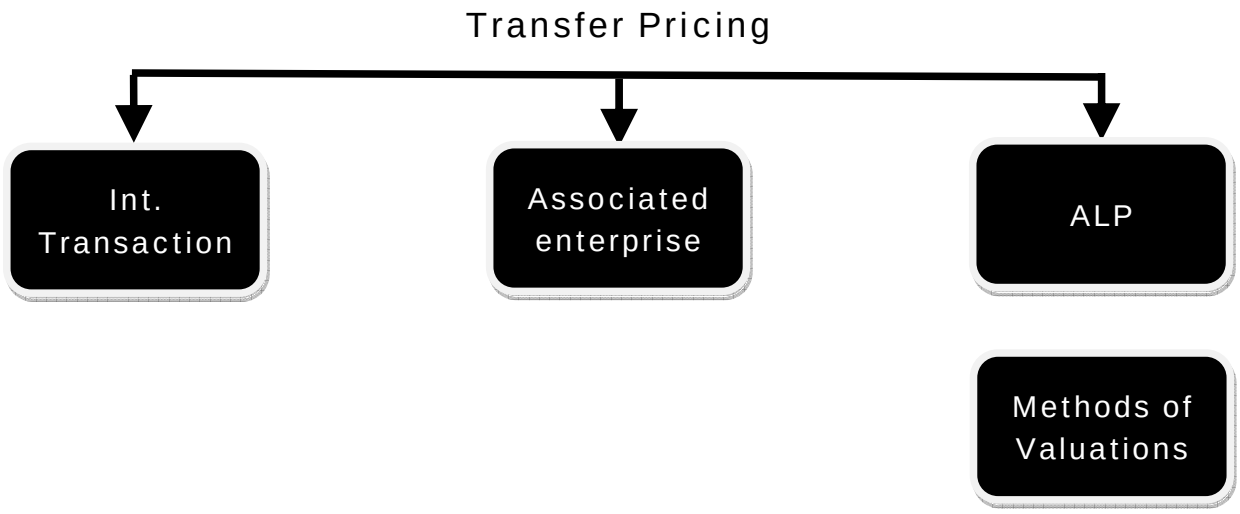
Income regularly assessed = 30 - 28 = 2

Transfer pricing income will be = 28 - 10 = 18

General principle

The countries having cross border trades shift their profits from countries having higher tax rates to lower tax rates which leads to revenue loss for the countries having higher tax rates. Transfer pricing relates to the pricing of transactions that take place within related associate of a group company in different tax jurisdictions. The major percentage of world trade is between related entities of an mnc which is in relation to tangible goods, intangible properties, services and financing. Due to different tax rates and rules between different countries, the mncs structure their transfer pricing in a way that higher profit is in countries with lower tax rates and lower profit is in countries with higher tax. This difference between countries gives mncs potential encouragement to structure their transfer pricing according to their benefits. Transfer pricing ('tp') issues from a substantial part of tax base in all countries and this makes tax authorities to be more cautious about it. As compared to other countries, india is late in introducing tp regulations. To avoid tax evasion from the cross border transactions of the mncs and to get reasonable fair and equitable profits and tax in said transactions new sections 92, 92A, 92B, 92C, 92D, 92E and 92F have been included in the income-tax act, 1961 through the finance act, 20014. This 2001 amendment has first time defined the terms 'associated enterprise and 'international transaction which brought clarity to the law and greater respect

Among businesses for indian tax authorities which can now efficiently handle tp transactions. These sections provide for a transfer pricing mechanism which is based on computation of income from cross-border transactions. The cbdt has also issued draft rules. This tp legislation and rules are related to the computation of income from international transactions among associated enterprises with regard to the arm's length price (ALP). For determination of alp, the tp rules require all the characteristics of the controlled transaction that are likely to affect its open market value to be taken into account. They can be functions performed, assets used and risks taken.



Computation of income from international 92

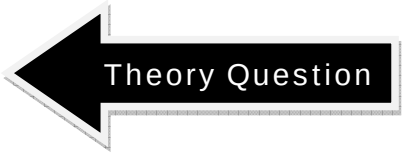
(1) Any income (also includes expense or interest) arising from an international transaction shall be computed having regard to the arm's length price.

(2) Where in an international transaction, two or more associated enterprises enter into a mutual agreement or arrangement for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises, the cost or expense allocated or apportioned to, or, as the case may be, contributed by, any such enterprise shall be determined having regard to the arm's length price of such benefit, service or facility, as the case may be.

Provisions are only for the benefit of revenue

The provisions transfer pricing shall not apply in a case where the computation of income or the determination of the allowance for any expense or interest or any cost or expense allocated or apportioned, or, as the case may be, has the effect of reducing the income chargeable to tax or increasing the loss. 92(3)

Meaning of international transaction. Section 92B.



"international transaction" means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.

A transaction entered into by an enterprise with a person other than an associated enterprise shall be deemed to be a transaction entered into between two associated enterprises, if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined in substance between such other person and the associated enterprise.

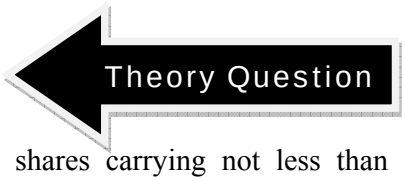
Meaning of associated enterprise. Section 92A

"associated enterprise", in relation to another enterprise, means an enterprise

(*a*) Which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or

(*b*) In respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

Deemed associate enterprise



(a) One enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the other enterprise; or

(*b*) Any person or enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in each of such enterprises; or

(*c*) A loan advanced by one enterprise to the other enterprise constitutes not less than fifty-one per cent of the book value of the total assets of the other enterprise; or

(*d*) One enterprise guarantees not less than ten per cent of the total borrowings of the other enterprise; or

(*e*) More than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise; or

(*f*) More than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two enterprises are appointed by the same person or persons; or

(*g*) The manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights; or

(*h*) Ninety per cent or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise; or

(*i*) The goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise; or

(*j*) Where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual; or

(*k*) Where one enterprise is controlled by a Hindu undivided family, the other enterprise is controlled by a member of such Hindu undivided family or by a relative of a member of such Hindu undivided family or jointly by such member and his relative; or

(*l*) Where one enterprise is a firm, association of persons or body of individuals, the other enterprise holds not less than ten per cent interest in such firm, association of persons or body of individuals; or

(*m*) There exists between the two enterprises, any relationship of mutual interest, as may be prescribed.

Illustrative cases of associate enterprise

Case study 1

'A' Limited is a resident of India with Head Office at Mumbai. It has a wholly owned subsidiary company 'B' (UK) Ltd. in U.K. where the holding of "A" Limited in "B" Limited is 26% or more. There are following transactions between the two companies :

1. 'A' Ltd. has exported goods to 'B' (UK) Ltd. for Rs.2 crores.
2. 'B' (UK) Ltd. has charged Pound 50000 to 'A' Ltd. for rent and incidental charges for use of its U.K. office premises by branch of 'A' Ltd.
3. 'A' Ltd. has given loan of Pound 1 million to 'B' (UK) Ltd. @ 3% P.A. interest.

All the above transactions will be considered as international transactions between two associated enterprises. 'A' Ltd. will have to establish that each of these transactions is at arm's length price. If it is shown that in transaction (ii) the amount charged by 'B' (UK) Ltd. is less than the arm's length price, the difference cannot be adjusted against the amount receivable under (i) or (iii) if the price charged by 'A' Ltd. is also shown to be less than arm's length price. In other words, it will have to be established that each transaction is at arm's length price.

Case Study 2

In the above case, the position will not alter even if 'C' Ltd. of Delhi holds 26% or more voting power in 'A' Ltd. and 26% or more voting power in 'B' (UK) Ltd. and 'A' Ltd. does not hold any shares in 'B' (UK) Ltd. By virtue of shareholding of 'C' Ltd., 'A' Ltd. and 'B' (UK) Ltd. will be deemed to be associated enterprises.

Case study 3

If 'X' Ltd. exports goods worth Rs.5 crores to its branch in U.K. and also imports goods worth Pound 3 million from the branch, these transactions will not be considered as international transactions. However, any sales by such U.K. branch of 'X' ltd. to 'B' (UK) Ltd. will be considered as international transaction between associated enterprises and it will be necessary to establish that the same is at arm's length price.

Case study 4

PQR Ltd. of USA has advanced loan of USD 5 million to XYZ Ltd. of Bangalore. The rupee equivalent of this amount is about Rs.20 crores. PQR Ltd. is holding 12 % of equity capital in XYZ Ltd. The total book value of the assets of XYZ Ltd. (Factory building and other assets) is Rs.35 crores. PQR Ltd. has given guarantees to a bank in USA for loan of USD 3 million is about Rs.12 crores taken by XYZ Ltd. There are following transactions between these two companies :

1. XYZ Ltd. is paying royalty @ 10% of its sales to PQR Ltd. under a collaboration agreement for the use of know-how for 10 years.
2. XYZ Ltd. is paying USD 80000 per year to PQR Ltd. for use of patents of USA Company.

3. PQR Ltd. had supplied certain machinery and spare parts to XYZ Ltd. and charged USD one million for machinery and USD 50000 for spares.
4. XYZ Ltd. is paying interest @ 10% P.A. to PQR Ltd. on the loan advanced by PQR Ltd.
5. XYZ Ltd. has exported finished goods worth USD 2 million to PQR Ltd.

It will be necessary for XYZ Ltd. to establish that each of the above transactions is at arm's length price since PQR Ltd. and XYZ Ltd. will be considered as associated enterprises as the loan given by PQR Ltd. is more than 50% of the total book value of assets of XYZ Ltd.

Case study 5

In the above case if the book value of assets of XYZ Ltd. is Rs.120 crores, and the total borrowings of XYZ Ltd. are Rs.100 crores, PQR Ltd. and XYZ Ltd. will be deemed to be associated enterprises. This is because the amount for which guarantee is given by PQR will exceed 10 % of total borrowings. XYZ Ltd. will have to explain that the above transactions are at arm's length prices.

Case study 6

M/s. CDX is a partnership firm in which there are four partners viz. Mr. J (12%), Mr. C (20%), Mr. D (40%) and Mr. X (28%). Mr. C, D and X are brothers but not related to Mr. J. Mr J is proprietor of M/s Jems India and exporters of jewelry from India. During the year he has exported to following firms.

Name	Country	Items	(Amount)(Rs. in Lacs)
M/s. ABC	Dubai	40	50
M/s. BCD	Europe	100	120
M/s. CDX	U.K.	10	30

From the above facts, it will be noted that all the above exports by M/s. Jems India will be deemed to have been made to associated enterprises and M/s. Jems India will have to establish that they are at arm's length prices.

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Download of video files *(Video files are copy right protected, It is not allowed to be downloaded. User must not copy or distribute it any manner what so ever, audio or video or both.)*	Yes (Selected Files Only)	No	No
Viewing online *(You must be connected to internet with at least broadband connection. You can also access these lectures with help of smart mobile phone if it supports Java and gives you speed of 384 kbps minimum.)*	Yes	Yes	Yes
Web meeting with professor *(From time to time it will be scheduled for solving doubt and important discussion.)*	No	Yes	Yes
E-mail support for handling queries *(generally accepted response time of 48 hours.)*	No	Yes	Yes
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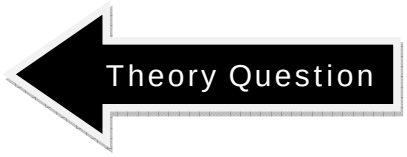
VALUATION RULES

Computation of arm's length price. Section 92C



(1) The arm's length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely :

(*a*) comparable uncontrolled price method;

(*b*) resale price method;

(*c*) cost plus method;

(*d*) profit split method;

(*e*) transactional net margin method;

(*f*) such other method as may be prescribed by the Board.

(2) The most appropriate method shall be applied, for determination of arm's length price, in the manner as may be prescribed. Provided that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices. Provided further that if the variation between the arm's length price so determined and price at which the international transaction has actually been undertaken does not exceed five per cent of the latter, the price at which the international transaction has actually been undertaken shall be deemed to be the arm's length price.

Provided that no deduction under section 10A or section 10B or under Chapter VI-A shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income under this sub-section :

Provided further that where the total income of an associated enterprise is computed under this sub-section on determination of the arm's length price paid to another associated enterprise from which tax has been deducted or was deductible under the provisions of Chapter XVIIB, the income of the other associated enterprise shall not be recomputed by reason of such determination of arm's length price in the case of the first mentioned enterprise.

Rule 10b. Determination of arm's length price

(A) comparable uncontrolled price method

i. The price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, or a number of such transactions, is identified ;

ii. Such price is adjusted to account for differences, if any, between the international transaction and the comparable uncontrolled transactions or between the enterprises entering into such transactions, which could materially affect the price in the open market ;

iii. The adjusted price arrived at under sub-clause (ii) is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction ;

GUIDELINES FOR COMPARABLE PRICE

The comparability of an international transaction with an uncontrolled transaction shall be judged with reference to the following, namely :

(a) the specific characteristics of the property transferred or services provided in either transaction ;

(b) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions ;

(c) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions ;

(d) conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

USABILITY OF DATA

The data to be used in analysing the comparability of an uncontrolled transaction with an international transaction shall be the data relating to the financial year in which the international transaction has been entered into. Provided that data relating to a period not being more than two years prior to such financial year may also be considered if such data reveals facts which could have an influence on the determination of transfer prices in relation to the transactions being compared.

	Manner of computation	Rs.
1	COMPARABLE PRICE of product Y (warrenty 9m, 300 gb) (Product X actual import at 2,150 per unit, warrenty 6m, 260 gb)	2,200
2	ADJUSTMENTS on merits	
	WARRANTY VALUE	-300
	40 GB DIFFERENCE	-200
3	ALP (COST OF HDD)	1,700

(B) resale price method

i. The price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise, is identified ;

ii. Such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions ;

iii. The price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services ;

iv. The price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market ;

v. The adjusted price arrived at under sub-clause (iv) is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise ;

	Manner of computation	Rs.
1	PRICE AT WHICH RESOLD	50000
2	ADJUSTMENTS on merits	
	GP (REASONABLE 20 %)	10000
	COST ON A/C OF PURCHASE	2000
3	ALP COST OF PRODUCT	38000

(C) cost plus method,

i. The direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise, are determined ;

ii. The amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, is determined ;

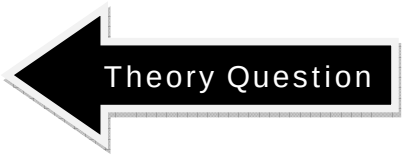
iii. The normal gross profit mark-up referred to in sub-clause (ii) is adjusted to take into account the functional and other differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market ;

iv. The costs referred to in sub-clause (i) are increased by the adjusted profit mark-up arrived at under sub-clause (iii) ;

v. The sum so arrived at is taken to be an arm's length price in relation to the supply of the property or provision of services by the enterprise ;

	PARTICULARS	Rs.
1	MANUFACTURING COST	10,000
2	ADD: GP MARGIN	2,000
	ADJ: DIFFRENCES	-----
3	ALP (SALE PRICE)	12,000

(D) profit split method,



which may be applicable mainly in international transactions involving transfer of unique intangibles or in multiple international transactions which are so inter-related that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction

i. The combined net profit of the associated enterprises arising from the international transaction in which they are engaged, is determined ;

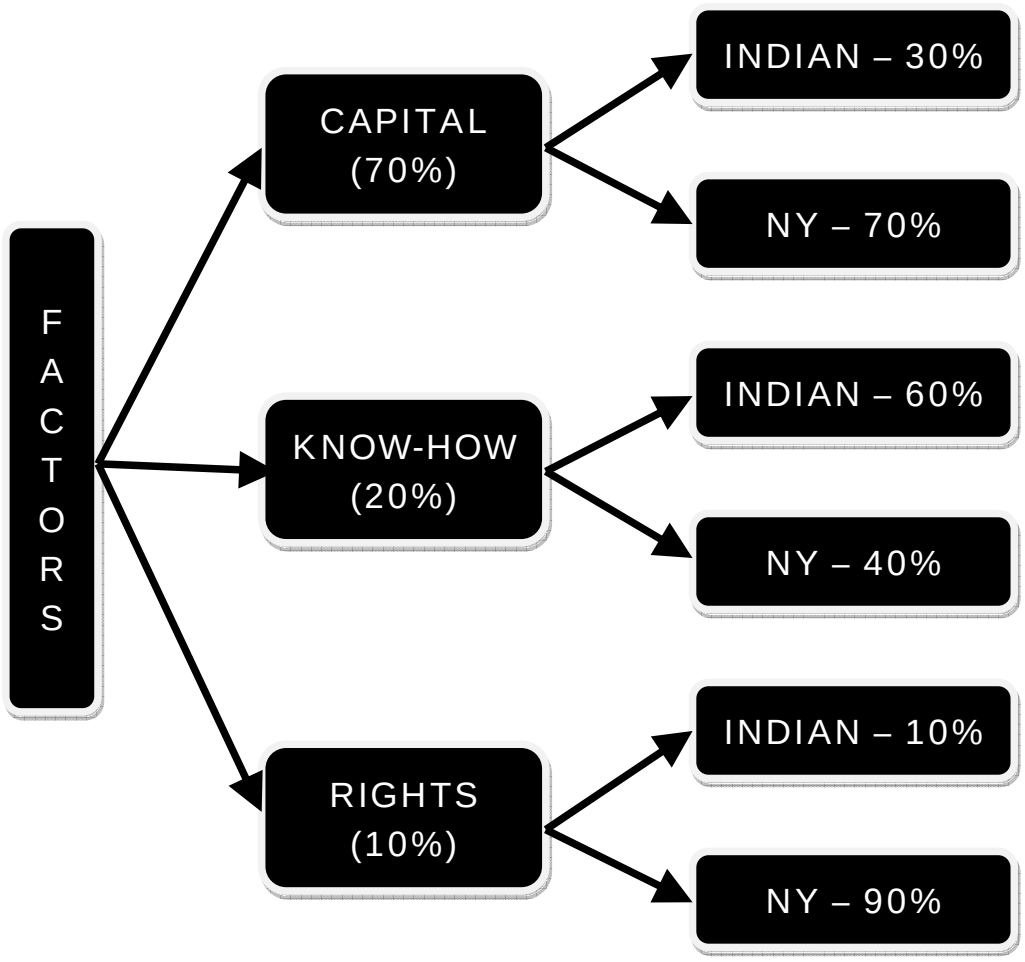
ii. The relative contribution made by each of the associated enterprises to the earning of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employ-ed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances ;

iii. The combined net profit is then split amongst the enterprises in proportion to their relative contributions, as evaluated under sub-clause (ii) ;

iv. The profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction :

Provided that the combined net profit referred to in sub-clause (i) may, in the first instance, be partially allocated to each enterprise so as to provide it with a basic return appropriate for the type of international transaction in which it is engaged, with reference to market returns achieved for similar types of transactions by independent enterprises, and thereafter, the residual net profit remaining after such allocation may be split amongst the enterprises in proportion to their relative contribution in the manner specified under sub-clauses (ii) and (iii), and in such a case the aggregate of the net profit allocated to the enterprise in the first instance together with the residual net profit apportioned to that enterprise on the basis of its relative contribution shall be taken to be the net profit arising to that enterprise from the international transaction ;

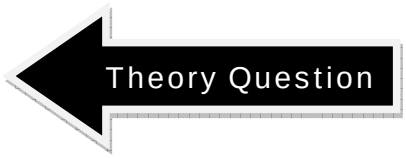
Let us assume that profits out of business is evolved out of these factors and two companies Indian and New York (NY) has following contribution to these factors. Total profits 100. (Indian company profit 40)



		IND	NY	IND	NY
	Rs.	%	%	AMT	AMT
CAPITAL	70	30 %	70 %	21	49
KNOWHOW	20	60 %	40 %	12	8
RIGHTS	10	10 %	90 %	1	9
TOTAL	100			34	66

ALP profit of Indian company is = 34
Actual profites of Indian company = 40
TP income = 6

(E) transactional net margin method



i. The net profit margin realised by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base ;

ii. The net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base ;

iii. The net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market ;

iv. The net profit margin realised by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii) ;

v. The net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction.

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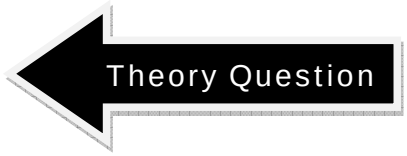
92CA. Reference to transfer pricing officer.



(1) Where any person, being the assessee, has entered into an international transaction in any previous year, and the Assessing Officer considers it necessary or expedient so to do, he may, with the previous approval of the Commissioner, refer the computation of the arm's length price in relation to the said international transaction under section 92C to the Transfer Pricing Officer.

(2) Where a reference is made the Transfer Pricing Officer shall serve a notice on the assessee requiring him to produce or cause to be produced on a date to be specified therein, any evidence on which the assessee may rely in support of the computation made by him of the arm's length price in relation to the international transaction.

(3) On the date specified in the notice, or as soon thereafter as may be, after hearing such evidence as the assessee may produce, including any information or documents and after considering such evidence as the Transfer Pricing Officer may require on any specified points and after taking into account all relevant materials which he has gathered, the Transfer Pricing Officer shall, by order in writing, determine the arm's length price in relation to the international transaction in accordance with 92C and send a copy of his order to the Assessing Officer and to the assessee.

(4) On receipt of the order, the Assessing Officer shall proceed to compute the total income of the assessee under 92C having regard to the arm's length price determined by the Transfer Pricing Officer.

(5) With a view to rectifying any mistake apparent from the record, the Transfer Pricing Officer may amend any order passed by him and the provisions of section 154 shall, so far as may be, apply accordingly.

(6) Where any amendment is made by the Transfer Pricing Officer, he shall send a copy of his order to the Assessing Officer who shall thereafter proceed to amend the order of assessment in conformity with such order of the Transfer Pricing Officer.

(7) The Transfer Pricing Officer may, for the purposes of determining the arm's length price under this section, exercise all or any of the powers specified 131 (Power regarding discovery, production of evidence, etc.) or 133(6) (Power to call for information in relation to banks) .

Penalty Provisions			
Section	Nature of Default	Minimum penalty	Maximum Penalty
271AA	Failure to keep and maintain information and document in respect of international transaction.	2 per cent of the value of each international transaction	-
271BA	Failure to furnish report under section 92E.	Rs. 1,00,000	-
271G	Failure to furnish information or document under section 92D.	2 per cent of the value of international transaction for each failure	-

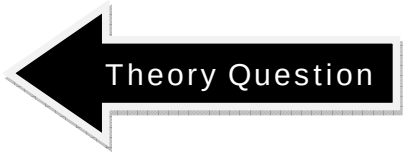
ASSESSMENT OF NON-RESIDENTS

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

"royalty"



"royalty" means consideration including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains" for—

(i) the transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property ;

(ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property ;

(iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property ;

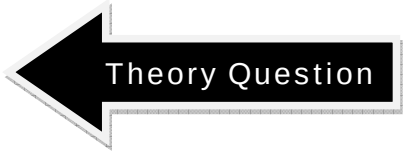
(iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill ;

(iva) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB;

(v) the transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films ; or

(vi) the rendering of any services in connection with the activities referred to in sub-clauses (i) to (iv), (iva) and (v).

technical services



"fees for technical services" means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head "Salaries".

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5) This form with photograph attached send to ***{ KALPESH CLASSES, Diamond Queen Building, 2nd Floor, Office No. 208, 198 Raja Ram Mohan Roy Marg, Above State Bank of India, Prarthana Samaj, Mumbai – 400 004. Maharashtra. India. Tel. : 2382 06 76 (022) Tel. : 2380 11 21 (022) }.*** *Scanned copy of this set may be send at info@kalpeshclasses.com for speedy processing and activation, however hard copy must also be send to us. In case we do not receive the hard copy in 15 days we may temporarily suspend your account without any notice.*

Membership Type	1	2	3
Membership Name	**Free**	**DT**	**IDT**
Description	***Wealth Tax (excluding valuation rules and questions / answers.)***	***Direct Taxes for CA final (Includes membership type 3) (also included 130 + Class work problems and solution)***	***Indirect taxes of CA final. (included +100 Class work problems and solution)***
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Membership commence (May 2011 Exam)	16th May	16th May	16th May
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Web meeting with professor *(From time to time it will be scheduled for solving doubt and important discussion.)*	No	Yes	Yes
E-mail support for handling queries *(generally accepted response time of 48 hours.)*	No	Yes	Yes
Maximum time each video can be Logged in. *(This limit is kept for security purposes. Video Logged in for less then 3 min is not counted for this purpose.)*	10	10	10
Fees (Including taxes if any) ***(Not Refundable in any circumstances.)***	Rs. Nil	Rs. 15,500	Rs. 12,500
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Membership Activation time. *(You can Commence online lectures any time, you are never too late for classes.)*	automatic	48 Hours of payment.	48 Hours of payment.
Study notes in softcopy provided for download. *(*likely to be provided.)*	No	Yes	No*
Membership expiry for May 2011 exam (Respective hours or this date whichever is earlier.)	No	18th May	18th May
New Batch for Nov 2011 Online lectures commence for May 2011 students of CA final.	20th May	20th May	20th May
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Section	115 AC	115ACA	115AD
Assessee	NR	Individual, who is a resident and an employee of an Indian company or its subsidary 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 15 %)
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	30 %	15 % (however basic exemption limit is available) (No deducation 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	

Section	115BBC
Assessee	Any
Income covered	Any income comprising of any anonymous donation received by any assessee on behalf of any university or other educational institution
Rate of tax	30 % Amount in excess of five per cent of the total donations received by the assessee; or one lakh rupees;
TDS	--
Return to be filed	--
deduction u/s 28 to 44C	--
Provisio 1 To 48	NA
Provisio 2 To 48	NA

CHAPTER XII-A INCOMES OF NRI

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.

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. 172 SHIPPING BUSINESS OF NR

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.

Sec 172 now time limit for passing order of NR shipping assessees

No order assessing the income and determining the sum of tax payable thereon shall be made under the said section after the expiry of nine months from the end of the financial year in which the return is furnished.

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)

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.

NR SHIPPING

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.

NR AIRCRAFTS

44BBA. PROFITS AND GAINS OF THE BUSINESS OF OPERATION OF ARICRAFT 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.

NR - POWER PROJECTS

SEC. 44BBB FOREIGN COMPANIES ENGAGED IN THE BUSINESS OF CIVIL CONSTRUCTION, ETC., IN CERTAIN 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.

Section 44BBB Business of Civil Construction in Turnkey Projects by Foreign Company	Amt	Amt
Amt received/Receivable by Foreign Co.		
Service Charges	4.85	
Installation charges	3.61	
Income from Civil construction	16.54	25.00
Business Income u/s 44BBB 10%		2.5

SEC. 44C HEAD OFFICE EXPENDITURE

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 these provisions.

- 32(2), 32A, 33,33A carried forward depreciation
- 36(1)(ix) capital expense on family planning
- 72, 73, 74, 74A carried forward losses
- Deducation under chapter VIA

"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, gra-tuity, 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 ROYALTIES ETC., IN CASE OF NR

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 :

Provided further that the provisions of section 44BB shall not apply in respect of the income referred to in this section.

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.

Section to be applied	PE 44DA	No PE 44BB
Royalty Income	120	120
Less:		
Indian Expense in relation to earn this income (actual)	82	--
Net Income (No presumption to be applied if assessee has place of operation / PE in India.)	38	12

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 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 44D or DA or 115A or 293A apply for the purposes of computing profits or gains or any other income referred to in those sections.

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

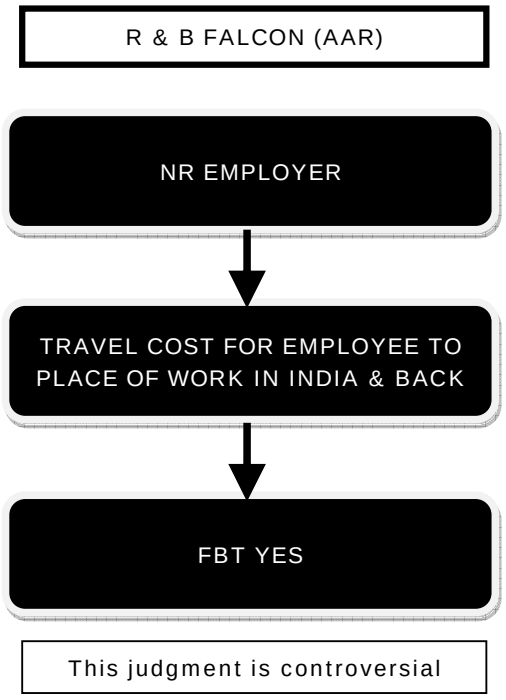
Officer shall proceed to make an assessment of the total income or loss of the assessee under section 143(3) and determine the sum payable by, or refundable to, the assessee.

Section 44BB Business of Exploration of Mineral Oil by Non-Resident	Amt	Amt
Amt received / Receivable by Non-resident Co.		
Rendering service in India	1.85	
Hiring of Plant & Machinery in India	2.16	
Hiring of Plant & Machinery outside India	3.5	7.5
Business Income 10%		0.75

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.

Mobilisation / demobilization charges



The Uttarakhand High Court in CIT v. R & B Falcon Drilling Co. [2009] 181 Taxman 62 held that section 44BB does not exclude the mobilization/demobilization charges paid for transportation of the plant and machinery from a place outside India to the locations in India or its territorial waters over passing the view of the Tribunal that the mobilization/demobilization charges in respect of voyage conducted in the Indian territorial waters only were to be included in the gross revenue and the remaining amount of such charges was not part of the gross revenue for the purpose of computation of income under section 44BB. Yet further the Uttarakhand High Court in CIT v. RBF Rig Corpn. [2009] 181 Taxman 144 also held that reimbursed catering expenses and fuel expenses are parts of gross receipts for purpose of section 44BB.

Presumptive tax covers only the income targeted by the provision. In respect of income from exploration of mineral oil, the presumptive tax provision under section 44BB would have application to a non-resident company which was receiving mobilisation charges by way of reimbursement incurred for transportation of drilling units of rigs from abroad to the drilling spots. It was also found that it was not a case of actual reimbursement of expenditure as claimed, since the consideration was a fixed sum forming part of the business governed by section 44BB. It was so held in Sedco Forex International Inc. (formerly known as Forex Neptune International Inc.) v. CIT [2008] 299 ITR 238 (Uttarakhand).

A circular cannot travel beyond the statute. In the case of an amount falling under the presumptive scheme of taxation as under section 44BB as regards the income from exploration of mineral oil, the

rate prescribed at 10 per cent. has to be followed. Circular No.1767 dated 1st July, 1987 prescribing 1 per cent. in respect of mobilisation charges is, therefore, beyond the Board's powers as held in Sedco Forex International Inc.'s case (supra). The reason for prescribing a lower rate is probably because the service of mobilising rigs for performing drilling operations may not by itself be treated as income from exploration of mineral oil under section 44BB. The lesser rate was prescribed by the Board though for a limited period without any further circular as to its continuation or otherwise. The High Court in CIT v. Trans Ocean Offshore Inc. [2008] 299 ITR 248 (Uttarakhand) held following its earlier decision in Sedco Forex International's case (supra) that the tax should have been levied on 10 per cent. of gross receipts. It further held that the Tribunal was not justified in following a circular which was no longer in force, as it was not renewed. Further, the circular referred to purchases of rigs, etc. made outside India and not for mobilisation service. Apart from the inference as to whether such amount would fall squarely under section 44BB, it would appear that the Board can relax the rigours of the tax in genuine cases under section 119 even as decided by the Supreme Court in UCO Bank v. CIT [1999] 237 ITR 889.

293A POWER OF GOVERNMENT TO MAKE EXEMPTION, ETC.,

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

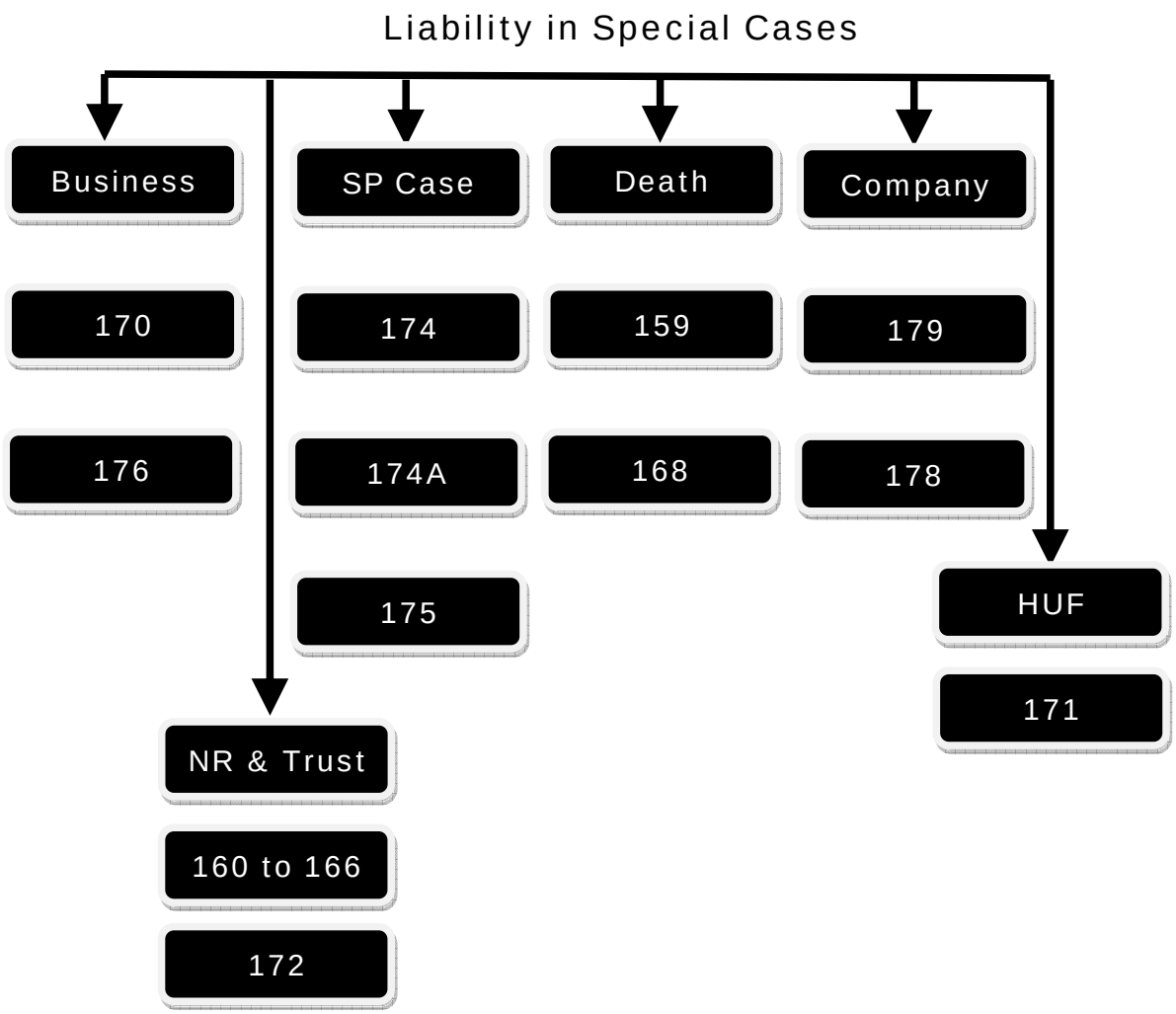
(*a*) Persons with whom the Central Government has entered into agreements for the association or participation of that Government or any person authorised by that Government in any business consisting of the prospecting for or extraction or production of mineral oils;

(*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*).

PART H

LIABILITY IN SPECIAL CASES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SP Case
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174A
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Death
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168
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NR & Trust
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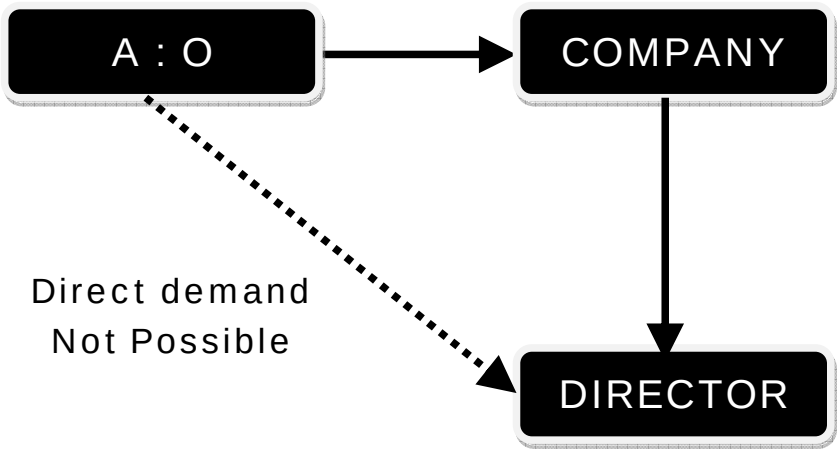
SEC. 179 DIRECTORS OF PRIVATE COMPANY

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



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

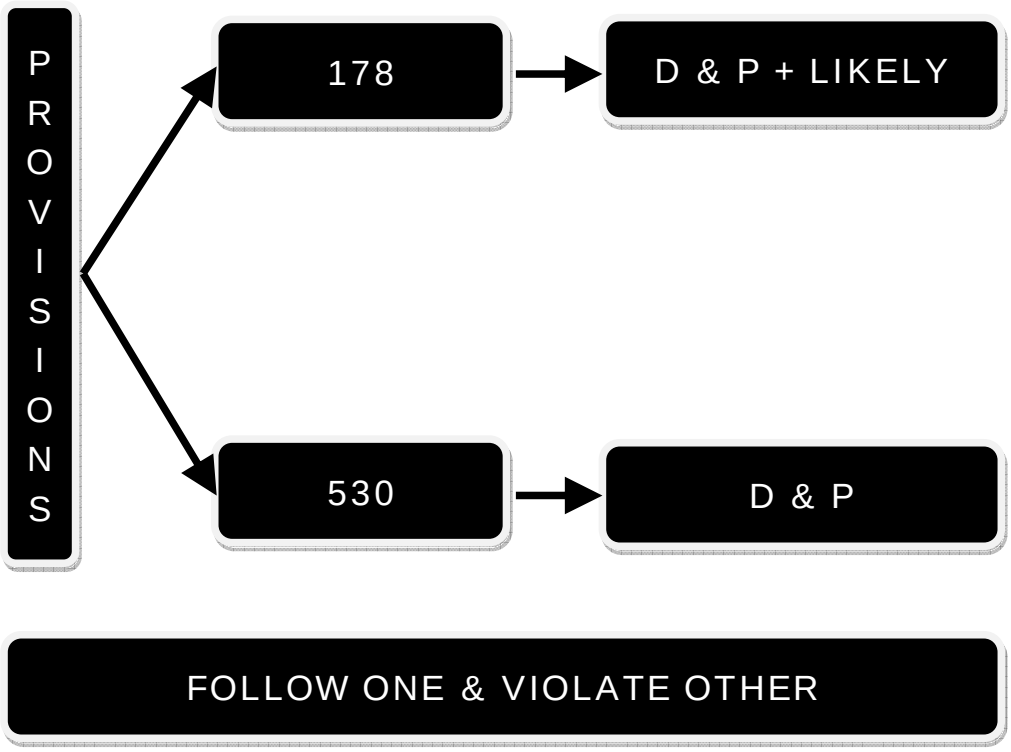
Notice has to be given to the authorities under the Act within 30 days after a person becomes a liquidator. The relevant time to compute the period of limitation would be the date of assumption of duties by the person as liquidator and not the date of the resolution of the company. The notice contemplated 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.

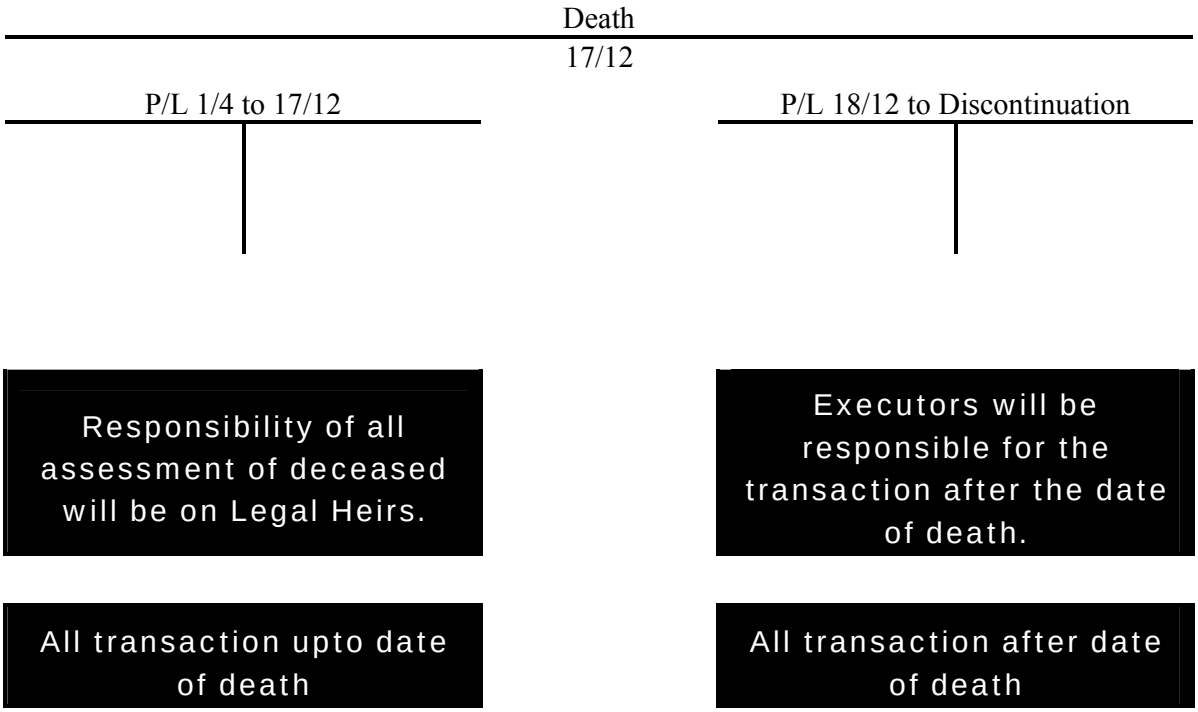
Sec. 178 read with 530(1)(a) of company law

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)



SEC. 159 LEGAL REPRESENTATIVES



Where Mr. X dies leaving Mr. S (son) and wife Mrs. X, and appointed his advocate as executor in will. Legal Heirs will be son and wife and advocate will be executor of will.

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.).

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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)

SEC. 160 REPRESENTATIVE ASSESSEE.

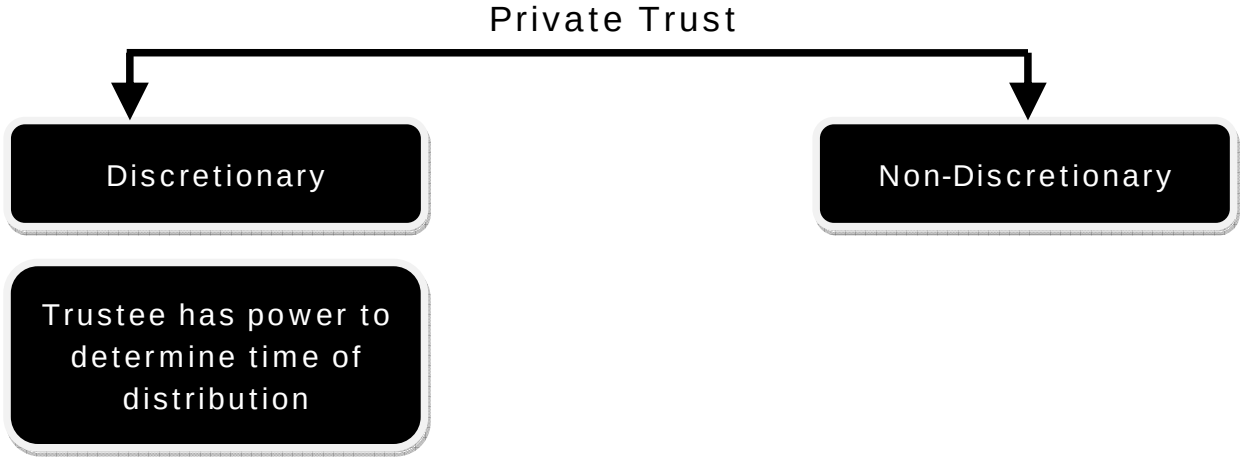
"representative assessee" means

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).



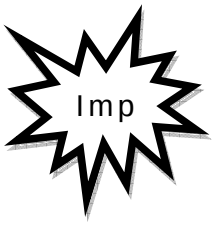
SEC. 163 AGENT OF NON RESIDENT.

"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.

Business connection



"Business connection", is a concept which has given rise to considerable litigation. Mutual interest, rather than mere common interest may constitute business connection. However, transactions between principal and principal and those at arm's length would not constitute business connection. Besides, mere continuous dealing without relationship, creating obligation on each other, would not constitute business relationship.

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

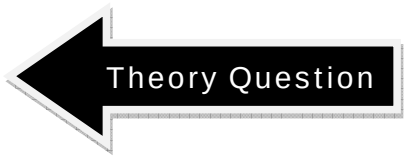
4) The professional connection between the appellants and B was a "business connection" within the meaning of section 9(1).Sections 9(1) and 163 are comprehensive enough to include all heads of income mentioned in section 14.The expression "business" does not necessarily mean trade or manufacture only: 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(l) [also 163] and was liable to be included in his assessment. [1986] 160 ITR 0746B Hazoora 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)

DUTIES AND RIGHTS

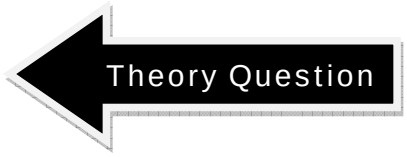
SEC. 161 LIABILITY OF REPRESENTATIVE ASSESSEE.



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.



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.

Direct assessment is not barred

[1999] 236 ITR 0037 MOTI TRUST VS. CIT (SC)

Section 5 of the Act defines the total income of any person to include income received by him or received on his behalf or which accrues or arises to him. A person may be directly assessed in respect of such income. The income of a discretionary trust which is within the accounting year distributed to and received by the beneficiary would, therefore, be subject to assessment in his hands

and tax thereon would be recoverable from him. Such income would squarely fall within the broad sweep of total income under section 5 and the beneficiary would be liable to assessment and recovery of tax thereon under section 4

The word "charged" in the context in which it is used in section 164 means only "levied". Section 164 does not make the trustee of a discretionary trust liable to assessment or the recovery of tax on the income of the trust. It harks back to section 161 when it refers to "persons . . . . liable as representative assessees". It is section 161, therefore, which has to be read to make the trustee even of a discretionary trust liable to assessment and recovery of tax on income received by him as a trustee. Further, section 161 protects the representative assessee by stating that assessment upon him shall be deemed to be only in his representative capacity, by mandating that tax can be levied upon and recovered from him only in like manner and to the same extent as it would be leviable upon and recoverable from the person represented by him and by stating that he may not be assessed under any other provisions of the Act.

Section 166 is clarificatory. It does not empower any assessment or recovery by itself. It only makes it clear that sections 160 to 165 do not bar the direct assessment of the person on whose behalf or for whose benefit the income is receivable or the recovery from such person of the tax payable thereon, provided that is permissible under any other provisions of the Act. But that is not to say that the beneficiary of a discretionary trust, because he does not fall within the ambit of section 166, may not be assessed upon income received by him and tax recovered from him thereon if that is permissible under any other provisions of the Act for section 166 is merely clarificatory.

Conclusion:

The Revenue has the option to assess and recover tax from either the trustees or the beneficiaries of a discretionary trust in respect of such income thereof as has been distributed to and received by the beneficiaries in the course of the accounting year.

RATES OF TAX FOR PRIVATE TRUST

WHERE SHARE OF BENEFICIARIES UNKNOWN. 164



where any income in respect of which the trust or oral trust are liable as representative assessees or any part thereof is not specifically receivable on behalf or for the benefit of any one person or where the individual shares of the persons on whose behalf or for whose benefit such income or such part thereof is receivable are indeterminate or unknown tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate.

Provided that in a case where—

(i) none of the beneficiaries has any other income chargeable under this Act exceeding the maximum amount not chargeable to tax in the case of an association of persons or is a beneficiary under any other trust; or

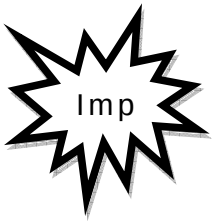
(ii) the relevant income or part of relevant income is receivable under a trust declared by any person by will and such trust is the only trust so declared by him or

(iii) the relevant income or part of relevant income is receivable under a trust created before the 1st day of March, 1970, by a non-testamentary instrument and the Assessing Officer is satisfied, having regard to all the circumstances existing at the relevant time, that the trust was created bona fide exclusively for the benefit of the relatives of the settlor, or where the settlor is a Hindu undivided family, exclusively for the benefit of the members of such family, in circumstances where such relatives or members were mainly dependent on the settlor for their support and maintenance; or

(iv) the relevant income is receivable by the trustees on behalf of a provident fund, superannuation fund, gratuity fund, pension fund or any other fund created bona fide by a person carrying on a business or profession exclusively for the benefit of persons employed in such business or profession,

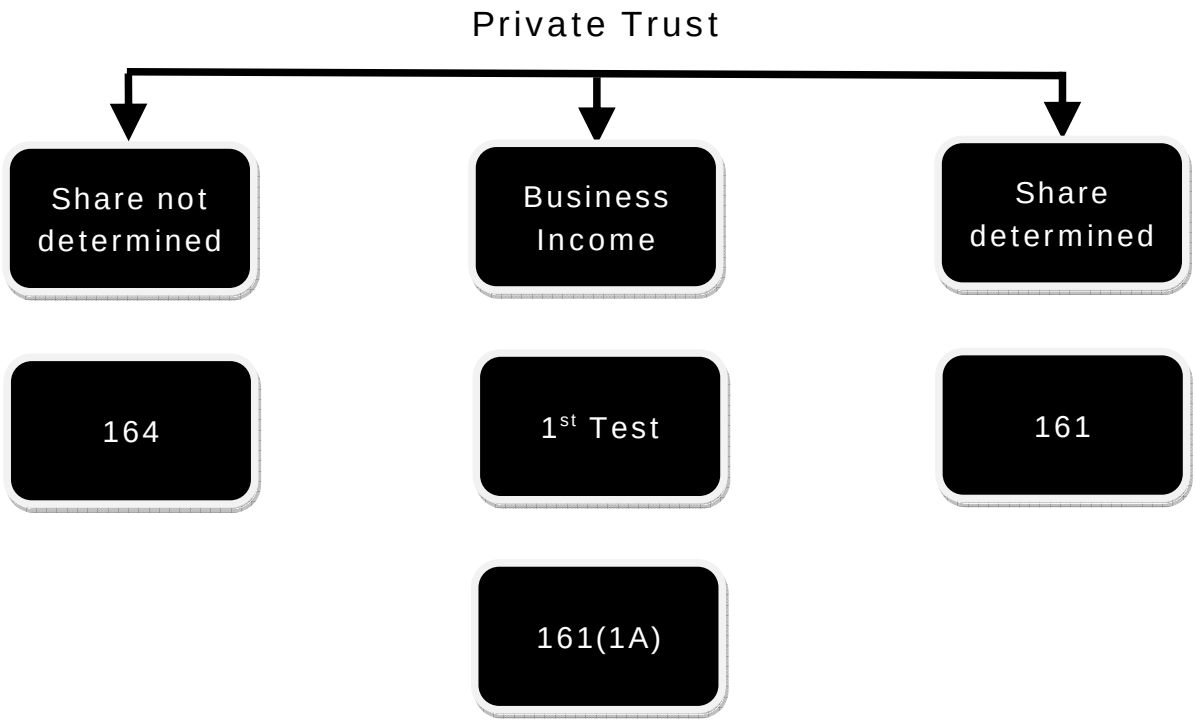
tax shall be charged on the relevant income or part of relevant income as if it were the total income of an association of persons

TRUST WITH BUSINESS INCOME 161(1A)



Where any income in respect of which the trust is liable as representative assessee 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.

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, then MMR rate will not be applicable.


Private Trust
Share not determined
Business Income
Share determined
164
1st Test
161
161(1A)

SEC. 174 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)

P.Y.	A.Y.	Rates of taxes
31.3.03	03/04	RESPECTIVE YEAR
31.3.04	04/05	RESPECTIVE YEAR
31.3.05	05/06	RESPECTIVE YEAR
31.3.06	06/07	RESPECTIVE YEAR
1-4-06 TO 1-8-06	Suppose date of leaving is 01-08-2006 then Based on finance act whether it is approved by legislature or not accordingly the rates of taxes will be applied by the officer. AY = PY	

Read 174 with 160

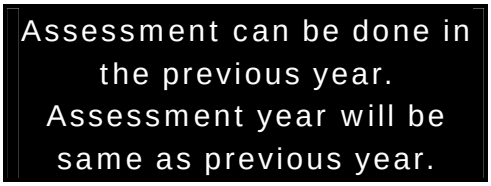
Because the agent of the non-resident firm can be assessed under sections 160 and 163 of the Act, assessment and recovery of the income in the hands of the non-resident principal is not barred. Section 166 clearly indicates that the Income-tax Officer has got the jurisdiction to either assess a non-resident 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 on enabling provision. [1975] 100 ITR 0637- Barium Chemicals Ltd. vs. Income-tax Officer (Andhra Pradesh High Court)

Leaving India

15/12

P/L 1-4 to Event



174A. AOP OR BOI 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.

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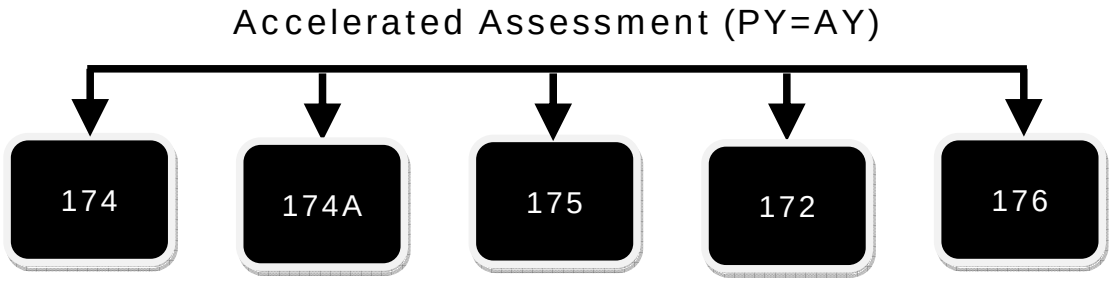
SEC.175 PERSONS LIKELY TO TRANSFER PROPERTY TO AVOID TAX.

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.



ASSESSMENT AFTER PARTITION OF HUF 171

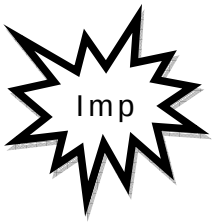
A Hindu family hitherto assessed as undivided shall be deemed for the purposes of this Act to continue to be a Hindu undivided family, except where and in so far as a finding of partition has been given under this section in respect of the Hindu undivided family.

Where, at the time of making an assessment under section 143 or section 144, it is claimed by or on behalf of any member of a Hindu family assessed as undivided that a partition, whether total or partial, has taken place among the members of such family, the Assessing Officer shall make an inquiry thereinto after giving notice of the inquiry to all the members of the family.

On the completion of the inquiry, the Assessing Officer shall record a finding as to whether there has been a total or partial partition of the joint family property, and, if there has been such a partition, the date on which it has taken place.

Assessing Officer finds after completion of the assessment of a Hindu undivided family that the family has already effected a partition, whether total or partial, the Assessing Officer shall proceed to recover the tax from every person who was a member of the family before the partition, and every such person shall be jointly and severally liable for the tax on the income so assessed.

Partial partition is not recognized 171 (9)



Where a partial partition has taken place after the 31st day of December, 1978, among the members of a Hindu undivided family hitherto assessed as undivided, it shall be not recognized. Such family shall continue to be liable to be assessed under this Act as if no such partial partition had taken place;

"partition" means

(i) where the property admits of a physical division, a physical division of the property, but a physical division of the income without a physical division of the property producing the income shall not be deemed to be a partition; or

(ii) where the property does not admit of a physical division, then such division as the property admits of, but a mere severance of status shall not be deemed to be a partition;

"partial partition" means

a partition which is partial as regards the persons constituting the Hindu undivided family, or the properties belonging to the Hindu undivided family, or both.

PART – I

SETTLEMENT COMMISSION

DIVIDEND TAX

PENALTY

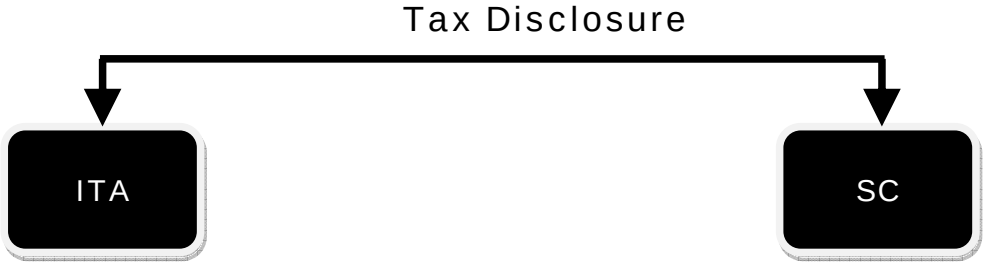
281 / 281B

TRO

ITCC

ADVANCE TAX AND INTEREST

SETTLEMENT COMMISSION

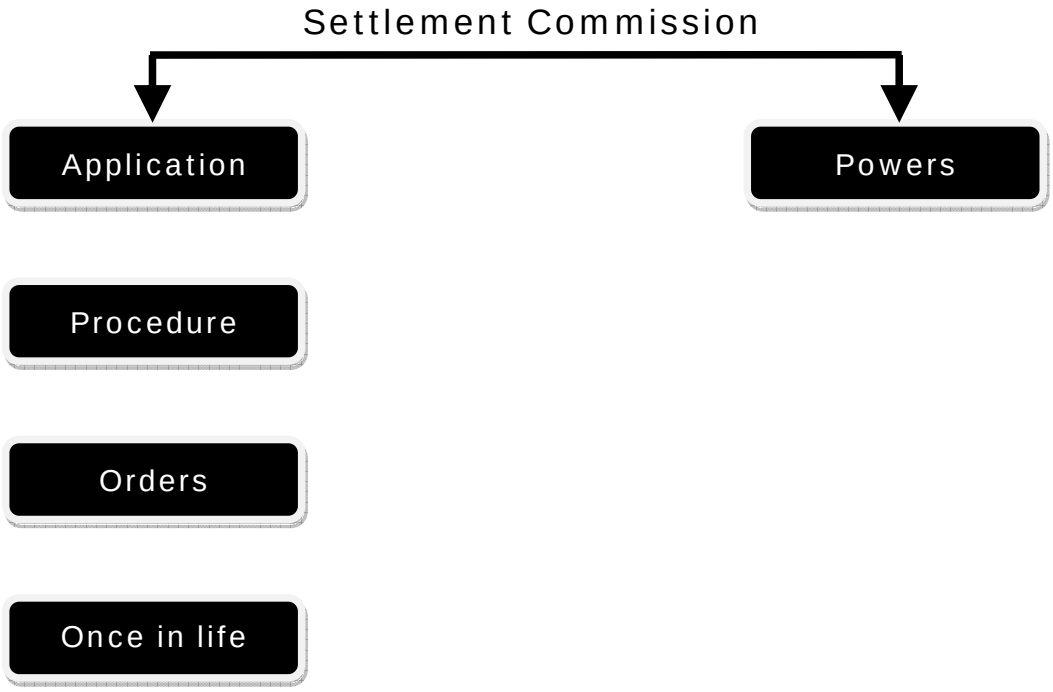


There are umpteen instances, where the Government, after establishing high-powered Commissions/Committees, scuttled their powers and functions later on without mentioning any justifiable reasons. In late sixties, a Commission headed by a retired Chief Justice of India for enquiring some aspects in the functioning of large industrial houses (popularly referred to as Birla Commission) had to be wound up after nearly 7 years without submitting any report because of apathetic attitude of the Government, which apparently did not want the Commission to function efficiently and submit its report. MRTP Commission was established with great enthusiasm in 1969 to curb monopolies, monopolistic and restrictive trade practices, but soon it became disillusioned because the Government stopped referring cases concerning Monopolies and Monopolistic Trade Practices to it and started taking decisions concerning these matters itself. The MRTPC was left only with Restrictive Trade Practices work. Then the Commission concerning Disinvestment of Government's holdings in PSUs was wound up just after a year or so of its setting up as the Government did not find its functioning palatable and decided to take decisions in such matters itself. Till date, the Competition Commission is not fully constituted for reasons best known to every one. There are various other instances of similar nature. The Settlement Commission is the latest casualty of snap decisions. In the later discussion, it is proposed to show how the decision in regard to downgrading the jurisdiction of the Commission is irrational and arbitrary.

Comprehensive settlement mechanism is a hallmark of an advanced tax system. Many of the changes made appear retrograde. These curtail the Commission's powers and status. If only proceedings before the Assessing Officers can be subject-matter of settlement, there seems to be no logic in having a high-powered body, as is at present. Further, the changes made put fetters against comprehensive settlement and more important would make filing and processing of applications for settlement difficult. These would shatter taxpayers' hopes for a correct settlement. The way the changes have been made do not indicate that proper thought has been given to the changes made. These, prima facie, appear to be arbitrary and irrational. The new provisions almost appear as precursor to eventual withdrawal of the settlement provisions.

It takes years to build an institution. But it can be demolished in no time. A building is not pulled down for some small cracks here and there. These are cemented to make the building stronger. However, in the case of the Commission, the changes made are intended to ensure that more cracks may develop so that the building may be pulled down or fall by itself. How far such a policy can be good needs to be pondered and deliberated upon.

In the past three decades, significance and objective of the Settlement Commission has been clipped. It seems that the Government has risen after seeing the numerous pending cases and has tried to simplify the process with speedy settlement but nevertheless making it a bit powerless. The focus is thereby now only at revenue generation.



International scenario

Several countries provide for monetary settlement of tax and waiver of criminal proceedings. In the US, the scope of monetary settlement has been widened to cover all types of frauds including tax frauds. The Internal Revenue Code, 1954, permits the IRS to enter into a written agreement for monetary settlement. Such agreement is final and conclusive unless there is fraud, malfeasance or misrepresentation of material fact.

Constitution of settment commission 245B.

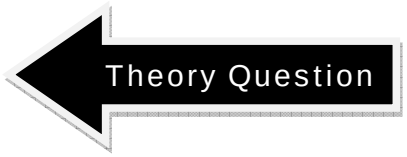
(1) The Central Government shall constitute a Commission to be called the Income-tax Settlement Commission for the settlement of cases.

(2) The Settlement Commission shall consist of a Chairman and as many Vice-Chairmen and other members as the Central Government thinks fit and shall function within the Department of the Central Government dealing with direct taxes.

(3) The Chairman, Vice-Chairman and other members of the Settlement Commission shall be appointed by the Central Government from amongst persons of integrity and outstanding ability, having special knowledge of, and, experience in, problems relating to direct taxes and business accounts:

Provided that, where a member of the Board is appointed as the Chairman, Vice-Chairman or as a member of the Settlement Commission, he shall cease to be a member of the Board.

Jurisdiction and powers of Settlement Commission. / benches of settlement commission 245BA.



The jurisdiction, powers and authority of the Settlement Commission may be exercised by Benches thereof. Bench shall be presided over by the Chairman or a Vice-Chairman and shall consist of two other Members. The Bench for which the Chairman is the Presiding Officer shall be the principal Bench and the other Benches shall be known as additional Benches. The Chairman may authorise the Vice-Chairman or other Member appointed to one Bench to discharge also the functions of the Vice-Chairman or, as the case may be, other Member of another Bench.

When one of the persons constituting a Bench (whether such person be the Presiding Officer or other Member of the Bench) is unable to discharge his functions owing to absence, illness or any other cause or in the event of the occurrence of any vacancy either in the office of the Presiding Officer or in the office of one or the other Members of the Bench, the remaining two persons may function as the Bench and if the Presiding Officer of the Bench is not one of the remaining two persons, the senior among the remaining persons shall act as the Presiding Officer of the Bench :

Provided that if at any stage of the hearing of any such case or matter, it appears to the Presiding Officer that the case or matter is of such a nature that it ought to be heard of by a Bench consisting of three Members, the case or matter may be referred by the Presiding Officer of such Bench to the Chairman for transfer to such Bench as the Chairman may deem fit.

The Chairman may, for the disposal of any particular case, constitute a Special Bench consisting of more than three Members.

The places at which the principal Bench and the additional Benches shall ordinarily sit shall be such as the Central Government may, by notification in the Official Gazette, specify and the Special Bench shall sit at a place to be fixed by the Chairman.

In the event of the occurrence of any vacancy in the office of the Chairman by reason of his death, resignation or otherwise, the Vice-Chairman or, as the case may be, such one of the Vice-Chairmen as the Central Government may, by notification in the Official Gazette, authorise in this behalf, shall act as the Chairman until the date on which a new Chairman, appointed in accordance with the provisions of this Chapter to fill such vacancy, enters upon his office.

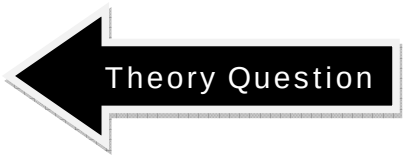
When the Chairman is unable to discharge his functions owing to absence, illness or any other cause, the Vice-Chairman or, as the case may be, such one of the Vice-Chairmen as the Central Government may, by notification in the Official Gazette, authorise in this behalf, shall discharge the functions of the Chairman until the date on which the Chairman resumes his duties.

On the application of the assessee or the Chief Commissioner or Commissioner and after notice to them, and after hearing such of them as he may desire to be heard, or on his own motion without

such notice, the Chairman may transfer any case pending before one Bench, for disposal, to another Bench.

If the Members of a Bench differ in opinion on any point, the point shall be decided according to the opinion of the majority, if there is a majority, but if the Members are equally divided, they shall state the point or points on which they differ, and make a reference to the Chairman who shall either hear the point or points himself or refer the case for hearing on such point or points by one or more of the other Members of the Settlement Commission and such point or points shall be decided according to the opinion of the majority of the Members of the Settlement Commission who have heard the case, including those who first heard it.

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	It is now provided that after 31-5-2007, an assessee can make an application to the Commission only during the pendency of the proceedings before the Assessing Officer. Further, an assessee shall not be allowed to make the application before the Commission during the pendency of the following proceedings of assessment :  (a) Assessment/reassessment proceedings in response to a notice u/s.148. (c) Proceedings of making fresh assessment where original assessment was set aside u/s.254 by the ITA Tribunal or u/s.263 or S. 264 by the Commissioner, Provided that no such application shall be made unless,— (i) in a case where proceedings for assessment or reassessment for any of the assessment years referred to section 153A or section 153B the additional amount of income-tax payable on the income disclosed in the application exceeds fifty lakh rupees, (ii) in any other case, the additional amount of income-tax payable on the income disclosed in the application exceeds ten lakh rupees, and such tax and the interest thereon, has been paid on or before the date of making the application and the proof of such payment is attached with the application.
Payment of taxes	Now such tax along with interest, if any, should be paid on or before the date of making the application and proof of such payment should be attached with the application.

Intimation to officer	It is also provided that the applicant shall intimate to the Assessing Officer in the prescribed manner.
Immediate Quick procedure	It is now provided that the Settlement Commission, within 7 days of receipt of the application, shall issue a notice to the applicant to explain as to why his application be admitted. After hearing the applicant, within 14 days from the end of receipt of the application, the Settlement Commission shall pass an order for rejecting the application or allowing the application to be proceeded with. Complexity of the investigation involved in a case shall not be the criteria for admitting or rejecting the application. Further, where no order of rejection or admission of an application is passed within the aforesaid period, the application shall be deemed to have been allowed to be proceeded with.
	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.
1st Report of CIT	If an application made on or after 1-6-2007 is allowed to be proceeded, the Settlement Commission shall issue a notice to the Commissioner within 30 days from the date on which the application was received. The Commissioner shall send his report within 30 days from the date on which the communication from the Settlement Commission is received by him;
Invalidating application based on report of CIT	On receipt of the report of the Commissioner, the Settlement Commission shall hear the applicant and the Commissioner within fifteen days from the date of receipt of the report. If it is found that the application was not a valid application, the Commission by passing an order may declare the application as invalid. Copy of the order declaring an application as invalid will have to be sent to the applicant and the Commissioner. In case an application is declared invalid the proceedings before the Commission shall abate. If the Commissioner does not send the report within the specified period, the Commission may proceed in the matter further without the report of the Commissioner.

245d. Procedure on receipt of an application.

Theory Question

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 assessed 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.

Orders of the settlement commission

Theory Question

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.
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.
Time limit for order	The Commission shall, after giving an opportunity to the Commissioner and to the applicant and considering the reports of the Commissioner and other material available with it, pass the settlement order. It is now provided that the Commission shall pass such order within 18 months from the end of month in which the application was received.

Powers of the settlement commission

Theory Question

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
No immunitiy from IPC.	It is provided that the Commission shall not grant immunity from prosecution under any law other than the Income-tax Act and Wealth-tax Act.
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 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.

If rejected or invalidated case send back to cit

It is now provided that if the application made on or after 1-6-2007 is rejected or such application or an application is declared the proceedings before the Commission shall abate and the Assessing Officer or the Income- tax Authority before whom the proceedings were pending at the time of making the application, as the case may be, shall resume and complete the proceedings.

Once in lifetime application only

It is also provided that after 1-6-2007, an assessee can apply for settlement only once during his lifetime. For this purpose, an application which was not admitted shall not be deemed to be an application.

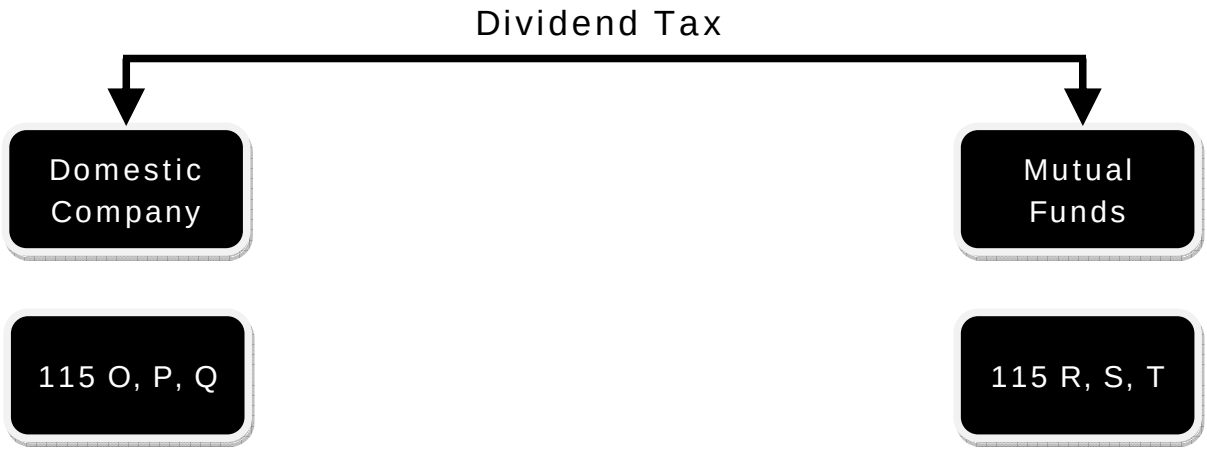
Proceedings are not confined to income disclosed

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)

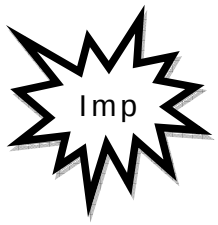
TAX ON DISTRIBUTED PROFITS OF DOMESTIC COMPANIES.



	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	15 %	25 % for money market mutual fund 12.5 % if payee is Individual or HUF (other then money market mutual fund) 20 % for others (other then money market mutual fund)
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.
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.	"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 65 % of the total proceeds of such fund:

Inter corporate dividend adjustment



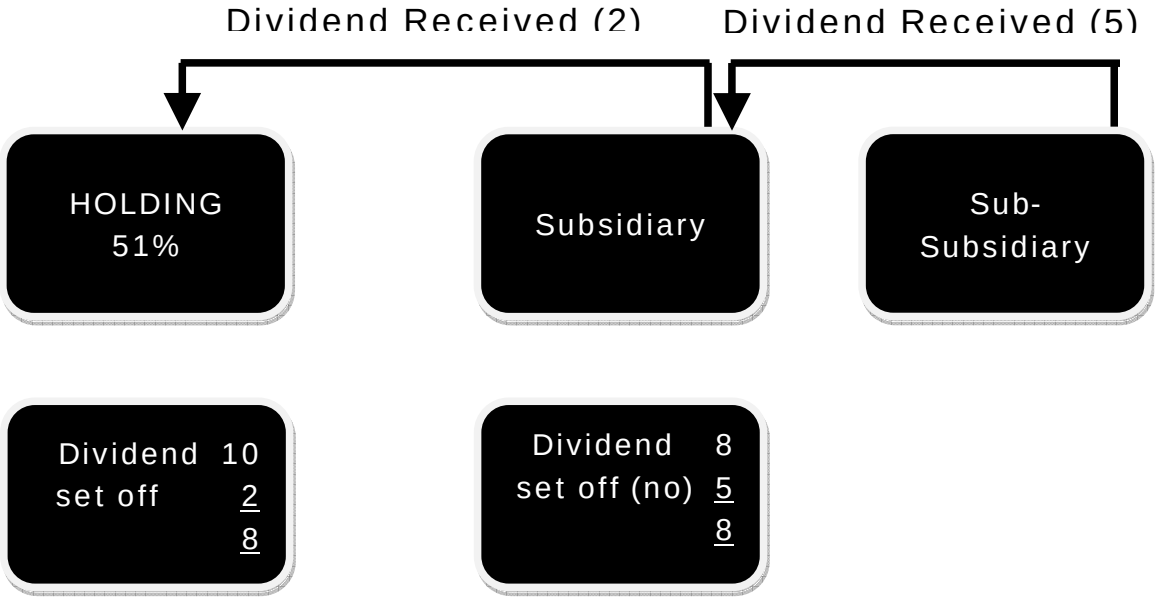
The amount dividend shall be reduced by, The amount of dividend, if any, received by the domestic company during the financial year, if

(a) such dividend is received from its subsidiary;

(b) the subsidiary has paid tax under this section on such dividend; and

(c) the domestic company is not a subsidiary of any other company (Provided that the same amount of dividend shall not be taken into account for reduction more than once)

Company shall be a subsidiary of another company, if such other company, holds more than half in nominal value of the equity share capital of the company.

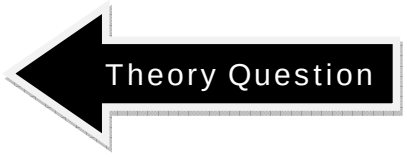


Payments to new pension trust no dividend tax

The amount of dividend, if any, paid to any person for, or on behalf of, the New Pension System Trust referred to in 10 (44).

PENALTY

Mens rea an ingredient of concealment



The question of *mens rea* or wrong intention of the assessee in furnishing of wrong particulars of his income still had to be taken account of for levy or deletion of penalty. The position remains the same even after omission of this word as the word 'concealment' itself involves the state of mind of the assessee in disclosing his income in the return. In many cases, the absence of *mens rea* or wrong intention has been taken into account to deal with the levy or cancellation of penalty under section 271(1)(*c*). This issue can be explained with the help of relevant case laws which are as under :

In Dahod Sahakari Kharid Vechan Sangh Ltd. v. CIT [2006] 282 ITR 321/[2005] 149 Taxman 456 (Guj.), the assessee withdrew from insurance scheme and received refund which was not shown as income but was credited to gratuity fund by mistake. The High Court held that it was simply a mistake of accounting. The amount was duly shown in the books of account but under wrong head and the same was reflected in its balance sheet. It was a case of Co-op. Society which was governed by a Board. No personal interest can be attributed to any member of the Board. As such the very ingredient of mens rea was absent. In this case, the Court took support from two case laws. One was the case of National Textiles v. CIT [2001] 249 ITR 125/114 Taxman 203 (Guj.).

The other case was of K.C. Builders v. Asstt. CIT [2004] 265 ITR 562/135 Taxman 461 (SC), in which it was observed

> "The word 'concealment' inherently carried with it the element of *mens rea.* Therefore, the mere fact that some figure or some particulars have been disclosed by itself, even if it takes out the case from the preview of furnishing inaccurate particulars. Mere omission from the return of an item of receipt does neither amount to concealment nor deliberate furnishing of inaccurate particulars of income unless and until there is some evidence to show or some circumstances found from which it can be gathered that the omission was attributable to an intention or desire on the part of the assessee to hide or conceal the income so as to avoid the imposition of tax thereon. In order that a penalty under section 271(1)(*iii*) may be imposed, it has to be proved that the assessee has consciously made the concealment or furnished inaccurate particulars of his income. . . ."

Taking support from these two decisions, the Court held that in the circumstances of the case, penalty for concealment was not leviable.

In Dy. CIT v. Rural Electrical Co-op. Society Ltd. [2005] 279 ITR 319/[2006] 152 Taxman 237 (MP), in assessment year 1987-88, due to non-disclosure of one entry, certain additions were made to the income. Penalty proceedings were initiated. The assessee explained that the accounts were prepared in head office and the amount concerned was credited to reserve account in place of profit and loss account. It was held that every concealment does not attract the rigour of section 271(1)(*c*). It must be deliberate and intentional being in the knowledge of the assessee to evade payment of income-tax. The assessee was a Government of India undertaking. Due to above facts, it was found that there was no intention on the part of the assessee to conceal any income. The penalty was cancelled and the Court affirmed such decision.

In Bharat Rice Mill v. CIT [2005] 278 ITR 599/148 Taxman 145 (All.), by mistake, the assessee did not disclose the closing stock in the year under consideration but it was disclosed in the accounts of

subsequent year as opening stock. It was held as an inadvertent mistake in accounting and the penalty levied was cancelled. The value of closing stock was included in the income of the assessee by way of reassessment proceedings. A catena of decisions was considered in this case. But the main case relied upon by the Court in cancelling the penalty was the decision of Supreme Court in *K.C. Builders'* case (*supra*) in which it was held that the word 'concealment' inherently carries with it the element of *mens rea*, which was held to be absent in the present case being an inadvertent mistake in accounting.

'Mens rea'—whether relevant consideration

While acknowledging the decisions in various cases which clearly lay down that in considering a question of penalty, *mens rea* is not a relevant consideration, the Supreme Court remarked that even assuming that when the statute says that one is liable for penalty if one furnishes inaccurate particulars, it may or may not by itself be held to be enough if the particulars furnished are found to be inaccurate is anything more needed but the question would still be as to whether reliance placed on some valuation of an approved valuer and, therefore, the furnishing of inaccurate particulars was not deliberate, meaning thereby that an element of *mens rea* is needed before penalty can be imposed, would have received serious consideration in the light of a large number of decisions of the Court.

'Conceal' and 'inaccurate' -

The Supreme Court observed that the expression 'conceal' is of great importance. According to *Law Lexicon*, the word 'concealed' means :

"to hide or keep secret. The word 'conceal' is con + celare which implies to hide. It means to hide or withdraw from observation; to cover or keep from sight; to prevent the discovery of; to withhold knowledge of. The offence of concealment is, thus, a direct attempt to hide an item of income or a portion thereof from the knowledge of the income-tax authorities."

In *Webster's Dictionary,* 'inaccurate' has been defined as :

> "not accurate, not exact or correct, not according to truth; erroneous; as an inaccurate statement, copy or transcript."

It signifies a deliberate act or omission on the part of the assessee. Such deliberate act must be either for the purpose of concealment of income or furnishing of inaccurate particulars.

'Concealment of income' and 'furnishing of inaccurate particulars' are different. Both concealment and furnishing of inaccurate particulars refer to deliberate act on the part of the assessee. A mere omission or negligence would not constitute a deliberate act of *suppressio veri* or *suggestio falsi*. Although it may not be very accurate or apt but *suppressio veri* would amount to concealment, *suggestio falsi* would amount to furnishing of inaccurate particulars. Accordingly, the deletion of the word 'deliberately' was not of much significance. But what is material is its application.

Supreme Court in UOI v. Dharamendra Textile Processors [2008] 306 ITR 277/174 Taxman 571, wherein it has been held that wilful concealment is not an essential ingredient for attracting civil liability.

Further today in the online E-filing of returns, there is no place to include any notes to income-tax return or to include any explanations in respect of any legal position taken by the assessee on a

specific claim while filing the return of income. Under the Income-tax Act, there are many issues which are debatable and, hence, assessee takes a legal position based on judicial pronouncements existing at the time of filing returns. An assessee would prefer making a claim in a transparent manner by providing on record all relevant facts, reasonings and relevant judicial pronouncements. However, in absence of an opportunity to submit such an explanation (through online e-filing of returns), the assessee is clearly losing the opportunity to provide proper explanations and is exposed to the vagaries of penalties levied by the Assessing Officers whimsically even on the genuine claims made by him.

Based on the above, in today's scenario, it appears that once additions/disallowances are made in the assessment orders, there is no onus on the department to prove that the assessee has concealed his income or furnished inaccurate particulars. The onus is entirely on the assessee to prove his *bona fides.* The Assessing Officers merrily just have to mention 'Initiate penalty proceedings under section 271(1)(*c*) of the Income-tax Act'.

In today's world where transparency and governance are provided highest ratings, to make the law fair and just for the assessees following should be considered :

- The Assessing Officers should mandatorily provide reasons for initiation of penalty proceedings. This will also bring discipline with the Assessing Officers to genuinely initiate penalty proceedings where assessee has really concealed his income or has furnished inaccurate particulars and avoid to some extent ill-motivated initiation of penalty proceedings. Penalty proceedings should not just be initiated on each and every addition/disallowance made in the assessment order.
- Penalty provision requires strict adherence and, hence, the onus to prove that there was concealment of income with a view to avoid tax, should be on the department. Penalty should only be levied in cases where *mens rea* exists.
- Opportunity should be provided at the time of filing return of income to the assessee to provide full explanations and reasonings in respect of the claims made in the income-tax return.

This would certainly help the genuine and honest taxpayers in the long way and at the same time provide department with a level-playing opportunity to prove in case assessee has really concealed the income or has furnished inaccurate particulars.

Keeping in view the wisdom of philosopher Plato 'When there is an income-tax, the just man will pay more and the unjust less, on the same amount of income', it is imperative for the Government to empower tax administration with adequate provisions to limit the unjust. It is only natural and proper to accept that taxpayers prefer to pay taxes honestly to be free and unburdened, being on the safer side of law.

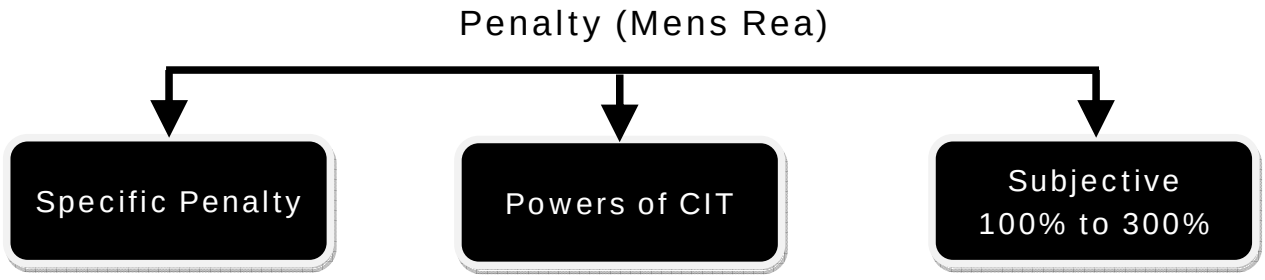
Every Government wants to collect maximum revenue via voluntary compliance. It is, however, worth noting the observation of Chief Justice Sabyasachi Mukherjee of the Supreme Court in the case of CWT v. Arvind Narotam [1988] 173 ITR 479/39 Taxman 368 :

> "It is true that the tax avoidance in a developing economy should not be encouraged on practical as well as ideological grounds. One would wish, as noted by Reddy J., that one could get the enthusiasm of Justice Holmes that taxes are the price of civilization and one would like to buy civilization. But the question which many ordinary taxpayers very often ask is, does he with taxes buy civilization or does he facilitate the waste and ostentation of the few. Unless waste and ostentation in Government spending are avoided or eschewed no amount of moral sermon would change people's attitude to tax avoidance."

Section	Nature of Default	Minimum penalty	Maximum Penalty
140A(3)	Failure to pay whole or any part of income-tax or interest or both in accordance with the provisions of section 140A(1).	Such amount as the Assessing Officer may impose [Sec. 221(1)]	Tax in arrears
158BFA	Failure to furnish in time return to total income including undisclosed income in respect of search initiated under section 132/132A after December 31, 1997	Amount of tax leviable	300 per cent of the amount of tax leviable
221(1)	Default in making payment of tax within prescribed time	Such amount as the Assessing Officer may impose	Tax in arrears
271(1)(b)	Failure to comply with a notice under sections 115WD(2), 115WE(2), 142(1), 143(2) or with a direction issue under section 142(2A) (Note 1)	Rs. 10,000 for each failure	Rs. 10,000 for each failure
271(1)(c)	Concealment of particulars of income or fringe benefits or furnishing of inaccurate particulars of income or fringe benefits (Note 1)	100% of tax sought to be evaded	300% of amount of tax sought to be evaded
271(4)	Distribution of profit by registered firm otherwise than in accordance with partnership deed and as a result of which partner has returned income below the real income.	Up to 150 per cent of the difference between tax on partner's income assessed and tax as income returned	150 per cent of such difference
271A	Failure to keep or maintain books of account, documents, etc., as required under section 44AA	Rs. 25,000	Rs. 25,000
271AA	Failure to keep and maintain information and document in respect of international transaction	2 per cent of the value of each international transaction	-
271AAA	Undisclosed income in the case of search (applicable if search is initiated on or after June 1, 2007)	Note No. 2	Note No. 2
271B	Failure to get accounts audited under section 44AB or furnish said report as required under section 44AB	½ % of the total sales, turnover, or gross receipts	Rs. 1,50,000
271BA	Failure to furnish report under section 92E	Rs. 1,00,000	-

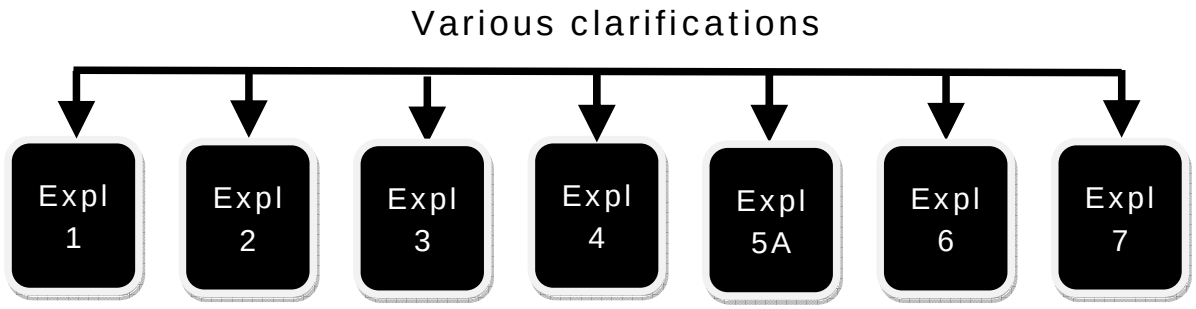
271C	Failure to deduct the whole or any part of tax as required under section 192 to 196C or (with effect from June1, 1997) if any person fails to pay tax on dividends under section 115-O or under second proviso to section 194B	Amount of tax which such person has failed to deduct or pay	-
271CA	Penalty for failure to collect tax at source	Amount of tax which a person has failed to collect	-
271D	Taking or accepting any loan or deposit in contravention of the provisions of section 269SS	Amount of loan/deposit taken or accepted	-
271E	Repaying any deposit or loan or deposit referred to in section 269T otherwise than in accordance with the provisions of section 269T	Amount of deposit so repaid	-
271F	Failure to furnish return of income as required by section 139 before the end of the relevant assessment year	Rs. 5,000	-
271F	Failure to furnish return of income under proviso to section 139 on or before the end of the assessment year	Rs. 5,000	-
271FA	Failure to furnish annual information return	Rs. 100 for each day of default	-
271FB	Failure to furnish return of fringe benefits	Rs. 100 for each day of default	-
271G	Failure to furnish information or document under section 92D	2 per cent of the value of international transaction for each failure.	
272A(1)(a)	Failure to answer any question put to a person (who is legally bound to state the truth of any matter touching the subject of his assessment) by an income-tax authority.	Rs. 10,000 for each default	Rs. 10,000 for each default
272A(1)(b)	Failure to sigh any statement made by a person in course of income-tax proceeding	Rs. 10,000 for each default	Rs. 10,000 for each default

272A(1)(c)	Failure to comply with summons issued under section 13(1) to attend office to give evidence and produce books of account or other documents.	Rs. 10,000 for each default	Rs. 10,000 for each default
272A(1)(d)	Failure to comply with the provisions of section 139A (omitted from June 1, 2002)	Rs. 10,000 for each default	Rs. 10,000 for each default
272A(2)	Failure to comply with a notice issued under section 94; to give notice to discontinuance of business/profession under section 176(3); to furnish returns/ statements mentioned in section 133, 206, 206C or 285B; to allow inspection of register referred to in section 134 (or of any entry in such register or to allow copies of such register to be taken); to furnish return of income under section 139(4A) or 139(4C) or to deliver in due time a declaration mentioned in section 197A; to furnish a certificate as required in section 203 or 206C; to deduct and pay tax under section 226; to furnish a statement under section 192(2C); to deliver a copy of declaration referred to in section 206C(1A); to deliver within time a statement referred to in section 200(3) or 206C(3) or to deliver quarterly return under section 206A(1)	Rs. 100 for everyday during which default continues	Rs. 100 for every day during which default continues
272AA	Failure to comply with the provisions of section 133B	upto Rs. 1,000	Rs. 1,000
272B	Failure to comply with provisions of section 139A	Rs. 10,000	-
272BB(1)	Failure to comply with the provisions of section 230A	Upto Rs. 10,000	Rs. 10,000
272BB(1A)	Failure to quote tax deduction or collection number	Rs. 10,000	-
272BBB	Failure to comply with provisions of section 206CA	Rs. 10,000	-

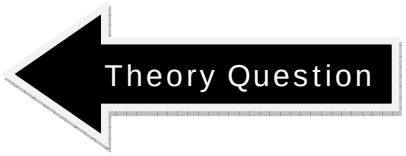

Penalty (Mens Rea)
Specific Penalty
Powers of CIT
Subjective
100% to 300%

Note no. 1

Penalty u/s 271, various clarification about concealed income or tax evaded, etc.



Explanation 1



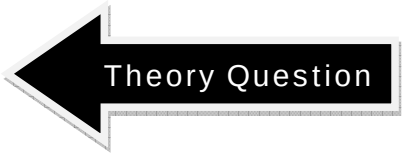
Where in respect of any facts material to the computation of the total income of any person under this Act,

(*A*) such person fails to offer an explanation or offers an explana- tion which is found by the Assessing Officer or Commissioner (Appeals) or the Commissioner to be false, or

(*B*) such person offers an explanation which he is not able to substantiate and fails to prove that such explanation is *bona fide* and that all the facts relating to the same and material to the computation of his total income have been disclosed by him

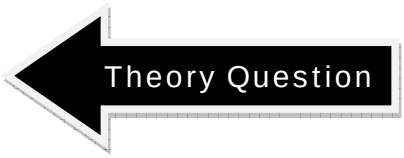
Then, the amount added or disallowed in computing the total income of such person as a result thereof shall, for the purposes of clause (*c*) of this sub-section, be deemed to represent the income in respect of which particulars have been concealed.

Explanation 2



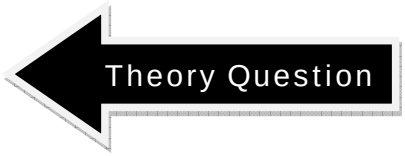
Where the source of any receipt, deposit, outgoing or investment in any assessment year is claimed by any person to be an amount which had been added in computing the income or deducted in computing the loss in the assessment of such person for any earlier assessment year or years but in respect of which no penalty had been levied, that part of the amount so added or deducted in such earlier assessment year immediately preceding the year in which the receipt, deposit, outgoing or investment appears (such earlier assessment year hereafter in this *Explanation* referred to as the first preceding year) which is sufficient to cover the amount represented by such receipt, deposit or outgoing or value of such investment (such amount or value hereafter in this *Explanation* referred to as the utilised amount) shall be treated as the income of the assessee, particulars of which had been concealed or inaccurate particulars of which had been furnished for the first preceding year; and where the amount so added or deducted in the first preceding year is not sufficient to cover the utilised amount, that part of the amount so added or deducted in the year immediately preceding the first preceding year which is sufficient to cover such part of the utilised amount as is not so covered shall be treated to be the income of the assessee, particulars of which had been concealed or inaccurate particulars of which had been furnished for the year immediately preceding the first preceding year and so on, until the entire utilised amount is covered by the amounts so added or deducted in such earlier assessment years.

Explanation 3.



Where any person fails, without reasonable cause, to furnish within the period of section 153 a return of his income which he is required to furnish under section 139 in respect of any assessment year, and until the expiry of the period aforesaid, no notice has been issued to him under 142 (1) or 148 and the Assessing Officer or the Commissioner (Appeals) is satisfied that in respect of such assessment year such person has taxable income, then, such person shall, be deemed to have concealed the particulars of his income in respect of such assessment year, notwithstanding that such person furnishes a return of his income at any time after the expiry of the period aforesaid in pursuance of a notice under section 148.

Explanation 4 "the amount of tax sought to be evaded"

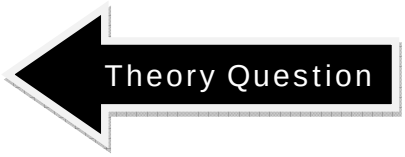


(*a*) in any case where the amount of income in respect of which particulars have been concealed or inaccurate particulars have been furnished has the effect of reducing the loss declared in the return or converting that loss into income, means the tax that would have been chargeable on the income in respect of which particulars have been concealed or inaccurate particulars have been furnished had such income been the total income.

(*b*) in any case to which *Explanation 3* applies, means the tax on the total income assessed as reduced by the amount of advance tax, tax deducted at source, tax collected at source and self-assessment tax paid before the issue of notice under section 148.

(*c*) in any other case, means the difference between the tax on the total income assessed and the tax that would have been chargeable had such total income been reduced by the amount of income in respect of which particulars have been concealed or inaccurate particulars have been furnished.

Explanation 5A



Where, in the course of a search initiated under section 132 on or after the 1st day of June, 2007, the assessee is found to be the owner of

(*i*) any money, bullion, jewellery or other valuable article or thing (hereafter in this *Explanation* referred to as assets) and the assessee claims that such assets have been acquired by him by utilising (wholly or in part) his income for any previous year; or

(*ii*) any income based on any entry in any books of account or other documents or transactions and he claims that such entry in the books of account or other documents or transactions represents his income (wholly or in part) for any previous year,

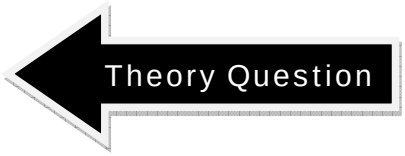
which has ended before the date of search and,—

(*a*) where the return of income for such previous year has been furnished before the said date but such income has not been declared therein; or

(*b*) the due date for filing the return of income for such previous year has expired but the assessee has not filed the return,

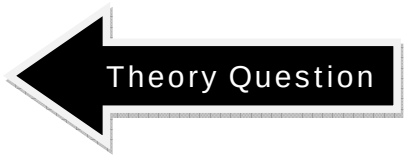
then, notwithstanding that such income is declared by him in any return of income furnished on or after the date of search, he shall, for the purposes of imposition of a penalty, be deemed to have concealed the particulars of his income or furnished inaccurate particulars of such income.

Explanation 6.



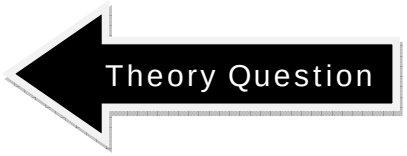
Where any adjustment is made in the income or loss declared in the return under the proviso to section 143(1)(a) and additional tax charged under that section, the provisions of this section shall not apply in relation to the adjustment so made. (for the old provision thus for adjustments of 143(1) today this is not applicable.)

Explanation 7



Where in the case of an assessee who has entered into an international transaction defined any amount is added or disallowed in computing the total income as transfer pricing income, then, the amount so added or disallowed shall, be deemed to represent the income in respect of which particulars have been concealed or inaccurate particulars have been furnished, unless the assessee proves to the satisfaction of the Assessing Officer or the Commissioner (Appeals) or the Commissioner that the price charged or paid in such transaction was computed in accordance with the provisions contained in section 92C and in the manner prescribed under that section, in good faith and with due diligence.

NOTE NO. 2 -- PENALTY IN CONCEALMENT SECTION 271AAA-



Section 271AAA is applicable if
a search is initiated under section 132 on or after June 1, 2007
there is some "undisclosed income", and
undisclosed income pertains to a "specified previous year".

What is the quantum of concealment penalty – If the above conditions are satisfied, 10 per cent of "undisclosed income" of the "specified previous year" is concealment penalty which can be imposed by the Assessing Officer in addition to tax. If section 271AAA is applicable, penalty under section 271(1)(c) cannot be imposed.

Is it possible to avoid the aforesaid penalty [Section 271AAA(2)] – The aforesaid penalty of 10 percent of "undisclosed income" of the "specified previous year" can be avoided if the following conditions are satisfied-

1. If the assessee in a statement under section 132(4) in the course of the search, admits the undisclosed income.
2. Further, he specifies the manner in which such income has been derived.
3. He substantiates the manner in which the undisclosed income was derived.
4. He pays the tax, together with interest, if any, in respect of the undisclosed income.

If the above 4 conditions are satisfied penalty under section 271AAA (i.e., 10 per cent of "undisclosed income" of the "specified previous year") can be avoided. under section 271(1)(c) even if such income is declared by the taxpayer in any return of income which is furnished on or after the date of search.

ACCEPTANCE OF LOANS OR DEPOSITS

SEC. 269SS MODE 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.

Book entries not liable for penalty

[2002] 253 ITR 0103- CIT VS. GOVIND KUMAR (RAJ)

The Commissioner (Appeals) came to the conclusion that the book entries made by the assessee with reference to the payment made on its behalf by the other party was at the most a type of accommodation or loan and not a deposit which otherwise is contemplated by section 269T and held that there was no justification in treating the assessee to have contravened the provisions 269T.

No penalty for reasonable cause

[2003] 260 ITR 0590- CIT VS. MANOJ LALWANI (RAJ)

"no penalty shall be imposable on the person or the assessee, as the case may be, for any failure if he proves that there was reasonable cause for the said failure", will have its full operation. Section 273B permits the assessing authority not to impose a penalty under section 271D. Under section 273B a judicial discretion is left with the assessing authority not to levy a penalty under section 271D if the authority is satisfied that there was a reasonable cause for not complying with the provisions of section 269SS.

Where the assessee has accepted a deposit in cash, penalty is not automatically exigible, since it could be saved notwithstanding violation of section 269SS, if there was reasonable cause. Where the assessee had taken a loan of Rs. 2.5 lakhs of which Rs. 2.45 lakhs was deposited immediately in the bank to meet the urgent demand for a time bound supply, there was reasonable cause. In such cases, the Assessing Officer has no jurisdiction to impose penalty, so that the Tribunal had to waive the same, where it has been wrongly levied.

[2003] 262 ITR 0163- CIT VS. INDORE PLASTICS P. LTD. (MP)

The assessee was a private limited company. One RCK was its promoter and managing director during the period relevant to assessment year 1990-91. During that year, the assessee-company accepted deposits in cash from the promoter from time to time aggregating in all Rs. 2,31,320. According to the Assessing Officer as also the Commissioner (Appeals), the said payment was in contravention of section 269SS and the assessee was liable to pay penalty under section 271D. However, held that the penalty so imposed is to be vacated on the finding that the said payment was not by way of deposit or loan, but towards adjustments of the amount drawn by the promoter from the company's account.

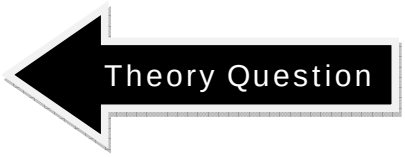
In other words section 271D provides for penalty for acceptance of loan or a deposit by any means other than account payee cheque or account payee draft where the amount involved exceeds Rs. 20,000. The provision is confined to loans or deposits and not to other trading transactions. In CIT v. Indore Plastics P. Ltd. [2003] 262 ITR 163 (MP), the assessee-company received moneys from its promoter to the extent of about Rs. 2 lakhs. Since it was received in cash, penalty of an equal amount was levied. The court found that the receipt was neither a deposit nor a loan, but merely an adjustment of amount, which he owed to the company, so that the receipt did not fall within the meaning of loan or deposit under section 269SS of the Act.

Transaction	Point to note	Conclusion
Father lending 85,000 to son for purchase of motor bike.	1) Personal 2) Related party 3) Accounted money	Transaction between related party with no intention to lend funds is not a loan transaction. Thus penalty is not imposable.
Brother lending funds to another brother.	1) Business funds used for business purpose 2) Related party 3) Accounted money	
Company lending funds to another group company.	1) Business funds used for business purpose 2) Related party 3) Accounted money 4) Current account in books maintained	

POWERS ASSOCIATED WITH PENALTIES

POWER TO REDUCE OR WAIVE PENALTY, ETC., 273A.

Reduction by commissioner



Commissioner may, in his discretion, whether on his own motion or otherwise, reduce or waive the amount of penalty imposed or imposable on a person under 271 (1) if he is satisfied that such person

- Prior to the detection by the Assessing Officer, of the concealment of particulars of income or of the inaccuracy of particulars furnished in respect of such income, voluntarily and in good faith, made full and true disclosure of such particulars,
- Co-operated in any enquiry relating to the assessment of his income and has either paid or made satisfactory arrangements for the payment of any tax or interest payable in consequence of an order passed.

A person shall be deemed to have made full and true disclosure of his income or of the particulars relating thereto in any case where the excess of income assessed over the income returned is of such a nature as not to attract the provisions 271 (1).

if in a case falling under 271 (1) (*c*), the amount of income in respect of which the penalty is imposed or imposable for the relevant assessment year, or, where such disclosure relates to more than one assessment year, the aggregate amount of such income for those years, exceeds a sum of five hundred thousand rupees, no order reducing or waiving the penalty shall be made by the Commissioner except with the previous approval of the Chief Commissioner or Director General, as the case may be.

Once in life time benefit

Whether such order relates to one or more assessment years, he shall not be entitled to any relief under this section in relation to any other assessment year at any time after the making of such order.

COMMISSIONER TO GRANT IMMUNITY FROM PENALTY WHERE SETTLEMENT COMMISSION PROCEDURE IS ABATED. 273AA.

Theory Question

A person may make an application to the Commissioner for granting immunity from penalty, if

(*a*) he has made an application for settlement under section 245C and the proceedings for settlement have abated under section 245HA and

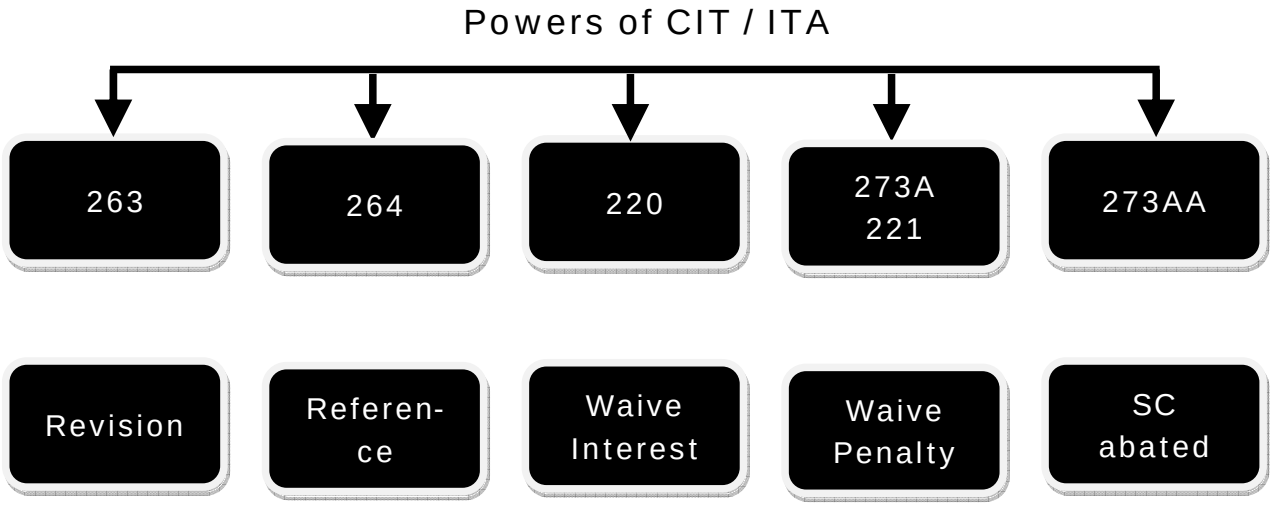
(*b*) the penalty proceedings have been initiated under this Act.

The application to the Commissioner shall not be made after the imposition of penalty.

The Commissioner may, subject to such conditions as he may think fit to impose, grant to the person immunity from the imposition of any penalty under this Act, if he is satisfied that the person has, after the abatement, co-operated with the income-tax authority in the proceedings before him and has made a full and true disclosure of his income and the manner in which such income has been derived.

The immunity granted to a person shall stand withdrawn, if such person fails to comply with any condition subject to which the immunity was granted and thereupon the provisions of this Act shall apply as if such immunity had not been granted.

The immunity granted to a person may, at any time, be withdrawn by the Commissioner, if he is satisfied that such person had, in the course of any proceedings, after abatement, concealed any particulars material to the assessment from the income-tax authority or had given false evidence, and thereupon such person shall become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

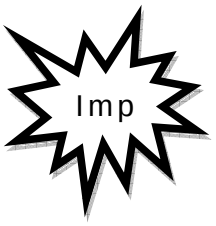


Penalty not to be imposed in certain cases.

273B. Notwithstanding anything contained in the provisions of section 271, section 271A, section 271AA section 271B section 271BA, section 271BB section 271C section 271CA section 271D section 271E, section 271F, section 271FA, 77section 271FB section 271G section 272A, sub-section (1) of section 272AA] or section 272B or sub-section (1) or sub-section (1A) of section 272BB or sub-section (1) of section 272BBB or clause (b) of sub-section (1) or clause (b) or clause (c) of sub-section (2) of section 273, no penalty shall be imposable on the person or the assessee, as the case may be, for any failure referred to in the said provisions if he proves that there was reasonable cause for the said failure.

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.



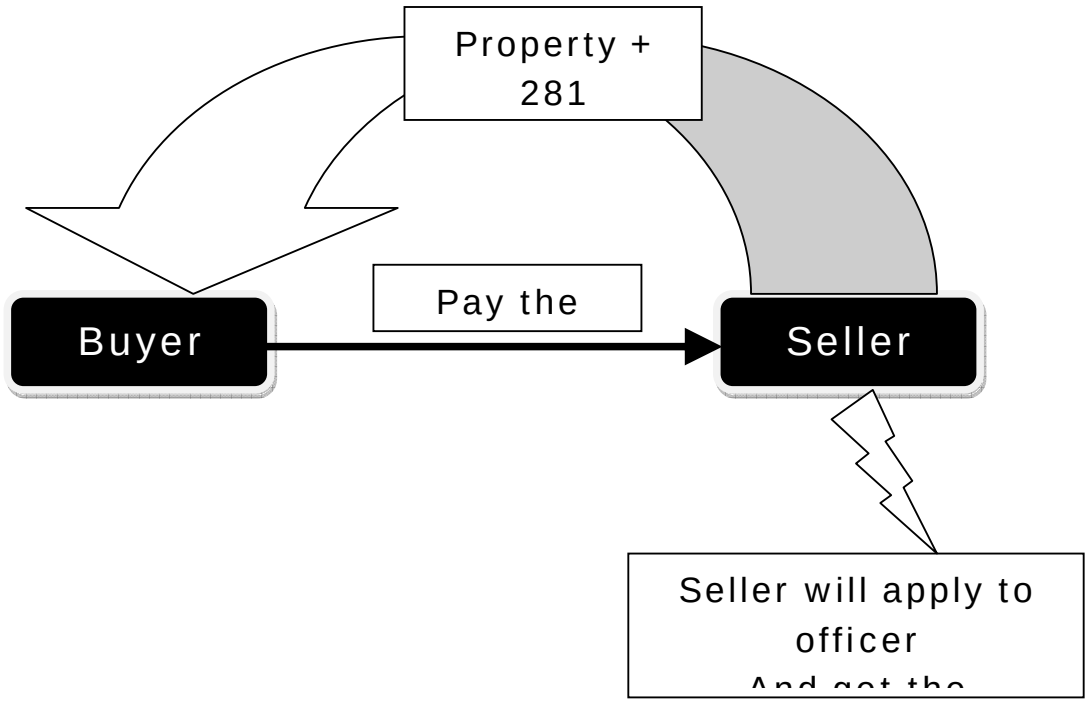
Such charge or transfer shall not be void if it is made

(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

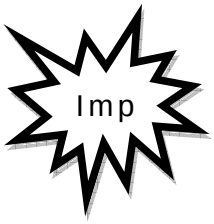
Where there is any transfer during pendency of proceedings section 281 declares such transfers to be void. When assessee made application for no objection certificate for transfer it is duty of applicant to disclose all relevant material. It is an Duty of authority to consider application in a judicious 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.



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.

The period during which the proceedings for assessment or reassessment are stayed by an order or injunction of any court shall be excluded from the period specified in the first proviso.

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)

Scope of property

[2001] 248 ITR 0209- STOCK EXCHANGE, AHMEDABAD VS. ACIT (SC)

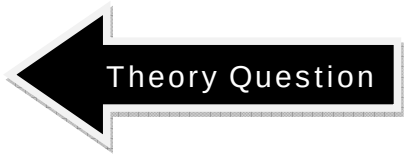
Is the membership card in a stock exchange a property capable of being attached and sold ? This was the issue which arose, when a stock exchange card was sought to be attached in garnishee proceedings for recovery of outstanding taxes. The attachment was questioned by the Ahmedabad Stock Exchange before the High Court by way of writ. The reasoning of the Court, while rejecting the case of the stock exchange was, that it is possible for the member to nominate a successor and that such right can be sold in certain circumstances.

The Supreme Court, however, has reversed this decision pointing out that the right of nomination is not an automatic one and that even in a case of succession, it is subject to conditions. Membership constituted a personal permission for participation in stock exchange recognised under the Securities Contracts Act and governed by regulations and bye-laws thereunder apart from the rules of the stock exchange for exercising the rights and privileges of membership. The rules provide for forfeiture of membership, vesting such card in the stock exchange itself in case of default. Neither the fact that there may be margin money or security deposit kept in the stock exchange in relation to the membership card, nor the fact that the card may be sold or auctioned by the stock exchange can make it a property, since the membership is governed by rules. It is not a property which could be attached under section 281B.

In coming to the conclusion, the Supreme Court referred to its earlier decision in Vinay Bubna v. Stock Exchange, Mumbai [1999] 97 Comp Cas 874 (SC), where the card was held not to be a private asset, but a personal permission given by the stock exchange so that the powers under the membership card thus vested in the stock exchange.

TAX RECOVERY PROCEDURE -- TRO

Assessee in default



Section 220 requires that any amount (other than advance tax) specified in a notice of demand under section 156 of the Act shall be paid within thirty days of service of the notice at the place and to the person mentioned in the notice. The Assessing Officer with the previous approval of the Joint Commissioner can lessen the period, if he has reason to believe that it will be detrimental to allow the full period of thirty days. Non-payment of such demand entails payment of interest and also makes the assessee a defaulter by virtue of section 220(4). The consequence will be that the assessee is liable to pay penalty besides the mandatory interest.

1. If, in a case where payment by instalments is allowed the assessee commits defaults in paying any one of the instalments within the time fixed, the assessee shall be deemed to be in default as to the whole of the amount then outstanding, and the other instalment or instalments shall be deemed to have been due on the same date as the instalment actually in default.
2. Where an assessee has presented an appeal under section 246 or section 246A the Assessing Officer may, in his discretion and subject to such conditions as he may think fit to impose in the circumstances of the case, treat the assessee as not being in default in respect of the amount in dispute in the appeal, even though the time for payment has expired, as long as such appeal remains undisposed of.
3. Where an assessee has been assessed in respect of income arising outside India in a country the laws of which prohibit or restrict the remittance of money to India, the Assessing Officer shall not treat the assessee as in default in respect of that part of the tax which is due in respect of that amount of his income which, by reason of such prohibition or restriction, cannot be brought into India, and shall continue to treat the assessee as not in default in respect of such part of the tax until the prohibition or restriction is removed.

Penalty Provisions			
Section	Nature of Default	Minimum penalty	Maximum Penalty
221(1)	Default in making payment of tax within prescribed time	Such amount as the Assessing Officer may impose [Sec. 221(1)]	Tax in arrears

Reduction or waiver of interest 220

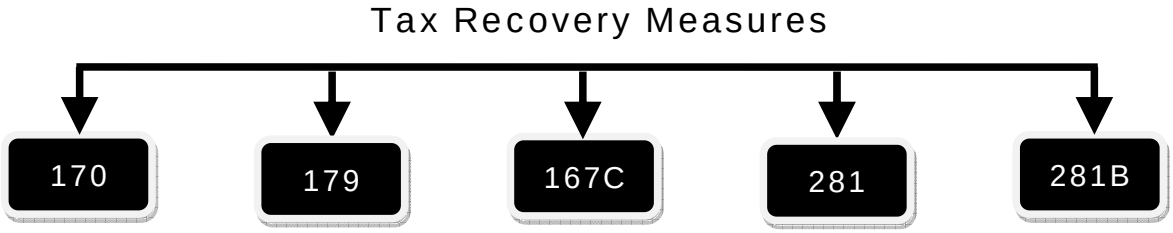
Theory Question

Chief Commissioner or Commissioner may reduce or waive the amount of interest paid or payable by an assessee if he is satisfied that

(i) payment of such amount has caused or would cause genuine hardship to the assessee ;

(ii) default in the payment of the amount on which interest has been paid or was payable was due to circumstances beyond the control of the assessee ; and

(iii) the assessee has co-operated in any inquiry relating to the assessment or any proceeding for the recovery of any amount due from him.



Penalty payable when tax in default 221.

Theory Question

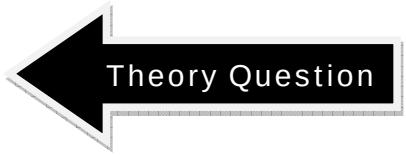
When an assessee is in default or is deemed to be in default in making a payment of tax, he shall, in addition to the amount of the arrears and the amount of interest payable be liable, by way of penalty, to pay such amount as the Assessing Officer may direct, and in the case of a continuing default, such further amount or amounts as the Assessing Officer may, from time to time, direct, so, however, that the total amount of penalty does not exceed the amount of tax in arrears.

The assessee shall be given a reasonable opportunity of being heard :

Where the assessee proves to the satisfaction of the Assessing Officer that the default was for good and sufficient reasons, no penalty shall be levied.

Where as a result of any final order the amount of tax, with respect to the default in the payment of which the penalty was levied, has been wholly reduced, the penalty levied shall be cancelled and the amount of penalty paid shall be refunded.

Recovery Proceeding



Recovery proceedings start with the issue of tax recovery certificate by the ITO to the Tax Recovery Officer (TRO) under section 222 of the 1961 Act. Once this is done, the ITO becomes more or less a 'decree holder' and the defaulter the 'judgment debtor' (the terms 'decree holder' and the judgment debtor have the same meaning as assigned to them in the Code of Civil Procedure, 1908). The TRO is the chief executive authority and in this capacity he is to recover the arrears of tax in the manner mentioned below:

1. Issue of notice to the defaulter requiring him to pay the amount in default covered by the tax recovery certificate within a period of 15 days of the service of the notice.

2. Attachment and sale of the defaulter's movable properties.

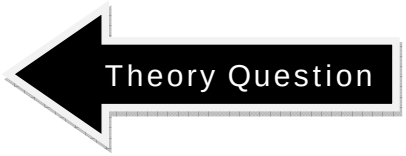
3. Attachment and sale of the defaulter's immovable properties.

4. Arrest of the defaulter and his detention in civil prison.

5. Appointment of a receiver for the management of the defaulter's business and immovable properties.

The TRO is not only an executive authority to collect the arrears of tax due from defaulters. He also exercises judicial functions. Orders passed by him in this capacity are appealable to the Tax Recovery Commissioner, civil courts or by filing writ petitions before the High Courts, as the case may be.

Issue of recovery certificate



The recovery certificate can be issued by the ITO notwithstanding the fact that proceedings for the recovery of the arrear have been effected by any other mode by the ITO. An *Explanation* has been added to section 222 by virtue of which the assets belonging to the wife and minor of the individual in whose case the provisions of section 64 of the 1961 Act are applicable, can be attached. The attachment will, however, continue to remain in operation even after the minor has attain majority but recovery can be made only of arrears arising before attaining majority. The position has been clarified by the CBDT *vide* Circular No. 179 dated September 30, 1975 The relevant paragraph reads as under:

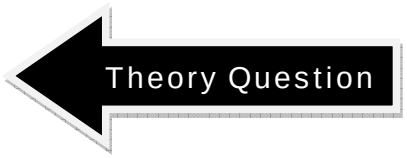
Under section 222, the Tax Recovery Officer is empowered to recover arrears of tax, *inter alia,* by attachment and sale of assessee's movable or immovable property or by appointment of a receiver for the management of assessee's movable and immovable properties with a view to curbing attempts at defeating the recovery of tax dues by transfer of properties to near relatives, the Amending Act has inserted an *Explanation* in sub-section (1) of section 222, to provide that, for the purpose of that sub-section, the assessee's movable or immovable property will include property which has been directly or indirectly transferred by him after 31-5-1973 to his spouse or minor child or daughter-in-law or son's minor child without adequate consideration.where such property is held by, or stands in the name of, any of the aforesaid persons. Accordingly, where an assessee is in default, it will be open to the Tax Recovery Officer to proceed against any movable or immovable property transferred by him after 31-5-1973 to the aforesaid relatives. The property transferred to the minor child or son's minor child will continue to remain liable to be proceeded against even after the date of attainment of

majority by the minor, but the liability will be restricted to any arrears due from the assessee in respect of any period prior to the said date."

Recovery of advance tax - Whether certificate can be issued

In practice, recovery certificates relating to advance tax demands are being issued by the ITOs. The question is as to whether recovery certificate can be issued in respect of a demand which is not final, *i.e.,* which has not arisen by the completion of the assessment. The Calcutta High Court has expressed the view that the certificate can be issued even though the assessment for the year had not been completed in the case of *Union of India* v. *Sikri & Sons* [1978] 112 ITR 529. But a contrary view has been adopted by the same Court, *i.e.,* Calcutta High Court in the case of *Union of India* v. *Raj Kumari Narendra Kumari* [1978] 113 ITR 299. In the former the question was that of the recovery of advance tax but in the latter case the ITO had imposed penalty under section 221 of the Income-tax Act for the non-payment of advance tax. In the latter decision, the former decision has been duly considered.relating to the relevant provisions of this Code, is absolutely essential, to all working in the recovery cell.

Other modes of recovery



Assessing Officer is specifically empowered to recover tax by one or more of the modes provided under the said section if no certificate has been drawn under section 222. Section 226(1A) clarifies that where a certificate has been drawn up under section 222, the TRO is also entitled to recover tax by any one or more of the modes provided in that section. The Court further observed that in view of sub-sections (1) and (1A) of section 226, either the Assessing Officer is entitled to recover tax if no certificate is drawn up under section 222, or the TRO is entitled to recover tax where certificate has been drawn up under section 222.

Smt. Tejal R. Amin v. Asstt. CIT [1994] 208 ITR 103/75 Taxman 543 wherein it has been held that where an assessee becomes an assessee-in-default inasmuch as he has not paid a certain amount of tax due from him, the department has no authority to recover such outstanding tax arrears from a third person who is a debtor of the defaulting assessee by treating such third person as an assessee-in-default and attaching his salary by invoking the provisions of section 226 of the Income-tax Act, 1961.

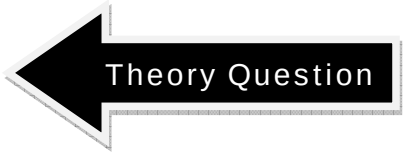
section 226 provides that if the assessee is in receipt of any income chargeable under the head 'Salaries', the Assessing Officer or the TRO may require any person to deduct from the salary the arrears of tax due from the assessee. It would mean that sub-section (2) provides one more mode of recovery of tax payable by the assessee, if he is having income under the head 'Salaries'. The Act also provides for another additional mode under sub-section (3) of recovering tax from the debtor of the assessee. It is provided therein that a procedure similar to a garnishee order which could be passed by a civil court under the provisions of the Code of Civil Procedure, 1908, is contemplated, whereby notice is given to the third party and after hearing objections, if any, that may be filed by the third party from whom the money is due or may become due to the assessee, the recovery steps may be taken. Depending upon the objection raised by the third party, the recovery steps are activated. If the objection raised is to the effect that the sum demanded or any part thereof is not due to the assessee or that he does not hold any money for or on behalf of the assessee, then the garnishee need not pay the amount. If no objection is raised, in terms of section 226(3), the person discharging any liability to the assessee after the receipt of a notice under this sub-section shall be personally

liable to the department to the extent of his own liability to the assessee. if the person to whom a notice under this sub-section is sent fails to make the payment in pursuance thereof, the TRO can treat him as an assessee-in-default in respect of the amounts specified in the notice. The section further provides that he shall be deemed to be 'an assessee-in-default' in respect of the amounts specified in the notice. Proceedings may be taken against him for the realisation of the amount as if it were an arrear of tax due from him in the manner provided in sections 222 to 225. Thus, if the person to whom notices are issued fails to make the payment, he is treated as a defaulter, and the amount in question can be recovered from him by following the procedure under sections 222 to 225 as if he is an assessee-in-default to the extent of the amount specified in the notice. It is apparent from the language of the said section that the Legislature has not provided that a debtor of the assessee is deemed to be an assessee-in-default and can be asked to pay the arrears of tax as of section 226. The scheme of sections 222 to 225 is to be adhered to for recovery of tax dues. In the absence of such a specific provision dealing with the recovery of tax arrears in respect of the defaulter from a debtor, the action taken by the TRO or the department cannot be upheld. The Court has observed that if the contention of the revenue was to be upheld, then the relevant part of the sentence, in the manner as provided in sections 222 to 225, would be redundant. This apart, the Court observed that the Legislature has made two specific deeming sections to the effect that (*i*) if the person to whom a notice under this sub-section is sent fails to make payment in pursuance thereof to the Assessing Officer or the TRO, he shall be deemed to be an assessee-in-default in respect of the amount specified in the notice, the liability of the said person being limited to the extent of the amount specified in the notice; and (*ii*) the amounts specified in the notice can be realised from such a person as if it were an arrear of tax due from him. Reading all these provisions together, the Court upheld the contentions of the petitioner and catagorically gave its decision that nowhere in the statute it is provided that such a person shall be deemed to be a person in default to all intents and purposes of the Act. Thus, it was held that such a person would be deemed to be an assessee in default only for a limited purpose and that too to recover only the amounts specified in the notice that can be recovered and not the entire amount of tax due by following the procedure under sections 222 to 225.

There is no provision that the salary of a third person who is a debtor of the assessee can be attached and recovered as an arrear of tax.

Recovery of tax in pursuance of agreements with foreign countries.

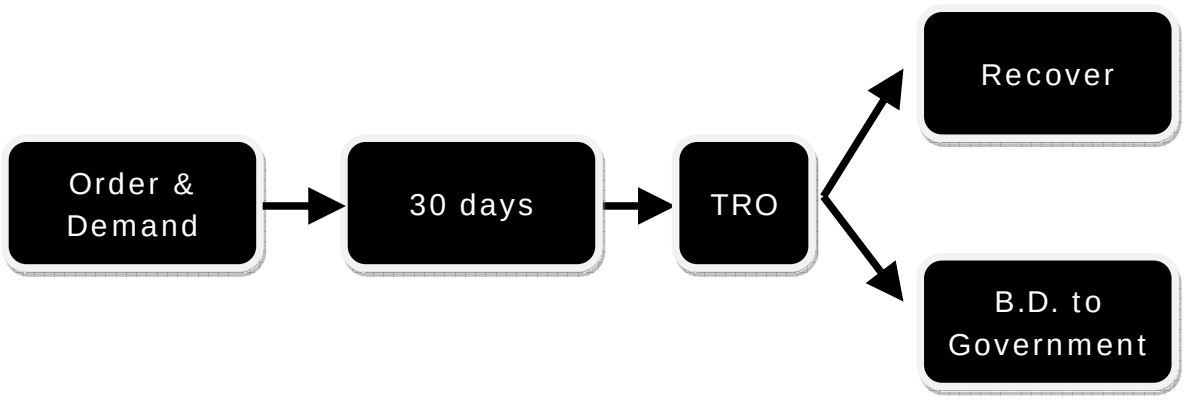
Where an agreement is entered into by the Central Government with the Government of any country outside India for recovery of income-tax under this Act and the corresponding law in force in that country and the Government of that country or any authority under that Government which is specified in this behalf in such agreement sends to the Board a certificate for the recovery of any tax due under such corresponding law from a person having any property in India, the Board may forward such certificate to any Tax Recovery Officer within whose jurisdiction such property is situated and thereupon such Tax Recovery Officer shall



(a) proceed to recover the amount specified in the certificate in the manner in which he would proceed to recover the amount specified in a certificate drawn up by him under section 222; and

(b) remit any sum so recovered by him to the Board after deducting his expenses in connection with the recovery proceedings.

Where an assessee is in default or is deemed to be in default in making a payment of tax, the Tax Recovery Officer may, if the assessee has property in a country outside India forward to the Board a certificate drawn up by him under section 222 and the Board may take such action thereon as it may deem appropriate having regard to the terms of the agreement with such country.



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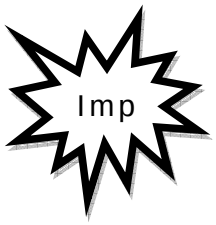
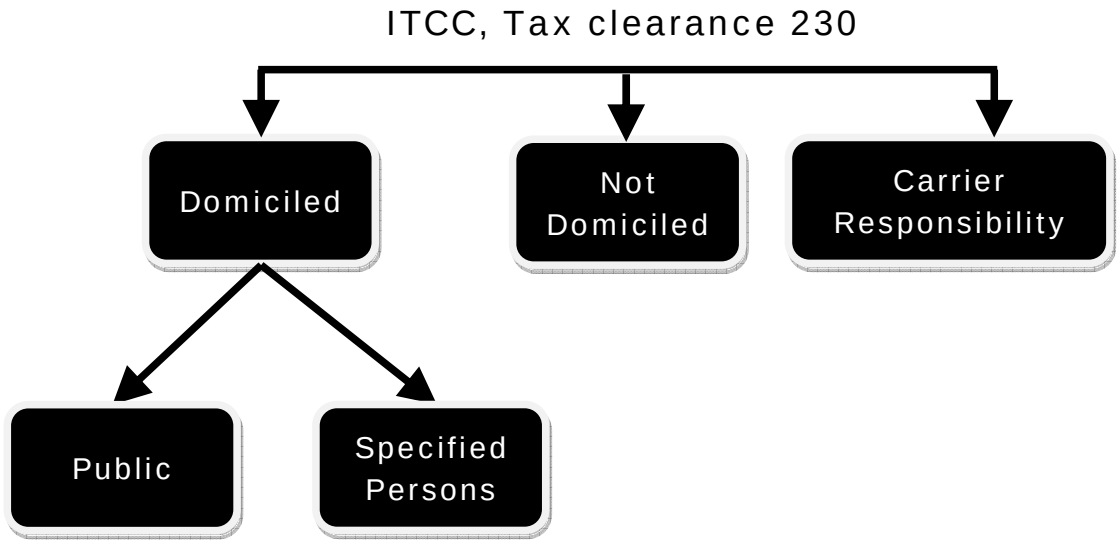


While a person going abroad will be required to produce tax clearance certificate. However, there is, great divergence between law and practice in the matter of production of tax clearance certificate. Some airlines require such certificate from Indian passport holder in a routine fashion while other airlines do not ask for such a certificate.



Persons not domiciled in India

(a) who is not domiciled in India;

(b) who has come to India in connection with business, profession or employment; and

(c) who has income derived from any source in India,

shall leave the territory of India by land, sea or air unless he furnishes to such authority as may be prescribed—

(i) an undertaking in the prescribed form from his employer; or

(ii) through whom such person is in receipt of the income,

to the effect that tax payable by such person who is not domiciled in India shall be paid by the employer or the person referred above, and the prescribed authority shall, on receipt of the undertaking, immediately give to such person a no objection certificate, for leaving India: Provided that nothing contained above shall apply to a person who is not domiciled in India but visits India as a foreign tourist or for any other purpose not connected with business, profession or employment.

who is domiciled in India

who is domiciled in India at the time of his departure from India, shall furnish, in the prescribed form to the income-tax authority or such other authority as may be prescribed

(a) the permanent account number allotted to him under section 139A

(b) the purpose of his visit outside India;

(c) the estimated period of his stay outside India:

Provided that no person

(i) who is domiciled in India at the time of his departure; and

(ii) in respect of whom circumstances exist which, in the opinion of an income-tax authority render it necessary for such person to obtain a certificate under this section,

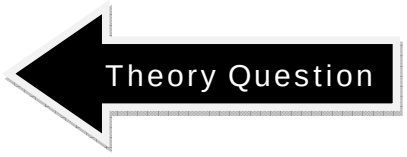
shall leave the territory of India by land, sea or air unless he obtains a certificate from the income-tax authority stating that he has no liabilities under this Act, or the Wealth-tax Act, or the Gift-tax Act, or the Expenditure-tax Act, or that satisfactory arrangements have been made for the payment of all or any of such taxes which are or may become payable by that person :

Provided that no income-tax authority shall make it necessary for any person who is domiciled in India to obtain a certificate under this section unless he records the reasons therefor and obtains the prior approval of the Chief Commissioner of Income-tax.

If the owner or charterer of any ship or aircraft allows any person who is required to obtain a tax clearance certificate to travel outside India without first satisfying himself that the person is in possession of the requisite certificate, he shall be personally liable to pay the tax liability of such person as may be determined by the ITO.

With a view to facilitating recovery of taxes, section 230 of the Income-tax Act, 1961, provides that subject to such exceptions as the Central Government may, by notification specify in this behalf, no person who is not domiciled in India, or who, even if domiciled at the time of his departure, has, in the opinion of an income-tax authority, no intention of returning to India shall leave India by land, sea or air unless he obtains from the 'competent authority' a certificate stating that he has no liabilities under the direct tax laws, or that he has made satisfactory arrangements for the payment of all or any of such taxes which are or may have become payable by him. If the competent authority is satisfied that a person not domiciled in India intends to return to India, he may in respect of such person issue an exemption certificate either in respect of a single journey or in respect of all journeys to be undertaken by that person within such period as may be specified in the certificate.

Meaning of term 'domicile'



The term domicile' has not been defined. Generally speaking, the domicile of a person is the country of his permanent residence. Domicile is broadly classified as under:

a. domicile by birth,

b. domicile by choice, and

c. domicile by operation of law.

Domicile is not the same as citizenship. However, for practical purposes, the Income-tax Department has always proceeded, and rightly so, on the basis that a person holding an Indian passport is domiciled in India.

ADVANCE PAYMENT OF TAX

Income liable for advance tax

All items of income (including capital gains, winnings from lotteries, crossword puzzles, etc.) are liable for payment of advance tax with effect from the assessment year 1989-90.

Liability to advance tax – when arises

Section 208 makes it obligatory to pay advance tax in every case where the advance tax payable is Rs. 10,000 or more. An assessee who has opted for the scheme of computing business income under section 44AD on presumptive basis at the rate of 8 per cent of turnover, shall be exempted from payment of advance tax

Due dates of payment of advance tax

Advance tax is payable as follows:

	In the case of a corporate assessee (% of)	In the case of a non-corporate assessee (% of)
On or before June 15	Upto 15 per cent	-
On or before September 15	Upto 45 per cent	Upto 30 per cent
On or before December 15	Upto 75 per cent	Upto 60 per cent
On or before March 15	Upto 100 per cent	Upto 100 per cent

Payment on last day when banks are closed

If the last day for payment of any installments of advance tax is a day on which the receiving bank is closed the assessee can make the payment on the next immediately following working day, and in such cases, the mandatory interest leviable under sections 234B and 234C would not be charged.
Payment of advance tax by the assessee of his own account

Computation of tax

Tax can be computed on the current income (estimated by the taxpayer) at the rates in force during the financial year. From the tax so computed, tax deductible or collectible at source will be deducted. Calculation can be made on similar lines in the case of upward / downward revision of current income.

Payment of advance tax in pursuance of order of assessing officer

If, despite the legal obligation cast upon a taxpayer (who had earlier been assessed to income-tax), he fails to pay advance tax (advance tax is lower than the correct amount), the Assessing Officer may pass an order requiring him to pay advance tax on his current year's income (specifying the amount of installments in which tax has to be paid). Such an order must be passed during the financial year but not later than the last day of February.
On receipt of the notice from the Assessing Officer to pay advance tax the assessee can submit his own estimate of lower current income/advance tax and pay tax accordingly. In such a case he has to send an intimation in Form No. 28A to the Assessing Officer.

Alternatively, if the advance tax on current income as per own estimate of the assessee is likely to be higher than the amount estimated by the Assessing Officer, the assessee shall pay higher tax in accordance with his own calculation. In such case, no intimation to the Assessing Officer is required.

Computation of tax by assessing officer –

The total income of the latest previous year in respect of which the assessee has been assessed by way of regular assessment or total income returned by the assessee in any return of income furnished by him for any subsequent previous year, whichever is higher, shall be taken as current income by the Assessing Officer.

Tax on the current income at the rates in force during the financial year minus tax deducted or collected at source, is the amount of advance tax payable by the assessee. Calculation can be made on similar lines when the assessee wants to make upward/downward revision of current income.

Payment of advance tax in pursuance of revised order of assessing officer

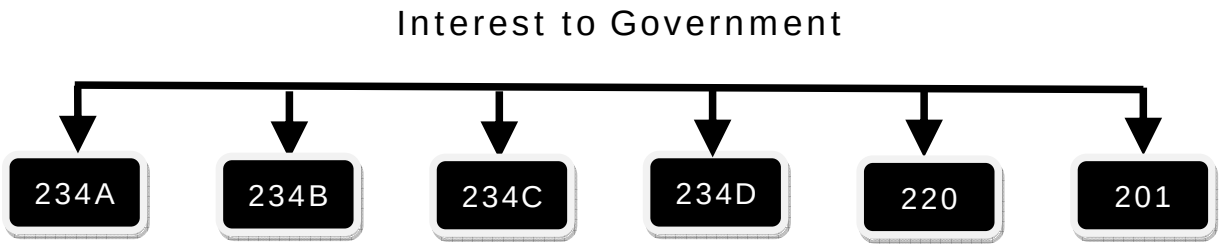
The order passed by the Assessing Officer to pay advance tax can be revised by him, under section 210(4) if subsequent to the making of an order to pay advance tax but before March 1 of the relevant financial year, a return of income in respect of any later year has been furnished or any assessment for any later year has been completed at a higher figure. On receipt of the revised order the assessee will have to pay advance tax accordingly.

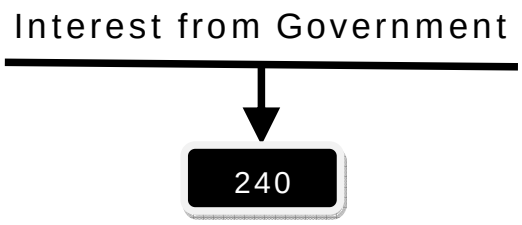
The assessee can, however, submit his own estimate of lower current income/advance tax and pay tax accordingly. In such a case he has to send an intimation in Form No. 28A to the Assessing Officer.

If, alternatively, the advance tax on current income as per own estimate is likely to be higher than the amount re-estimated by the Assessing Officer, the assessee shall pay higher tax in accordance with his own calculation. In such a case intimation to the Assessing Officer is not required.

INTEREST

In certain circumstances the assessee becomes liable to pay interest to the revenue, while in certain cases the revenue is required to pay interest to the assessee.





FOR DEFAULTS IN FURNISHING RETURN OF INCOME [SEC. 234A]-

If a return of income is furnished after the due date or is not furnished, the assessee is liable to pay interest under section 234A.

1.	Rate of interest	1 per cent per month or part of month
2.	Period for which interest is payable	Commencing on the date immediately following the due date for filing the return of income and ending on- a. the date of furnishing the return (where return has been filed after the due date); or b. the date of completion of assessment under section 144 (where no return has been furnished)
3.	Amount on which interest is payable	From the tax determined advance tax paid, tax deducted or collected at source, relief under section 90/90A/91 and MAT credit under section 115JAA (but not tax paid under section (140A) shall be deducted.

Tax paid before the due dates

Interest would not be payable in a case where tax has been deposited prior to due date of filing of income-tax return even if the return of income is filed after the due date of furnishing such return – CIT v. Dr. Prannoy Roy [2009] 179 Taxman 53 (SC). It is not open to the Assessing Officer to charge interest under section 234A in a situation where the assessee has paid due taxes and merely filing of income-tax return is delayed.

When assessment is made for the first time under section 147 –

A belated return cannot be submitted after the expiry of one year from the end of the assessment year. If an assessment is made for the first time under section 147, then the assessee cannot be made liable to pay interest for the period during which it was not possible on the part of the assessee to file return (i.e., after one year from the end of the assessment year) till issuance of notice under section 148 – Priti Pithawala v. ITO [2003] 12 Taxman 79 (Bom.) (Mag.).

Reduction of interest

There is no provision for reduction or waiver of interest.

No opportunity of hearing –

The liability to pay interest under section 234A, 234B and 234C is automatic and the question of granting opportunity of being heard does not arise – CIT v. R. Ramalingair [2000] 108 Taxman 1 (Ker).

Interest must be charged in the assessment order –

While charging interest under section 234A, 234B or 234C, the Assessing Officer is required to pass a specific order to this effect in its assessment order. When the assessment order is silent, as to whether any interest is leviable, the notice of demand under section 156 cannot be beyond the assessment order and the assessee cannot be served with any such notice demanding the interest. Interest cannot be charged by mere observation like charge interest as per law. It has to be by means of a speaking order – CIT v. Inchcape India (P.) Ltd. [2002] 124 Taxman 744 (Delhi), CIT v. Ranchi Club Ltd. [20012 247 ITR 209/114 Taxman 414 (SC), Tej Kumari v. CIT [2001] 247 ITR 210/114 Taxman 404 (Pat.).

Issue of notice under section 142(1)

Issue of notice under section 142(1)(ii) and 142(1)(iii) does not give the Assessing Officer jurisdiction to levy interest under section 234A – CIT v. Ranchi Club Ltd. [2001] 114 Taxman 414 (SC).

DEFAULT IN PAYMENT OF ADVANCE TAX [SEC. 234B]

under section 234B(1), interest is payable as follows:

When interest is payable	Amount on which interest is payable	Rate of interest	Period for which interest is payable
An assessee who is liable to pay advance tax, has failed to pay such tax	Interest is payable on assessed tax	Simple interest @ 1 per cent for every month or part of month	From April 1 of the assessment year to the date of determination of total income under section 143(1) or where regular assessment is made to the date of such regular assessment.
An assessee who has paid advance tax but the amount of advance tax paid by him is less than 90 per cent of assessed tax	Assessed tax minus advance tax	Simple interest @ 1 per cent for every month or part of month.	From April 1 of the assessment year to the date of determination of total income under section 143(1) or where regular assessment is made to the date of such regular assessment.

Assessed tax – Meaning of

'Assessed tax' means the tax on the total income determined under section 143(1) and where regular assessment is made, the tax on total income determined under such regular assessment as reduced by (a) tax deducted/collected at source on any income which is subject to such deduction or collection and which is taken into account in computing such total income, (b) relief/deduction of tax claimed u/s 90 or 91 on account of tax paid in a country outside India, (c) relief of tax claimed u/s 90A on account of tax paid in any specified territory outside India, and (d) tax credit claimed u/s 115JAA.

Reduction or waiver of interest where payment is made before the assessment.

Adjustment when tax is paid before regular assessment under section 140A. If before the date determination of total income under section 143(1) or completion of a regular assessment, tax is paid on the basis of self-assessment under section 140A, the interest shall be calculated as under:

a. up to the date of payment of tax under section 140A, interest will be calculated as mentioned in the table above; and
b. from the date of payment of tax under section 140A, interest will be calculated on the amount by which advance tax and tax paid under section 140A falls short of the assessed tax.

From the amount of interest computed above, amount paid under section 140A towards interest chargeable under section 234B shall be deducted.

DEFERMENT OF ADVANCE TAX [SEC. 234C]

Interest is payable under section 234C if an assessee has not paid advance tax or underestimated installments of advance tax. Interest is to be computed on the following basis

In case of a non-corporate assessee [sec. 234c(1)(b)] –

In case of a non-corporate assessee, interest under section 234C is payable as follows:

When interest is payable under section 234C	Rate of interest	Period of interest	Amount which is short of given % on which interest is payable
If advance tax is paid on or before September 15 is less than 30% (a-b)	Simple interest @ 1 per cent per month	3 months	30%
If advance tax is paid on or before December 15 is less than 60% (a-b)	Simple interest @ 1 per cent per month	3 months	60%
If advance tax is paid on or before March 15 is less than 30% (a-b)	Simple interest @ 1 per cent	-	100%

SHORT FALL

Tax on the total income declared in the return filed by the assessee. Less Total of (a) tax deducted/collected at source on any income which is subject to such deduction or collection and which is taken into account in computing such total income, (b) relief/deduction of tax claimed u/s 90 or 91 on account of tax paid in a country outside India, and (c) relief of tax claimed u/s 90A on account of tax paid in any specified territory outside India.

In the case of a corporate-assessee [sec. 234c(1)(a)] –

A corporate-assessee will be liable for interest under section 234C as under:

When interest is payable under section 234C by a company	Rate of interest	Period of interest	Amount which is short of given % on which interest is payable
If advance tax is paid on or before June 15 is less than 15%. (marginal relief up to 12 %)	Simple interest @ 1 per cent per month	3 months	15%
If advance tax is paid on or before September 15 is less than 45% (marginal relief up to 36 %)	Simple interest @ 1 per cent per month	3 months	45%
If advance tax is paid on or before December 15 is less than 75%	Simple interest @ 1 per cent per month	3 months	75%

If advance tax is paid on or before March 15 is less than 100%	Simple interest @ 1 per cent	-	100%

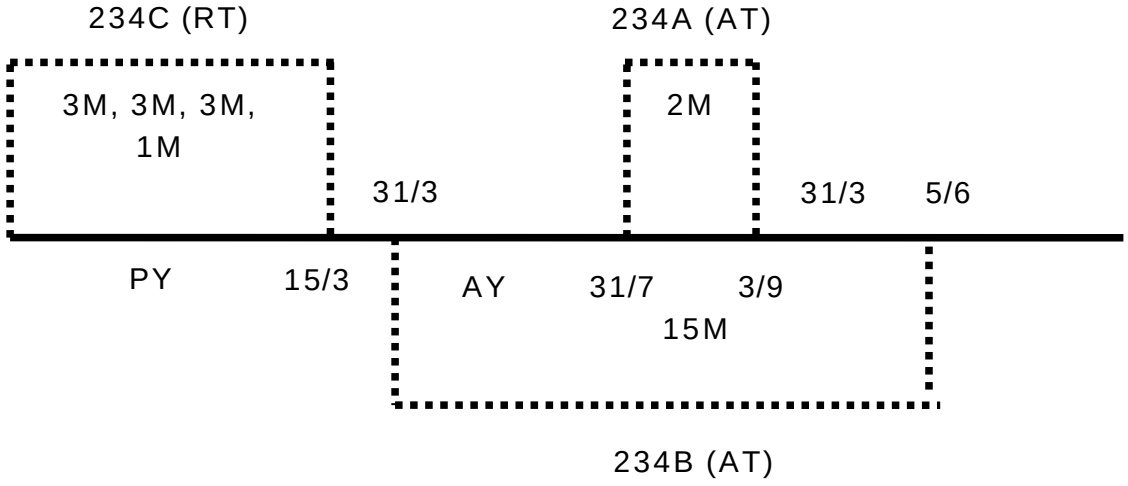
Short fall

Tax on the total income declared in the return filed by the assessee. Less Total of (a) tax deducted/collected at source on any income which is subject to such deduction or collection and which is taken into account in computing such total income, (b) relief/deduction of tax claimed u/s 90 or 91 on account of tax paid in a country outside India, (c) relief of tax claimed u/s 90A on account of tax paid in any specified territory outside India, and (d) tax credit claimed u/s 115JAA.

Short payment of advance tax in case of capital gains/casual income [first proviso to sec. 234c(1)] –

No interest will be levied in respect of any shortfall in the payment of advance tax due on the returned income if-

a. the shortfall is on account of an underestimate or failure to estimate the amount of capital gains or income of the mature referred to in section 2(24)(ix) (i.e., lottery income, gambling income, etc.); and
b. the assessee has paid the whole of the amount of tax payable in respect of such income, as part of the installments of advance tax which are immediately due, or if no installment is due, then such tax is paid before the end of the financial year.



INTEREST ON EXCESS REFUND [SEC. 234D] –

In any of the following two cases, interest is attracted under section 234D(1)-

Case one – if any refund is granted under section 143(1) but no refund is due on regular assessment.

Case two – if any refund is granted to the assessee under section 143(1) and the refund so granted exceeds the amount refundable on the regular assessment. For the aforesaid purpose, regular assessment means assessment under section 143(3) or 144. If an assessment is made for the first time under section 147 or section 153A, the assessment so made shall be regarded as a regular assessment.

Computation of interest

Rate of interest	0.5 per cent per month or part of a month
Period for which interest is payable	The period commencing from the date of grant of refund under section 143(1) to date of regular assessment
Amount on which interest is payable	In Case One on whole of the amount refunded in Case Two on the excess of amount refunded under section 143(1) over the amount refundable on regular assessment.

FOR MAKING LATE PAYMENT OF INCOME TAX [SEC. 220(2)]

If any assessee fails to pay any tax (other than advance tax) specified in a demand notice within 30 days of the service of notice of demand, he is liable to pay interest at the rate of 1 per cent for every month or a part of a month from the expiry of 30 days of the service of the demand notice.

Reduction or waiver

- The Chief Commissioner (or Commissioner) may reduce or waive the amount of interest payable by an assessee under section 220(2), if, he is satisfied that payment of such interest would cause genuine hardship to the assessee; the default in the payment of the amount on which interest was payable due to circumstances beyond the control of the assessee; and the assessee has co-operated in any inquiry relating to the assessment or in any proceeding for the recovery of any amount due from him.

Interest in case of appeal matters

The observation given in Circular No. 334 does not find support in the judicial pronouncement given by the Apex Court in Vikrant Tyres Ltd. v. First ITO [2001] 115 Taxman 202. In this case the assessee deposits the demand made by the Assessing Officer and goes in appeal. The appellate authority decides the issue in favour of the assessee and the tax collected is refunded. In further appeal by the revenue before the High Court, the assessee looses the case. Fresh demand notices are issued to the assessee demanding interest under section 220(2) for the period commencing from the refund of tax consequent upon the first appellate order. The assessee disputes the charge of interest from back date when he has satisfied with all the demands raised from time to time.

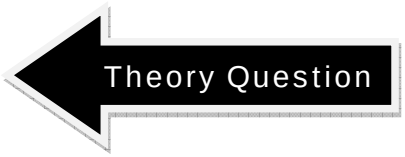
The Supreme Court held that for invoking section 220 one of the conditions is that if there is a default in payment of amount demanded under a notice by the revenue within the time stipulated therein and if such a demand is not satisfied, interest is leviable under section 220(2). The Court held that the section cannot be invoked to revive a demand notice, which has already been fully satisfied. The landmark ruling of the Supreme Court is a clear pointer to taxpayers to pay tax demands in full (and not in part) as and when they arise to save the burden of interest in the ultimate.

INTEREST PAYABLE TO ASSESSEE [SEC. 244A]

Interest is payable where any refund arises due to any excess payment of tax. Under the provisions there is no need for making claim for refund. When refund is of any advance tax (including tax deducted or collected at source), the interest is payable at the rate of 0.5 per per month or part of a month from the first day of the assessment year to the date of grant of refund. No interest is , however, payable if the excess payment is less than 10 per cent of the tax determined on regular assessment, or under section 143(1).

Where refund is of tax other than advance tax or tax deducted or collected at source, interest is payable at the rates given above from the date of payment of such tax or penalty up to the date on which the refund is granted.

Procedure to be followed in calculating interest. 119A.

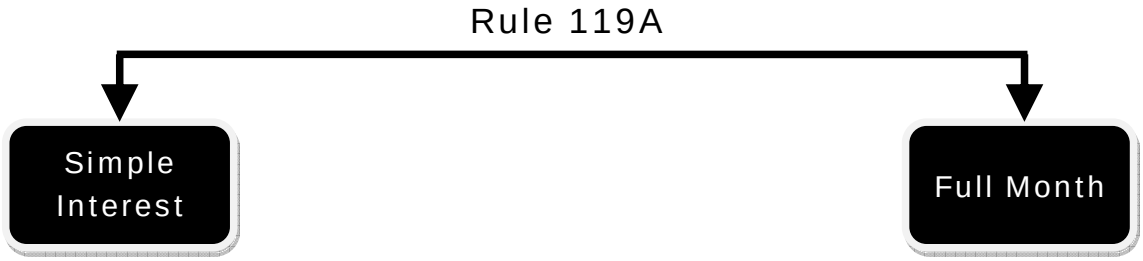


In calculating the interest payable by the assessee or the interest payable by the Central Government to the assessee under any provision of the Act,

(a) where interest is to be calculated on annual basis, the period for which such interest is to be calculated shall be rounded off to a whole month or months and for this purpose any fraction of a month shall be ignored; and the period so rounded off shall be deemed to be the period in respect of which the interest is to be calculated;

(b) where the interest is to be calculated for every month or part of a month comprised in a period, any fraction of a month shall be deemed to be a full month and the interest shall be so calculated;

(c) the amount of tax, penalty or other sum in respect of which such interest is to be calculated shall be rounded off to the nearest multiple of one hundred rupees and for this purpose any fraction of one hundred rupees shall be ignored and the amount so rounded off shall be deemed to be the amount in respect of which the interest is to be calculated.



Waiver or reduction of interest under section 234A, 234B and 234C which arises due to operation of any order of court

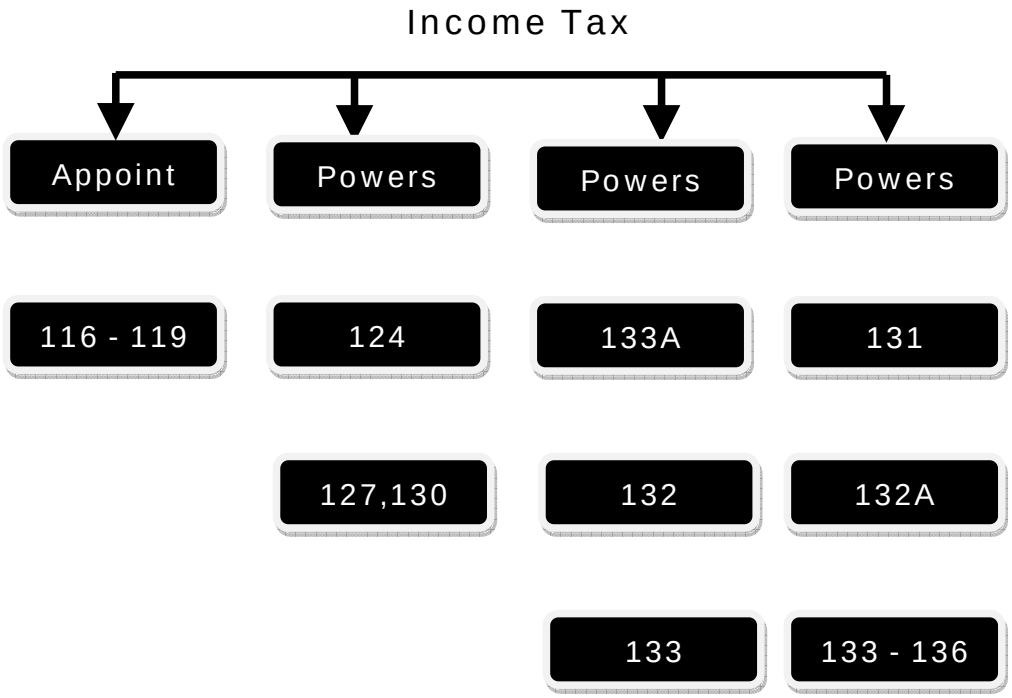
In excise of the powers conferred under section 119, the Central Board of Direct Taxes have directed that in cases where any income accrues or arises for any previous year due to the operation of any order of a Court, statutory authority or of the Government (other than an order of assessment, appeal, reference or revision passed under the provisions of the income tax Act) passed after the close of the said previous year (such income and the order hereinafter referred to as the "relevant income: and the :relevant order" respectively) interest under sections 234A, 234B and 234C shall be reduced or waived by the Chief Commissioner/Director General subject to certain conditions.

Conditions – The following conditions shall be satisfied-

a. the relevant income is disclosed in a return of income furnished for the said previous year or is otherwise disclosed to the Assessing Officer; and
b. the tax attributable to such income has been paid.

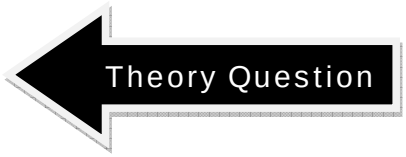
PART – J

ITA AND JURISDICTION POWERS PROCEDURE



POWER TO ISSUE INSTRUCTION TO SUBORDINATE AUTHORITY

Section 119(1) of the Income-tax Act, 1961 provides that "the Board may, from time to time, issue such orders, instructions and directions to other income-tax authorities as it may deem fit for the proper administration of this Act, and such authorities and all other persons employed in the execution of this Act, shall observe and follow such orders, instructions and directions of Board". Section 119(2) provides that "without prejudice to the generality of the foregoing power, (*a*) the Board may, if it considers it necessary or expedient to do so, for the purpose of proper and efficient management of the work of assessment and collection of revenue, issue, from time to time general or special orders in respect of any class of incomes or class of cases, setting forth directions or instructions (not being prejudicial to assessees) as to the guidelines, principles or procedures to be followed by other income-tax authorities in the work relating to assessment or collection of revenue or the initiation of proceedings for the imposition of penalties and any such order may, if the Board is of opinion that it is necessary in the public interest so to do, be published and circulated in the prescribed manner for general information."



Instructions of CBDT have force of law - Judicially recognized

Instructions issued by the CBDT to reduce the rigour of law have force of law. They are binding on tax authorities. It is judicially recognized that the concessional instructions issued by the CBDT are binding on the tax authorities.

In the case of *Navnit Lal C. Javeri* v. *K.K. Sen, AAC* [1965] 56 ITR 198, the Supreme Court noted that in order that the assurance given by the Minister in Parliament should be carried out, a Circular [No. 20(XXI-6)/55] was issued by the Central Board of Revenue on May, 10, 1955. That Circular pointed out to all the officers that it was likely that some of the companies might have advanced loans to their shareholders as a result of genuine transactions of loans, and the idea was not to affect such transactions and not to bring them within the mischief of the new provisions. The officers were, therefore, asked to intimate to all the companies that if the loans were repaid before June 30, 1955, in a genuine manner, they would not be taken into account in determining the tax liability of the shareholders to whom they might have been advanced. In other words, past transactions which would normally have attracted the stringent provisions, were substantially granted exemptions from the operation of the said provisions by making it clear to all the companies and their shareholders that if the past loans were genuinely refunded to the companies, they would not be taken into account under section 12(1B). The Supreme Court held that a circular of the kind which was issued by the Board would be binding on all officers and persons employed in the execution of the Act.

In *Ellerman Lines Ltd.* v. *CIT* [1971] 82 ITR 913 (SC), the learned Solicitor-General appearing for the revenue contended that the instructions issued by the Board of Revenue cannot have any binding effect and those instructions cannot abrogate or modify the provisions of the Act. The Supreme Court, relying on its judgment in the case of *Navnit Lal C. Javeri* (*supra*), rejected that contention and allowed to the British shipping company the concession granted under the instruction of the Board.

In *K.P. Varghese* v. *ITO* [1981] 131 ITR 597/7 Taxman 13 (SC) in giving restrictive interpretation to section 52(2) for levy of capital gains tax that there should be evidence of actual payment of consideration over and above the amount stated in the agreement, the Supreme Court relied on the Circular of the CBDT dated July 7, 1964 issued under section 119.

In *CIT* v. *Punalur Paper Mills Ltd.* [1987] 34 Taxman 268/[1988] 170 ITR 37 (Ker.), the issue was whether on the basis of Circular of the Board of Revenue dated September 28, 1970, the assessee is entitled to the extra shift allowance on the entire machinery, as claimed by it. It was argued on behalf of the revenue that the circular of the Board of Revenue is only an administrative direction and it will not override the law.

Instructions, etc., meant to be given to income-tax authorities –

The provisions of section 119 are abundantly clear that such order, direction or instruction must be given to some other income-tax authority so as to be binding on such authority. In CIT v. Kerala Financial Corpn. [1985] 155 ITR 228/30 Taxman 153 (Ker.), it was held that a letter of clarification issued by the Board to an assessee or other person who is not an authority under section 116 cannot be treated as a circular within the meaning of section 119. The Allahabad High Court held in Janata Metal Works v. CIT [1990] 53 Taxman 353 that a letter from the Chairman of the Board, addressed to the Commissioner entitled 'Action plan for 1987-1988' and meant to reduce the work load of the department and at the same time to check any abuse or unfair advantage being taken by unscrupulous assessees of the summary assessment scheme, cannot be treated as an instruction, order or direction within the meaning of section 119 and that it is more in the nature of administrative instruction.

Advertisement in newspapers –

In Janata Metal Works' case the Court took the view that an advertisement published in newspapers does not purport to be based on any circular or instruction issued by the Board and such

advertisement cannot be equated with law nor it can be relied upon to deprive the Assessing Officer of the statutory powers vested in him by law, no plea of estoppel can be taken in such cases. Earlier in Ved Prakash Gupta v. CIT [1957] 32 ITR 133 (All.), it was held that a press notification issued by the Ministry of Finance dealing with concessional scheme for payment of arrears of tax and voluntary disclosure of income has no legal force having not been passed under the provisions of the Act. The court refused to issue mandamus directing the Assessing Officer to follow the same. The view taken in these decisions appears to be based on the form, i.e., advertisement or notification, in which the decision taken was conveyed to the general public.

Nature of the powers

The powers given to the Board under section 119(1) are to issue orders, directions and instructions to income-tax authorities for proper administration of the Act. Subject to two restrictions, viz., (1) no directions can be given to make a particular assessment or to dispose of a particular case in a particular manner; (2) no interference can be made in the exercise of appellate function of the Commissioner (Appeals). The Board is the creation of the Act and the Legislature has delegated certain powers to it to ensure proper and efficient administration of the Act. In the garb of issuing instructions, the Board is not competent to arrogate to itself the power to legislate so as to run counter to the statutory provisions. In Kerala Financial Corpn. v. CIT [1994] 210 ITR 129/75 Taxman 573 (SC), it was held that such an order, instruction or direction cannot override the provisions of the Act; that would be destructive of the known principles of law as that would amount to giving power to delegate authority even to amend the provisions of law enacted by the Parliament. In Himachal Pradesh State Forest Corpn. Ltd. v. Dy. CIT [1998] 231 ITR 556 (HP), the Court observed that it is well settled that the Board's instructions cannot prevail over the statute and when the Legislature has introduced a provision in the statute, it is not for the Board to instruct the officer not to comply with the provisions of the statute in the guise of giving instructions to them.

Mitigation of hardship

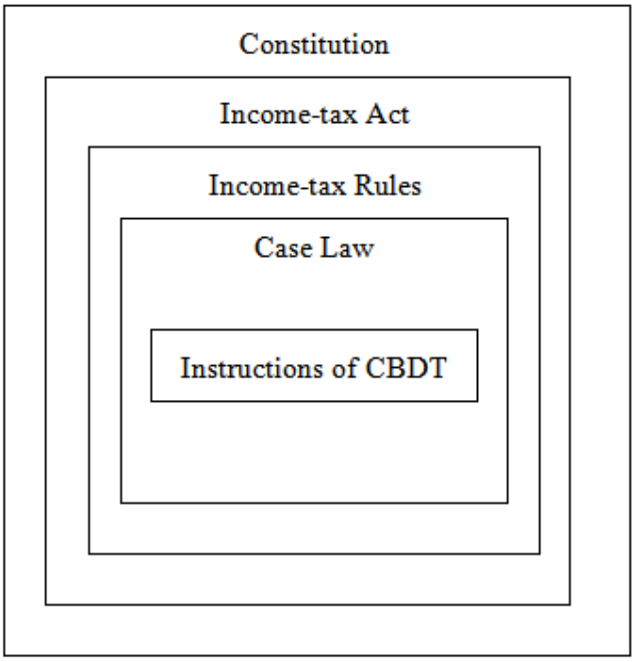
The Board can, however, issue instructions to mitigate hardship and rigours of law. Such benevolent circulars are in the nature of administrative relief and will go to the assistance of the assessee. They 'supplant' the law and do not 'supplement' it. In the garb of directions under section 119, the Board is not competent to impose any burden on the taxpayer. Reference can be made to Madhya Pradesh High Court decision in Jaikishan Gopikishan & Sons v. CIT [1989] 178 ITR 481/44 Taxman 230.

Clarificatory circulars

The Board may issue circulars clarifying the scope and ambit of statutory provisions of the Act. Such clarifications are invariably issued after each Finance Act and the Amendment Act. In Bombay Goods Transport Association v. CBDT [1994] 210 ITR 136/76 Taxman 334 (Bom.), it was held that such circulars interpreting the relevant provisions provide considerable aid to construction of a statute to ascertain the true intention of the Legislature as well as intention of those incharge of its administration.

Instructions of CBDT are part of income-tax law

The instructions of the CBDT are part of compendium of law that governs the levy and collection of income-tax. The figure given below depicts the hierarchical status of different types and forms of income-tax law.



Our Constitution is the fundamental law of land. All the activities of our Legislatures, executives and of judiciary have to be within its boundaries. The Rules framed under the authority of the Act constitute subordinate legislation. They are within the boundaries of the Act. The judges interpret the constitutional and statutory boundaries. Instructions of the CBDT issued under the authority of section 119 are recognized as part of compendium of income-tax law.

Forms of circulars

The circulars issued by the Board can be in various forms, but the binding nature of the circular is not affected simply because of a particular form. It depends on the contents of the subject-matter. Some of the forms of circulars are:

(a) Circular
(b) Advertisement
(c) Letter
(d) Order
(e) Press Note
(f) Clarification
(g) Instruction
(h) Questions and Answers - (Amnesty Scheme)

Binding nature

Section 119(1) in clear terms provides that all authorities employed in the execution of the Act are duty-bound to observe and follow the orders, instructions and directions of the Board. It is well established that Circulars issued by the Board are binding on the officer and persons employed in the execution of the Act, more so, circulars beneficial to the assessee which tone down the rigours of

law. The benefit of such circulars is available to the assessee even though the circulars might have mitigated from the strict tenor of the statutory provision and mitigate the rigours of law. In view of the binding nature of the circulars, it is not open to the revenue to raise a contention which is contrary to the circulars and instructions issued by the Board. Circulars issued by the Board are normally meant to be followed and accepted by the authorities as held in CIT v. Vasudev V. Dempo [1992] 196 ITR 216/66 Taxman 151 (SC). In Ellerman Lines Ltd. v. CIT [1971] 82 ITR 913 (SC). It was held that even if the directions given by the Board deviate from the provisions of the Act, they are binding on the officers.

The directions given by the Board are not binding on the courts. In Indo-Gulf Fertilizer Corpn. Ltd. v. Union of India [1992] 195 ITR 485/64 Taxman 96 (All.), it was held that so far as the authorities are concerned, the directions given by the Board are binding but so far as courts are concerned they would only examine whether the orders passed by the authorities are in accordance with the provisions of the Act or not and if the directions of the Board are beyond the scope of the provisions of the Act, the authorities can be asked to act according to law. In CIT v. Hero Cycles (P.) Ltd. [1998] 228 ITR 463/94 Taxman 271 (SC) it was held that it is well settled that the circulars issued by the Board can bind the ITO but not the appellate authority or the Tribunal or the Court or even the assessee. In Smt. K. Bhoomiamma v. CIT [1992] 194 ITR 723 (Kar.), it was held that a circular is binding on the income-tax authorities but if against the provisions of the Act, an unwilling assessee is entitled to ignore it. In Jaikishan Gopikishan & Sons's case (supra), it was held that a circular can deviate from the provisions of the Act but it is not open for the department to contend, even in cases where the circular goes beyond the terms of the section, that the circular has no legal effect or should not be given effect to. The decision of Calcutta High Court in Grindlays Bank PLC v. CIT [1993] 201 ITR 148 is also to the effect that circulars against law are binding on income-tax authorities but not on the Tribunal or Court.

Circulars issued by the Board to carry out an assurance given by the Minister in the Parliament to provide relief in case of extreme hardship, would be binding on all officers and persons employed in the execution of the Act - Navnit Lal C. Javeri v. K.K. Sen, AAC [1965] 56 ITR 198 (SC). In Bhartiya Engg. Corpn. (P.) Ltd. v. R.G. Deshpande, Addl. CIT [1981] 130 ITR 442/1 Taxman 441 (Bom.), the Commissioner rejected the application on the ground of limitation. On the basis of assurance given by the Board to the Public Accounts Committee that no application for refund will be rejected on the ground of limitation, the Court held the assurance given by the Board was in the nature of administrative directions and binding on the Commissioner.

Effect of modification or withdrawal of Circular

It is a settled legal position that benevolent circulars issued by the Board confer certain rights and privileges on the taxpayers. Such rights of the assessee cannot be adversely affected, for that assessment year in which the circular was operative, by subsequent recall or withdrawal of the circular. In CIT v. Geeva Films [1983] 141 ITR 632 (Ker.), it was held that a circular issued by the Board existing at the beginning of the assessment year will be applicable and the subsequent modification of the circular will have no relevance. The special leave petition filed by the department was dismissed by the Supreme Court in CIT v. Geeva Films [SLP No. 1909 of 1980]. A similar view was expressed by the Andhra Pradesh High Court in CIT v. N.T. Ramarao (HUF) [1987] 163 ITR 453/31 Taxman 5. The Madras High Court took a similar view in CIT v. Prasad Productions (P.) Ltd. [1989] 179 ITR 147/45 Taxman 95 and observed : ". . . The law to be applied is that in force in the assessment year, unless otherwise stated or implied and that the provisions of the Act as they stand

amended on the 1st of April of the financial year must apply to the assessment for that year. If this be the position with reference even to amendments in the Act, there is no reason as to why that cannot be regarded as applicable in respect of directions and instructions issued by the Board under section 119 and intended for the benefit of the assessee."

The cardinal principle is that the directions issued by the Board should not be against the provisions of the Act, but nevertheless even if these deviate from the statute these will be binding on the authorities. If subsequently such instructions are withdrawn and fresh instructions are issued, the Tribunal will be justified in giving effect to the revised instructions. This view was expressed in Karnataka State Financial Corpn. v. CIT [1988] 179 ITR 141 (sic). The reason is simple. Even if such instructions had not been withdrawn, the Tribunal would have interpreted the provisions as they appear in the statute.

Conclusion

The legal propositions regarding the scope and applicability of CBDT Circulars that emerge from a resume of case law can be summed up as under :

(i) Certain Circulars of the Board confer some privileges and rights on the assessee in regard to assessment.

(ii) Such circulars as they stand on the first day of April of the assessment year must apply to the assessment of that year.

(iii) Modification or withdrawal of such circulars during the pendency of assessment proceedings, cannot prejudicially affect the right of the assessee to have his assessment made in accordance with the circular as it stood prior to its amendment or withdrawal.

These propositions, of course, would not be applicable to circulars which affect only administrative or procedural aspects.

120 JURISDICTION OF INCOME-TAX AUTHORITIES.

Theory Question

Income-tax authorities shall exercise all or any of the powers and perform all or any of the functions conferred on, or, as the case may be, assigned to such authorities by or under this Act in accordance with such directions as the Board may issue for the exercise of the powers and performance of the functions by all or any of those authorities.

The directions of the Board may authorise any other income-tax authority to issue orders in writing for the exercise of the powers and performance of the functions by all or any of the other income-tax authorities who are subordinate to it.

In issuing the directions or orders the Board or other income-tax authority authorised by it may have regard to any one or more of the following criteria, namely

(a) territorial area;

(b) persons or classes of persons;

(c) incomes or classes of income; and

(d) cases or classes of cases.

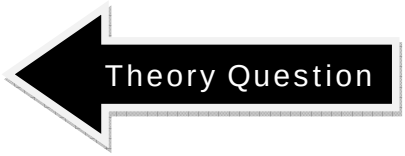
Board may, by general or special order, and subject to such conditions, restrictions or limitations as may be specified therein,—

(a) authorise any Director General or Director to perform such functions of any other income-tax authority as may be assigned to him by the Board;

(b) empower the Director General or Chief Commissioner or Commissioner to issue orders in writing that the powers and functions conferred on, or as the case may be, assigned to, the Assessing Officer by or under this Act in respect of any specified area or persons or classes of persons or incomes or classes of income or cases or classes of cases, shall be exercised or performed

The directions and orders may, wherever considered necessary or appropriate for the proper management of the work, require two or more Assessing Officers (whether or not of the same class) to exercise and perform, concurrently, the powers and functions in respect of any area or persons or classes of persons or incomes or classes of income or cases or classes of cases; and, where such powers and functions are exercised and performed concurrently by the Assessing Officers of different classes, any authority lower in rank amongst them shall exercise the powers and perform the functions as any higher authority amongst them may direct, and, further, references in any other provision of this Act or in any rule made thereunder to the Assessing Officer shall be deemed to be references to such higher authority and any provision of this Act requiring approval or sanction of any such authority shall not apply.

JURISDICTION OF ASSESSING OFFICERS. 124.



Where by virtue of any direction or order issued, the Assessing Officer has been vested with jurisdiction over any area, within the limits of such area, he shall have jurisdiction

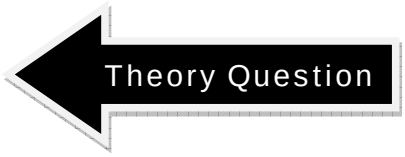
(a) in respect of any person carrying on a business or profession, if the place at which he carries on his business or profession is situate within the area, or where his business or profession is carried on in more places than one, if the principal place of his business or profession is situate within the area, and

(b) in respect of any other person residing within the area.

Where a question arises as to whether an Assessing Officer has jurisdiction to assess any person, the question shall be determined by the Director General or the Chief Commissioner or the Commissioner; or where the question is one relating to areas within the jurisdiction of different Directors General or Chief Commissioners or Commissioners, by the Directors General or Chief Commissioners or Commissioners concerned or, if they are not in agreement, by the Board or by such Director General or Chief Commissioner or Commissioner as the Board may, by notification in the Official Gazette, specify.

No person shall be entitled to call in question the jurisdiction of an Assessing Officer.

POWER TO TRANSFER CASES 127



The power of transfer conferred on the authorities is not purely of administrative nature. The said power has to be exercised after giving a reasonable opportunity of being heard and the order of transfer has to be passed after recording the reasons for the same. It has to be an order of a quasi-judicial nature and should not be arbitrary.

section 127 provides that the transferring authority shall give the assessee a reasonable opportunity of being heard wherever it is possible to do so. In other words, a show-cause notice should be sent to the assessee requiring him to show a cause as to why his case should not be transferred. This opportunity should be extended in all cases except where the authority finds it impossible to do so. However, the onus is squarely on the transferring authority to prove that it is not possible to afford such an opportunity.

However, the opportunity of being heard is not required to be given where the transfer is from any Assessing Officer to any other Assessing Officer and the offices of both the Assessing Officers are situated in the same city, locality or place. However, it may be noted that this sub-section waives only one of the two requirements. The requirement of recording reasons for passing the transfer order is not affected by this sub-section. Therefore, it is necessary to comply with the condition even in the case of transfer of case between the two Assessing Officers whose offices are situated in the same city, locality or place. In *Ajantha Industries* v. *CBDT* [1976] 102 ITR 281, the Supreme Court has held that the requirement of recording reasons for the transfer of case is a mandatory requirement. Any non-communication of the reasons will be fatal to the validity of the very transfer itself. In a series of cases, the judiciary has quashed the transfer orders made under section 127 on the basis that either a reasonable opportunity of being heard was not afforded or proper reasons had not been recorded for the transfer. A few of such decisions are - Sidh Gopal Gajanand v. ITO [1969] 73 ITR

226 (All.); Peacock Chemicals (P.) Ltd. v. CIT [1990] 182 ITR 98 (All.); Saptagiri Enterprises v. CIT [1991] 189 ITR 705 (AP); Y. Moideen Kunhi & Co. v. ITO [1993] 204 ITR 29 (Kar.); Anil Mittal v. Chief CIT [1997] 225 ITR 282 (Punj. & Har.); Rajasthan Mining & Engg. (P.) Ltd. v. CIT [1998] 98 Taxman 197 (Raj.); General Exporters v. CIT [1998] 98 Taxman 257 (Punj. & Har.); Vijayashanthi Investments (P.) Ltd. v. Chief CIT [1991] 187 ITR 405/56 Taxman 190 (AP) and V.K. Steel Industries (P.) Ltd. v. Asstt. CIT [1991] 187 ITR 403 (AP).

Transfer at request of assessee

Even though at the outset, it appears that the transfer is at the instance of the department, it is permissible for the assessee also to make an application for the transfer. The Bombay High Court in *Devidas's* case (infra) observed that though section 127 refers to *suo motu* jurisdiction, it is a settled law that such jurisdiction can be triggered either by an assessee or the revenue. In *Krishna Mohan Banik* v. *ITO* [1998] 232 ITR 339 (Gau.), it is held that regarding transfer of the assessment to any other Assessing Officer, it is always open to the petitioner to move the concerned authority under section 127. A right to have his case transferred from one Assessing Officer to another is conferred on the assessee, provided the assessee can satisfy the authorities of the need in this behalf, and can support the same on valid and proper grounds. In the case of *Shiraj Sunfix Co. (P.) Ltd.* (infra), the Allahabad High Court directed the Commissioner to consider the application of the assessee for transfer, wherein the assessee had alleged bias on part of the Assessing Officer. The following Court cases have also recognised the right of the assessee to make such application - *Autofin Ltd.* v. *CIT* [1977] 106 ITR 638 (AP); *Devi Dayal Marwah* v. *CIT* [1964] 52 ITR 829 (AP); *Shiraj Sunfix Co. (P.) Ltd.* v. *CIT* [1993] 201 ITR 457 (All.) and *Devidas* v. *Union of India* [1993] 200 ITR 697 (Bom.).

In the event of the Chief Commissioner or Commissioner refusing to transfer the case, the application may be made to the CBDT under section 120. Further, the said application may be moved to the CBDT con-currently also. On the question whether a writ lies against the refusal to transfer, it has been held that in *Shiraj Sunfix's Co. (P.) Ltd.'s* case (*supra*) ordinarily no writ lies against the same. However, if the order is *ex-facie* perverse or is vitiated by patent error on the face of the record, the High Court may interfere under article 226 of the Constitution.

As regards the question as to whether the case can be transferred from one place to another place even though the registered office of the company continues to be at the first mentioned place, it may be noted that for the purpose of assessment, the jurisdiction is conferred on the Assessing Officer under section 120(1)/(2). Sub-section (3) enlists various factors which may be considered by the CBDT or Chief Commissioner or Commissioner in conferring such jurisdiction which, *inter alia*, includes territorial area. Section 124(1) provides that where the jurisdiction is conferred on the basis of territorial area, the Assessing Officer having jurisdiction over the area where the assessee's principal place of business is situated is his jurisdictional Assessing Officer. In an old case of *Deenanat Hemraj* 2 ITC 304, it has been held that the principal place is the place where the business is directed or controlled. Therefore, if the business of a company is directed or controlled through its corporate office and not through the registered office, it may be said that the appropriate place for the purpose of jurisdiction is the place where the corporate office is located. Further, both sections 120 and 124 are silent on the question as to whether the location of registered office is the crucial test for deciding the jurisdiction.

Kapil Roller Flour Mills (P.) Ltd

A recent decision of the Punjab & Haryana High Court in the case of *Kapil Roller Flour Mills (P.) Ltd.* v. *CBDT* [1998] 101 Taxman 659 dealt with a writ application filed by the company against the refusal of the Board to entertain the transfer application. In this case, the Board refused the application to transfer the case from Rohtak to Ahmedabad quoting three reasons as follows :

(*a*) The registered office of the company was situated in Hissar since the year 1991 which had not yet been shifted to Ahmedabad.

(*b*) For administrative reasons, it would be proper if witnesses and papers found during the search and seizure operations were examined in the charge of Chief Commissioner, Chandigarh.

(*c*) The applicant had availed sales tax exemption under the Sales Tax Laws in respect of its Hissar plant and, therefore, could not close its business at Hissar in Haryana.

The High Court ruled that the above reasons quoted could not be faulted with and, therefore, dismissed the petition observing that the raids were carried out in the premises of the applicant and the applicant did not make any attempt to shift the registered office. It appears that the High Court was carried away more by the fact that the applicant was subjected to raid than that the applicant did not make any attempt to shift the registered office. It is respectfully submitted that the reasoning given by the High Court for rejecting the writ petition insofar as it related to non-shifting of registered office by the applicant requires a reconsideration. This is for the reason that the domicile of the registered office does not in any way decide the jurisdiction under the provisions of the Act.

Transfer not to affect the pending proceedings

Even though, the term 'case' for the purpose of section 120 and section 127 has been defined to mean all proceedings which may be pending or which may have been completed and to include all proceedings which may be commenced later, it may be noted that the transfer of case need not necessarily mean the complete transfer of all documents, files and other relevant records for all years. In other words, it need not be a transfer on lock, stock and barrel basis. The transfer may be made selectively, say, for a particular assessment year or years.

The said order of transfer does not affect the pending proceedings as per the verdict of the Supreme Court in the case of *CIT* v. *Bidhu Bhusan Sarkar* [1967] 63 ITR 278. For example, in the case of an assessee whose scrutiny assessment for an assessment year, say, assessment year 1997-98, is pending in Mumbai, while retaining the records relating to the assessment year 1997-98 at Mumbai, a petition may be moved before the Chief Commissioner for transfer of the jurisdiction in respect of other assessment years to Bangalore.

Conclusion

After a comprehensive reading of the provisions of the Act and judicial pronouncements, it may be concluded as follows :

(*a*) The ordinary power of transfer of case with Director General, Chief Commissioner and Commissioner under section 127.

(*b*) The Board has its inherent powers to transfer the case under section 120.

(*c*) The transferring authority shall satisfy the composite requirements of

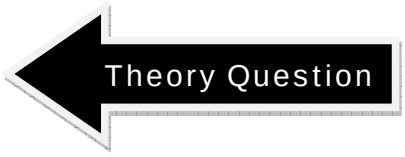
(1) affording the assessee a reasonable opportunity of being heard,

(2) recording the reasons for the same and mentioning the reasons in the order.

(*d*) The assessee may also make a petition under section 127 for the transfer of the case.

(*e*) The transfer of the case need not necessarily affect the pending proceedings.

DISCOVERY, PRODUCTION OF EVIDENCE, ETC. SEC. 131



The Assessing Officer, Deputy Commissioner (Appeals), Joint Commissioner, Commissioner (Appeals)] and Chief Commissioner or Commissioner and the Dispute Resolution Panel 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.

Powers need not be restricted

[2003] 262 ITR 0428- AMWAY INDIA ENTERPRISES VS. UNION OF INDIA (KER)

Section 131 grants power to the Assessing Officer to issue summons for discovery or inspection or for production of books of account. Where a Deputy Director of Income-tax (Inv.) in Kerala required information from a company with its head office in New Delhi on payments made by the company to their distributors in Kerala under section 131, such power was challenged unsuccessfully in Amway India Enterprises v. Union of India [2003] 262 ITR 428 (Ker). Apart from the question of jurisdiction, it was also contended that such a general enquiry calling for information on commission to all the distributors was not justified. The High Court felt that the enquiry was justified in that the Deputy Director under section 131(1A) has the power under section 131, that such power is not restricted and that the requirement of information relating to disbursements beyond a limit in the context of information that many of the distributors are not paying tax.

Food Corpn. Of India

The Apex Court in the case of *Food Corpn. of India* v. *Provident Fund Commissioner* [1990] 1 SCC 68, 71 has held that:

"The authority empowered under section 131 should exercise all his powers to collect all evidence and collate all material before coming to proper conclusion. That is the legal duty of such authority. It would be failure to exercise the jurisdiction, particularly when a party to the proceeding requests for summoning evidence from a particular person."

The following case law is also noteworthy :

(*a*) Where additions holding that some purchases were fictitious, were made on the ground that summons to the sellers were received back unserved, that itself would not lead to the conclusion that the purchases were inflated or fictitious - *Muthoottu Bankers* [1992] 106 Taxation (Coch.) (AT).

(*b*) The case before the Tribunal in *Shri Sagar Bose* [1995] 132 Taxation 154 (Cal.) (AT) illustrates how addition on the basis of insufficient evidence is bound to be deleted. The Assessing Officer got enquiries made through the inspector who reported that some of the purchasers were non-existent. The summons sent were received back. The assessee claimed that payments were made by account payee cheques and the sales tax numbers were printed on the bills given by the parties. The Assessing Officer rejected the assessee's request for issue of summons to the parties. No enquiries were made from the banks and the local dealers to establish *mala fides.* The addition was deleted.

(*c*) If the evidence of a witness is material, it is the duty of the officer to enforce his attendance as per the provisions of section 131(1), read with Order XVI, rule 10 of the Code. If in spite of an application under section 131 having been made by the assessee, the Income-tax Authority does not properly exercise his powers under the section for enforcing the attendance of a witness, he shall not be justified in fastening the blame at the door of the assessee and in disbelieving his version of the facts for that reason - *Nathu Ram Prem Chand* v. *CIT* [1963] 49 ITR 561 (All.).

(*d*) The assessee had paid commission to various parties and had requested the ITO to issue summons to those parties. Commission was disallowed without issuing summons. It was held that the officer was duty bound to issue the summons, as the assessee had no such powers to enforce their attendance. The matter was remanded to the Assessing Officer to decide the matter afresh after complying with the assessee's request - *Prashant Khosla Pneumatics Ltd.* v. *Asstt. CIT* [1995] 54 ITD 229 (Delhi) (AT).

(*e*) Where the assessee had produced letters of confirmation and discharged hundies and particulars of creditors and their GIR numbers were with the department and apart from issuing notices under section 131 at the instance of the assessee, the department did not pursue the matter further and did not examine the source of income of the creditors to find out whether they were creditworthy or were such who could advance the loans, the assessee could not do anything further. In the premises, if the Tribunal came to the conclusion that the assessee had discharged the burden that lay on it, then it could not be said that such a conclusion was unreasonable or perverse or based on no evidence - *CIT* v. *Orissa Corpn. (P.) Ltd.* [1986] 159 ITR 78/25 Taxman 80 (SC).

Penalty Provisions			
Section	Nature of Default	Minimum penalty	Maximum Penalty
272A(1)(a)	Failure to answer any question put to a person (who is legally bound to state the truth of any matter touching the subject of his assessment) by an income-tax authority.	Rs. 10,000 for each default	Rs. 10,000 for each default
272A(1)(b)	Failure to sigh any statement made by a person in course of income-tax proceeding	Rs. 10,000 for each default	Rs. 10,000 for each default
272A(1)(c)	Failure to comply with summons issued under section 13(1) to attend office to give evidence and produce books of account or other documents	Rs. 10,000 for each default	Rs. 10,000 for each default

POWER TO REQUISITION BOOKS 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	

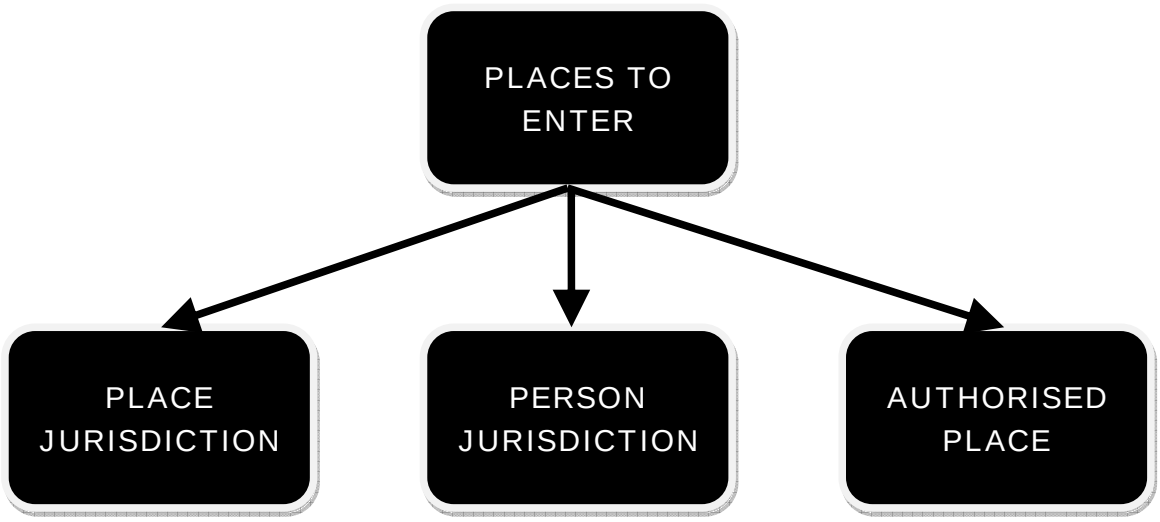
Then, the ITA referre to as the requisitioning officer to require the officer or authority referred to deliver such books of account, other documents or assets to the requisitioning officer.

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

The power of conducting survey under section 133A of the Income-tax Act, 1961 ('the Act') has been mainly given to the income-tax authorities to bring new assessees into the tax net. Its purpose is also to unearth black money, and check tax evasion. But the blanket power bestowed upon the income-tax authorities has created a number of practical difficulties. It clearly appears that the remedy has become worse than the disease. This power has been with the tax authorities for the last many years. Therefore, time has come now to review and study the entire working and the manner in which this power is used by the tax authorities. The acid test to be applied is to see whether the objects for which the power was given have been achieved or whether it has resulted in harassment and corruption only.



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,

Theory Question

(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.

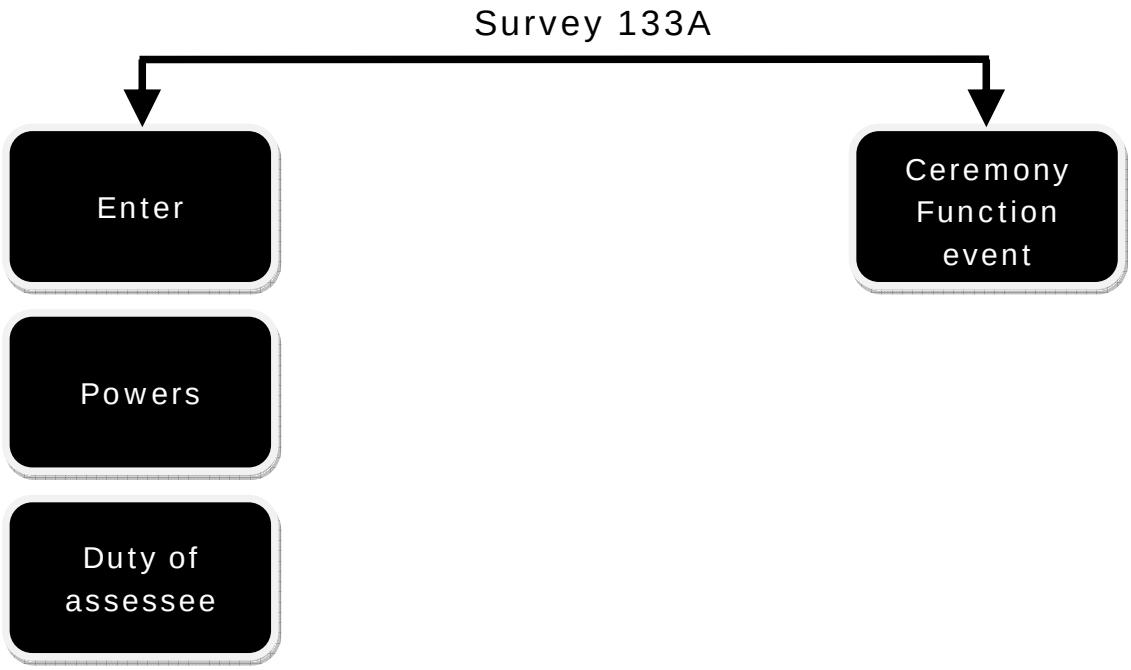
An income-tax authority may enter any place of business or profession only during the hours at which such place is open for the conduct of business or profession and, in the case of any other place, only after sunrise and before sunset. 133A(2)

Theory Question

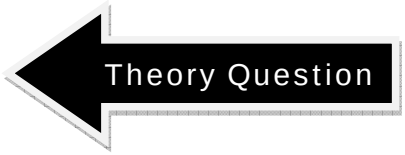
Duty of assessee

- 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.

Theory Question

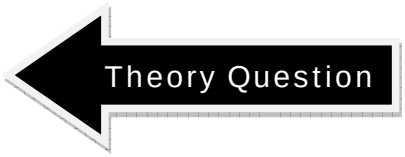


POWERS OF ITA 133A(3)



- 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 FOR 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.

This provision has added fuel to the fire. The unfettered power given under this section has brought about unnecessary harassment of assessees. Let us see the implications of this provision.

Under this section, the income-tax authorities are empowered to make inquiries regarding the nature and scale of expenditure in connection with any function, ceremony or event, if the relevant income-tax authority is of the opinion that it is necessary or expedient to do so. Generally, this job is assigned to an inspector. But under this sub-section, the authorities can ask for the information at any time after such function, ceremony or event is over and not when the ceremony or function is in progress. In big cities, at the time of a marriage, the inspectors visit the party concerned to inquire about the expenditure made in connection with the ceremony. Now under section 69A, if the assessee offers no explanation or offers an explanation which, in the opinion of the ITO, is not satisfactory, then such unexplained expenditure can be treated as income of the assessee by exercising this power. How much black money has been unearthed in this way can be a project for research. It is unlikely that any worthwhile results have been obtained by the exercise of this power. A review of this power is also overdue.

Survey only after completion of ceremony

An inquiry under section 133A(5) can be commenced only after the completion of the ceremony. In other words, the survey team cannot commence such inquiry before or during the celebration of the ceremony. Generally, a survey is conducted after 15 days from the date of the function. Thus, the celebration is not disturbed by the survey team. Moreover, the survey team can enter the place of business only during the hours at which such place is open for the conduct of business and in the case of any other place, after sunrise and before sunset [section 133A(2)].

The important fact that emerges out of the above discussion is that the person concerned has reasonable time at his disposal to get the necessary books of account and other records updated and authenticate the expenses incurred for the purpose of the ceremony by book entries and supporting bills, receipts, etc., and satisfy the survey team at the time of survey itself. As a result, no summons under section 131 shall be issued and considerable inconvenience to the concerned person shall be avoided.

Need to satisfy survey team about expenses in question

Every possible care and caution should be exercised to convince the survey team that all expenses incurred for the purpose of the ceremony have been met out of accounted and disclosed income only. Otherwise, a survey under section 133A(5) may be followed by a survey under section 133A(1), i.e., a general survey, under which the survey team is vested with much wider powers of investigation. If in the course of a survey under section 133A(1), the survey team forms an opinion that the person concerned has a large amount of unaccounted money, a search under section 132(1) may follow. The principle that prevention is better than cure may be found useful here.

Documentary evidence of expenses

It is very important to collect the details of expenses related to the special occasion and the bills/receipts supporting such expenses. A summary of details of such expenses and supporting papers shall satisfy the survey team in all respects and the task for both the parties will be easy. In respect of petty expenses, where a bill or receipt is not available, a note book in which the necessary details are recorded may constitute satisfactory evidence.

A recent decision ON SURVEY

A recent case decided by a Metropolitan Magistrate, Delhi is instructive. This case is that of Hans Raj Chhabra v. Mukesh Mittal, Assistant Commissioner [1994] 77 Taxman 273.

From the evidence on record, the Magistrate discovered that the departmental officers had snapped a telephone wire and damaged the property of the assessee. They had also taken away the books of account by putting him under fear of injury and false prosecution. Not only this, the documents were also fabricated and forged. The climax was that even two customers, who were in the shop at the time of survey, were also not permitted to leave the shop. On the basis of these facts, the Magistrate observed that this was prima facie a case under section 342/427/384/465/471, read with section 120B of the Code of Criminal Procedure, 1908. Therefore, he came to conclusion that concerned departmental officers should be summoned for facing trial for offences punishable under the aforementioned sections. This case shows how the power of survey is abused by the departmental authorities. In this case, the departmental authorities not only harassed the assessee, but told him that if he prevented them from removing books of account, then he would be inviting injury and it would totally ruin him and his business and the whole of his family. He was also asked to sign various

papers which were not read over and signatures were also obtained under duress. The worst part of this action was that even though the books were impounded on 4-5-1990 at the business place, it was stated that they were impounded in the office of the ITO. The assessee complained that this statement was absolutely false and was a fabricated piece of evidence. As stated earlier, even the customers were not permitted to leave the business premises. Is this not illegal detention? Does it not infringe articles 19 and 21 of our Constitution? In Menaka Gandhi's case Justice Krishna Iyer has observed by referring to the views of Socrates that "A citizen has right to go where he pleases" [1978] 1 SCC 248. But the authorities in this case ignored even the constitutional provisions and encroached upon the personal liberty of citizens.

How surveys are conducted ?

In big cities, when the survey party visits the place of business of a person, then the accounting of the stock goes on for days together. If the entire survey team goes on taking an account of the stock from morning till evening, then after a few days, the stage comes when both the assessee and the survey party get tired. Therefore, in a number of cases, the entire stock is taken on estimate basis. But naturally the officers never record this fact while taking the statement of the assessee. On paper, they create a rosy picture by stating that the entire stock has been actually verified and has been valued. On this basis, they bring pressure on the assessee to declare the income. Many a time the assessee has no alternative but to accept what the departmental authorities dictate. He knows that otherwise the nuisance of stock-taking will continue for days together, thus, affecting and paralysing his business. Thus, declarations are obtained under undue influence, and when such declarations are made, the department claims that the survey had been a great success, resulting in unearthing of black money but in reality it may not be so.

Secondly, it is true that in some cases, difference in the stock is detected, but does it mean that the excess stock is the suppressed income of one year only? After all, it may be the income of several years. This contention of the assessee is not accepted and there is a tug of war between the assessee and the tax authorities. But on grounds of equity and fairplay, it is not correct on the part of departmental authorities to tax such difference without giving the assessee the benefit of spread-over. Thirdly, how can they ignore that some stock is partly spoiled and some stock is of such a nature that the assessee will not be in a position to sell the same ? For example, if the colour of a certain lot of saries is faded, then it cannot be presumed that he would be in a position to sell the same at the normal gross profit. He will have either to sell those saries at a loss, or he may find it impossible to sell the same. The question is, as long as the suppressed stock is not sold, how can it be said that the assessee has earned income and is liable to pay tax ? Indeed, even if excess cash is found at the time of survey and if the assessee offers an explanation that it belongs to various persons, then the Tribunal has taken a view in case of *ITO* v. *Nagardas Jashraj* [1989] 28 ITD 386, Ahmedabad Bench that when the statement is made at the time of search and is supported by an affidavit, then such statement is reliable and in such a situation, the departmental authorities cannot come to the conclusion that the cash was the suppressed income of the assessee.

Assessment in survey cases

The assessment in such cases is a problem by itself. The result of survey may be material in making the assessment, but it is not the date of the survey, but the dates and the nature of the suppressed transactions discovered as a result of the survey that are important and material. This view has been taken by their Lordships of the Allahabad High Court in the case of *Shyam Lal Om Prakash* v. *CST* [1972] 29 STC 385. When the material recovered in a survey related to a year other than the relevant

assessment year, then the same could not be used for rejection of the account books for different years. This view has been taken by the Allahabad High Court in the case of *Baleshwar Flour & Oil Mills* v. *CST* [1987] 67 STC 450.

Conclusion

In view of the foregoing, it is suggested that the power of survey should be restricted only to new assessees, and the power of taking an account of cash or stock or other valuable assets in case of old assessees should be withdrawn. Or if at all such powers are to be retained, then income relatable to discrepancies found at the time of survey should not be assessed in one year but the benefit of spread over for at least 8 years should be given. If the administration is fair and judicious, then the assessee also would be co-operative and honest.

SEARCH AND SEIZURE

To "search" as per the *Shorter Oxford English Dictionary* means "to probe, scrutinize, examine, investigate". The right of the State to authorize a search has long been recognized. This is a power exercised against those who perpetrate fraud on the revenue. They should be found and brought to justice. Powers of search have therefore been incorporated into many a statute.

The right of the State to authorize a search has long been recognized. This is a power exercised against those who perpetrate fraud on the revenue. They should be found and brought to justice. Powers of search have therefore been incorporated into many a statute.

One of the methods by which the Department gathers information, evidence and other documents in order to facilitate a proper assessment of the income of an assessee is by the use of the powers conferred under section 132.

The provisions of section 132 provide for the authorization for search being issued by the authority concerned in favour of an authorized officer who is entitled to carry out the action of search and seizure. Clauses (a), (b) and (c) of section 132(1) lay down stringent conditions to be satisfied before the authority concerned makes up its mind to issue the authorization for search. This is because a search process creates serious inroads into the liberty and privacy of the person searched. Courts have been holding that unless there is enough information for the concerned authority to form a reasonable belief that the conditions prescribed in the aforesaid sub-sections have been satisfied, no authorization can be issued. Although courts may not look into the sufficiency of the reasons, it would be essential for the concerned authority to satisfy the court that there did exist prima facie reasons to authorize a search.

The Legislature in its wisdom has not made the actions taken by the Department pursuant to the provisions of section 132 appealable before the appellate authorities. Courts have been holding that the only recourse to the person searched is to move a writ petition under article 226 of the Constitution of India before the jurisdictional High Court questioning the legality or otherwise of the various actions taken under section 132, including the issue of the authorization for search.

Penalty Provisions			
Section	Nature of Default	Minimum penalty	Maximum Penalty
271AAA	Undisclosed income on the case of search (applicable if search is initiated on or after June 1, 2007)	10 % of un-disclosed income.	-

CONDITION PRECEDENT FOR CONDUCTING SEARCH (SECTION 132)

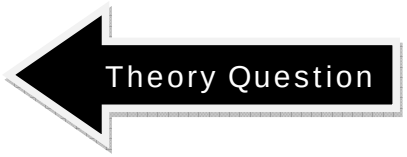
What is the principle underlying a search ? On the one hand is the freedom of the individual. His privacy and possessions are to be respected. A transgression thereof should be only under compelling reasons. On the other hand is the interest of society at large. Community living depends upon common good for the largest number. In a welfare State, the Government attempts to achieve this

objective. The resources for this are contributed by the masses - largely through taxes. Persons attempting to evade this responsibility, are to be found out and appropriate action taken. Balancing these interests, search and survey provisions have been introduced. Since these provisions are intrusions into an individual's privacy and possibly bring a stigma along with them, it is essential that due process of law is followed. Elaborate rules have been designed in this connection.

Under the criminal law, search follows naturally when an arrest is made. Search thus, is one of the incidents of the power of arrest. Under the Income-tax Act however, search need not be preceded by an arrest. A suspicion of undisclosed or concealed income/assets is sufficient for the issuance of a warrant of search.

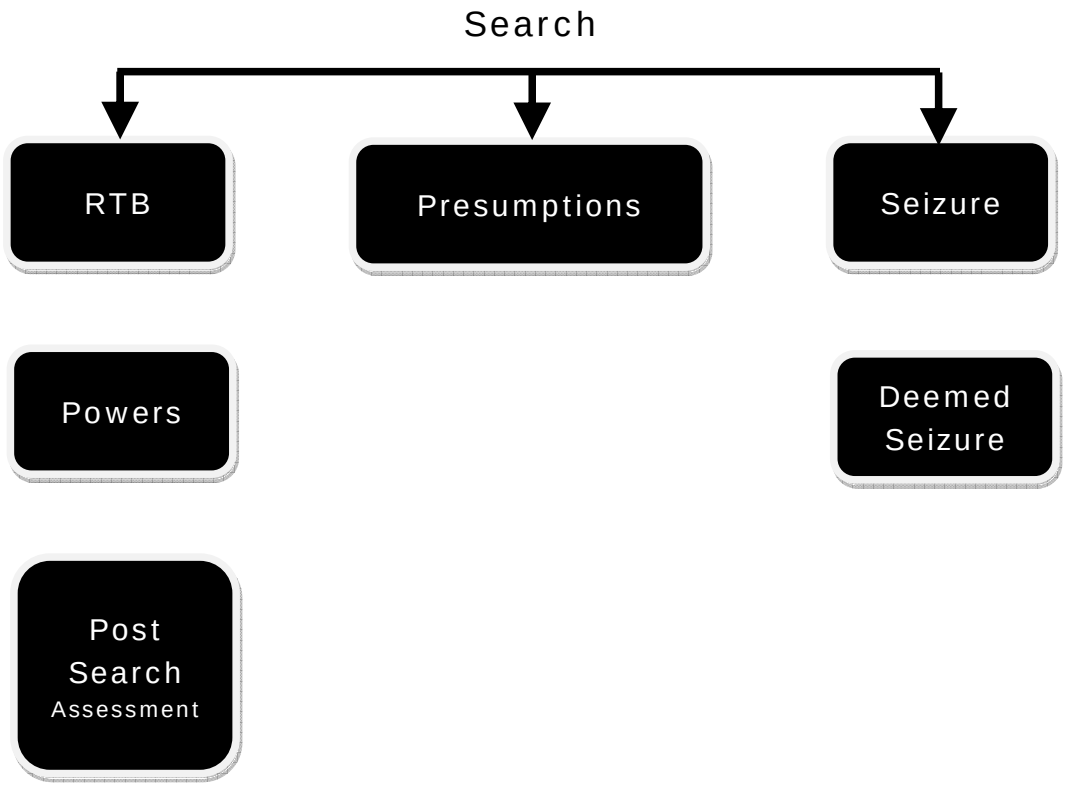
Where the Director General or Director or the Chief Commissioner Commissioner or Additional Director or Additional Commissioner any such Joint Director or Joint Commissioner as may be empowered in this behalf by the Board, in consequence of information in his possession, has reason to believe that

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 secretion 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.

Instruction No 7/2003, dated July 30, 2003

With a view of focus on high revenue yielding cases and to make the optimum use of manpower, the Board has decided that officers deployed in the Investigation Wing should restructure their activities. They should henceforth strictly adhere to the following guidelines :

(i) Searches should be carried out only in cases where there is credible evidence to indicate substantial unaccounted income/assets in relation to the tax normally paid by the assessee or where the expected concealment is more than Rs. 1 crore.

(ii) Search operation will also be mounted when there is evidence of hidden unaccounted assets arising out of a conspiracy to cause public harm, terrorism, smuggling narcotics, fraud, gangsterism, fake currency, fake stamp papers and such other manifestations ;

(iii) Tax payers who are professionals of excellence should not be searched without there being compelling evidence and confirmation of substantial tax evasion.

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.

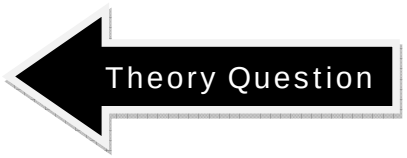
The conditions which require compliance before a search could be authorised, became the subject matter of decision in Mahesh Kumar Agarwal v. Dy. Dir. of I. T. [2003] 260 ITR 67 (Cal). There should be information giving rise to reason to believe. Reason to believe postulates belief itself and the existence 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 Bhujiawala 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



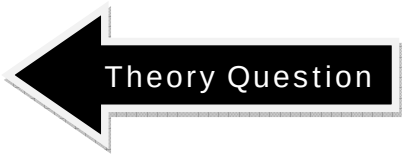
1) Enter and search any building, place, vessel, vehicle or aircraft where he has reason to suspect that such books of account, other documents, money, bullion, jewellery or other valuable article or thing are kept. (It shall be competent for authorized officer to exercise the powers in all cases where 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)
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.

Inspite 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)



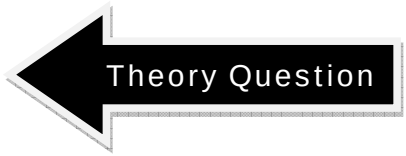
Where it is not possible or practicable to take physical possession of any valuable article or thing and remove it to a safe place due to its volume, weight or other physical characteristics or due to its being of a dangerous nature, the authorised officer may serve an order on the owner or the person 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.)

Prov. 2 to 132 (1) Deemed seizure	132(3)
It is not practical to seize any valuable article or thing due to v,w,d, pc	Where it is not practical to seize for the reasons other then prov. 2
Officer may serve an order on owner or possessor	Officer . . . . .
Shall not part or remove the assets without prior approval of officer	Shall not . . . . .
Deemed seizure	Expl. It is not a deemed seizure
Not applicable to stock in trade.	- - - -

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)

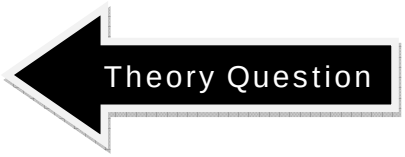


The authorised officer may, where it is not practicable to seize any such books of account, other documents, money, bullion, jewellery or other valuable article or thing, for reasons other than those mentioned in the second proviso to 132(1), serve an order on the owner or the person who is in immediate 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 me, 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)

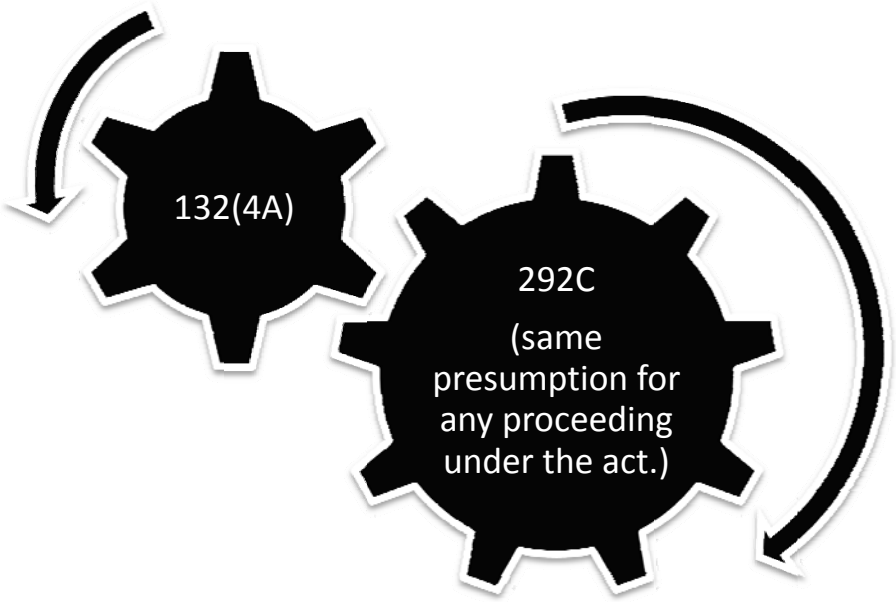


Where any books of account, other documents, money, bullion, jewellery or other valuable article or thing are or is found in the possession or control of any person in the course of a search,it may be presumed--

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.

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 can-not 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.

RIGHTS OF THE PERSON SEARCHED

To see the warrant of authorisation duly signed and sealed by the issuing authority.
To verify the identity of each member of the search party.
To make personal search of all members of the search party before the start of the search and on conclusion of the search.
To insist on personal search of ladies being taken only by a lady, with strict regard to decency.
To have at least two respectable and independent residents of the locality as witnesses.
A lady occupying an apartment being searched has a right to withdraw before the search party enters, if, according to custom, she does not appear in public.
To call a medical practitioner in case of emergency.
To allow the children to go to school, after checking their bags.
To have the facility to having meals, etc., at the normal time.
To inspect the seals placed on various receptacles, sealed in course of search and subsequently at the time of reopening of the seals.
To ensure that the facts stated by him have been so recorded correctly, as per section 132(4).
To have a copy of the panchnama together with all the annexures.
To have a copy of any statement that are used against him by the Department.
To have inspection of the seized books of account, etc., or to take extracts therefrom in the presence of any of the authorised officers or any other person empowered by him.
To see the warrant of authorisation and put signature on the same.

DUTIES OF THE PERSON SEARCHED

To identify all receptacles in which assets or books of account and documents are kept and to hand over keys to such receptacles to the authorised officer.
To identify and explain the ownership of the assets, books of account and documents found in the premises.
To identify every individual in the premises and to explain their relationship to the person being searched. He should not mislead by personation. If he cheats by pretending to be some other person or knowingly substitutes one person for another, it is an offence punishable under section 416 of the Indian Penal Code.
Not to remove any article from its place without notice or knowledge of the authorised officer. If he secretes or destroys any document with the intention of preventing the same from being produced or used as evidence before the court or public servant, he shall be punishable with imprisonment or fine or both, in accordance with section 204 of the Indian Penal Code.
To answer all queries truthfully and to the best of his knowledge. He should not allow any third party to either interfere or prompt, while his statement is being recorded by the authorised officer. In doing so, he should keep in mind that :

(i) if he refuses to answer a question on a subject relevant to the search operation, he shall be punishable with imprisonment or fine or both, under section 179 of the Indian Penal Code.
(ii) being legally bound by an oath or affirmation to state the truth, if he makes a false statement, he shall be punishable with imprisonment or fine or both under section 181 of the Indian Penal Code.

(iii) similarly, if he provides evidence which is false and which he knows or believes to be false, he is liable to be punished under section 191 of the Indian Penal Code.

To affix his signature on the recorded statement, inventories and the panchnama.

To ensure that peace is maintained throughout the duration of the search, and to co-operate with the search party in all respects so that the search action is concluded at the earliest and in a peaceful manner. Similar co-operation should be extended even after the search action is over, so as to enable the authorised officer to complete necessary follow-up investigation at the earliest.

132A. POWER TO REQUISITION

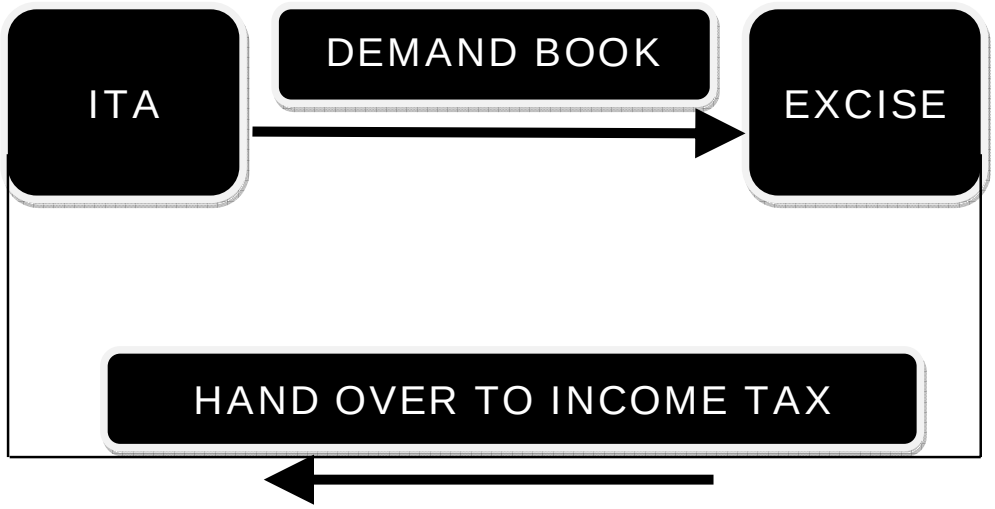
Where the Director General or Director or the Chief Commissioner or Commissioner, in consequence of information in his possession, has reason to believe that--

Theory Question

Any person to whom a summons or notices 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	Said books / documents / material / assets have been taken into custody 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 under the this Act 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 produce	
Any assets represent either wholly or partly income or property which has not been, or would not have been, disclosed for the purposes of act	

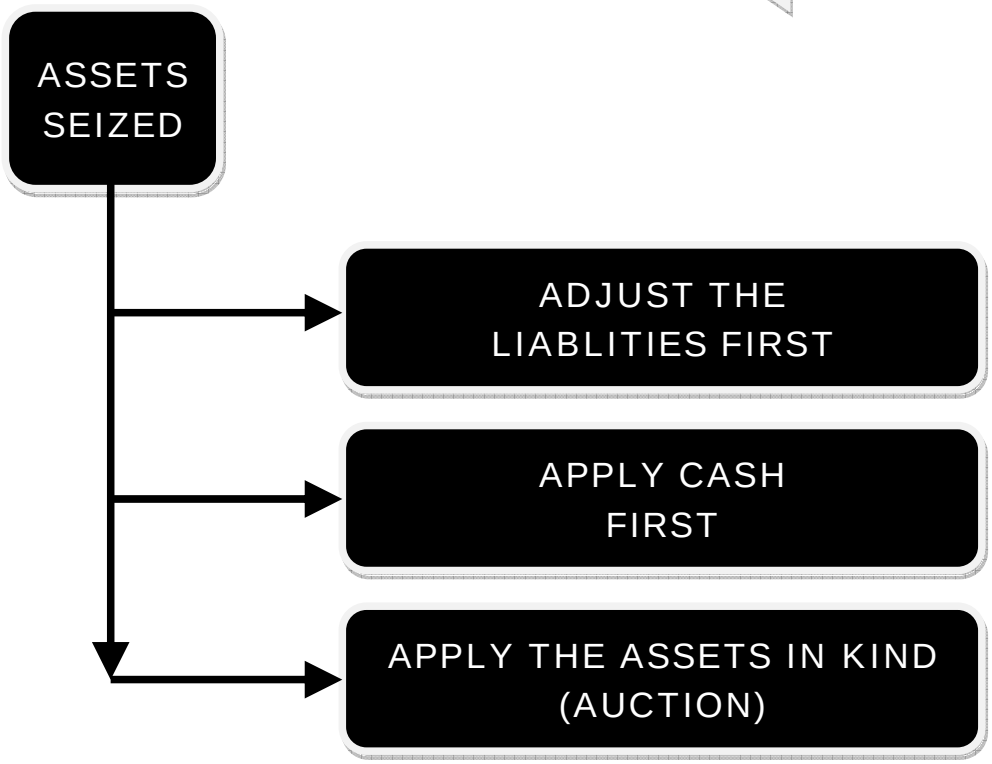
On a requisition being made the officer or authority as the case may be, shall deliver the books of account, other documents or assets to the requisitioning officer either forthwith or when such officer or authority is of the opinion that it is no longer necessary to retain the same in his or its custody.

Where any books of account, other documents or assets have been delivered to the requisitioning officer, the provisions of section 132 and section 132B shall, so far as may apply.



APPLICATION OF SEIZED OR REQUISITIONED ASSETS SECTION 132B

Theory Question



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.

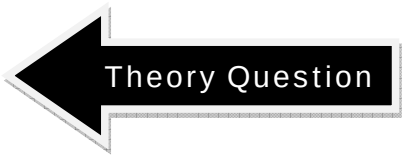
3) The assets other than money may also be applied for the discharge of any such liability as remains undischarged and for this purpose such assets shall be deemed to be under distraint as if such distraint was effected by the Assessing Officer or, as the case may be, the Tax Recovery Officer under authorisation 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 (less 3 months) 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.

SEC 153D POST SEARCH ASSESSMENT ORDER TO BE PASSED BY JC OR ABOVE OFFICER

New section 153D provides that no ***order of assessment or reassessment shall be passed*** by an Assessing Officer below the rank of ***Joint Commissioner*** in respect of,— *(*i) each assessment year falling within six assessment years immediately preceding the assessment year relevant to the previous year in which search is conducted under section 132 or requisition is made under section 132A; and *(i*i) the assessment year relevant to the previous year in which search is conducted or requisition is made under the said sections, except with the previous approval of the Joint Commissioner.

Some recent case law and its implications

1. The Delhi High Court in *M. B. Lal* v. *CIT* [2005] 279 ITR 298 (Delhi) has held that an appeal before the Tribunal does not take within its fold, questions touching the validity of the search. It is only the assessment proceedings under section 158BC that can be challenged in appeal. The satisfaction of the conditions precedent for a search, detailed in section 132(1)(a), (b) or (c) are beyond the scope of assessment proceedings. The validity of search may be questioned only in writ proceedings. In arriving at this decision, the High Court relied upon the Special Bench decision of the Income-tax Appellate Tribunal in *C. Ramaiah Reddy* v. *Asst. CIT (Investigation)* [2004] 268 ITR (AT) 49 (Bang.).

2. The Bombay High Court in *Diamond Star Exports Ltd.* v. *Deputy CIT (Investigation)* [2005] 278 ITR 36 (Bom) held the search proceedings invalid as there was no proper information for issuance of warrant. Other cases where search has been held to be illegal are : *Mahesh Kumar Agarwal* v. *Deputy Director of IT* [2003] 260 ITR 67 (Cal) ; *Ravi Iron Industries* v. *Director of Investigation* [2003] 264 ITR 28 (All) ; *Anita Sahai (Dr.) (Mrs.)* v. *Director of Income-tax (Investigation)* [2004] 266 ITR 597 (All) ; *Suresh Chand Agarwal* v. *Director-General of Income-tax (Investigation)* [2004] 269 ITR 22 (All). Though search may be illegal, the material obtained thereat may be used for regular assessment : *CIT* v. *K. V. Krishnaswamy Naidu and Co.* [2001] 249 ITR 794 (SC) ; *Dr. C. Balakrishnan Naiar* v. *CIT* [1999] 237 ITR 70 (Ker).

The trend portrayed through the above cases appears ominous. It is no doubt true that those who defraud the revenue should not go free. But is it not fundamental that the means which are adapted to this end are lawful. A good end does not justify a bad means. No man can take advantage of his own wrong-nullus commodum capere potest de injuria sua propria. A search which is mala fide, arbitrary, betrays application of mind ; is without jurisdiction ; is for a collateral purpose ; is patently erroneous should not be sustained. In such circumstances, the "effects" of an illegal search should also be quashed. The officers today, as it is, wield great powers. Sustaining of any wrong acts would aggravate their impunity in disregarding the due process of law.

3. Undisclosed income should be computed only on the basis of evidence found as a result of search. If there is no evidence or the evidence has already come on record or has been disclosed by the assessee, no block assessment can be made : *Morarjee Goculdas Spinning & Weaving Co Ltd.* v. *Deputy CIT* [2005] 95 ITD 1 (Mumbai) (TM)

In the context of the new assessment procedure, the above case law may not be very appropriate. Under the new procedure, the pending assessment proceedings abate. The "search assessment" would be the surviving assessment. In such an assessment, the Assessing Officer has to assess the entire income of an assessee. Thus, the duty is to complete the whole assessment de novo. His jurisdiction is not limited to assessing income represented by evidence found during search.

4. The undermentioned judgments contain a good discussion on "reasonable belief" about undisclosed income ; as also the meaning of "information": *M. S. Associates* v. *Union of India* [2005] 275 ITR 502 (Gauhati) ; *Sikkim Subba Associates* v. *Union of India* [2005] 276 ITR 456 (Sikkim).

Confession made during search

Taxpayers are not required to make a statement admitting or denying any concealment of income during the course of a survey. In this connection one may take note of the following instructions of the CBDT in F.No.286/2/2003-IT(Inv):

"Instances have come to the notice of the Board where assessees have claimed that they have been forced to confess the undisclosed income during the course of the search and seizure and survey operations. Such confessions, if not based upon credible evidence, are later retracted by the concerned assessees while filing returns of income. In these circumstances, confessions during the course of search and seizure and survey operations do not serve any useful purpose. It is, therefore, advised that there should be focus and concentration on collection of evidence of income which leads to information on what has not been disclosed or is not likely to be disclosed before the Income-tax Department. Similarly, while recording statements during the course of search and seizure and survey operations no attempt should be made to obtain confessions as to the undisclosed income. Any action on the contrary shall be viewed adversely.

Further in respect of pending assessment proceedings also, Assessing Officers should rely upon the evidence/materials gathered during the course of search/survey operations or thereafter while framing the relevant assessment orders."

From the foregoing instruction it is clear that it would not be open for an Assessing Officer to make an assessment merely relying on the confession statement of an assessee. The Assessing Officer would be bound to make an assessment only on the basis of evidence and materials gathered during the survey/search. The Ahmedabad Tribunal in the case of *Ashok Manilal Thakkar* v. *Asst. CIT* [2005] 279 ITR (AT) 143 has held that the statement (of disclosure) made during survey, has no evidentiary value. A return of income was filed without incorporating the "declared" income. Detailed reply was submitted why the declared income was not reflected in the return. Required explanation/evidence was also furnished. The Tribunal held that retraction was valid. The assessment was confirmed excluding the "declared income".

Conclusion

The present unsatisfactory state of "search assessments" is in large measure a contribution of all the three parties involved-the assessee, the assessing officer and the counsel concerned. The assessee blames the complex law and justifies the conduct citing the waste and ostentation of the Government. He is also under an "assurance" that the save for tax outgo, he would be left scot free. The tax gatherer, wields exorbitant power. The same is however not utilized solely for the state's benefits. A compromise is normally the bargain of the day. The counsel is unsure-whether he is to protect the assessee or the state-particularly when an offence is in evidence. One is therefore witness to a lack of will to enforce the law. Deterence consequently's not achieved. The provisions as drafted, favour the wrong doer. To search also means "an examination of one's conscience, an act of introspection". A survey of the landscape however indicates that these qualities appear to have ceased.

ASSESSMENT PROCEDURE

PRESUMPTION OF BOOKS AND ASSETS

A new section 292C relating to presumption as to assets, books of account, etc., is inserted, so as to provide that where any books of account, other documents, money, bullion, jewellery or other valuable article or thing are or is found in the possession or control of any person in the course of a search u/s 132, ***it may be presumed that***—

(i) Such books of account, other documents, money, bullion, jewellery or other valuable article or thing belong or belongs to such person;

(ii) The contents of such books of account and other documents are true; and

(iii) 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 at-tested.

The Supreme Court in the case of *Metraini v. CIT,* (287 ITR 209), held that the said presumptions are not available under any other proceedings under the Act. To meet with this situation, the new Section provides that the said presumptions will be applicable ***in any other proceeding under the Act.*** Corresponding amendments have also been made in the Wealth-tax Act.

TYPES OF RETURNS

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 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	Sept
2.	Where the assessee is a person other than a company:	Sept
	In case where accounts of the assessee are required to be audited under any law or under Income tax act.	Sept
	Where the assessee is a "working partner" in a firm whose accounts are required to be audited under any law	Sept
3	In any other case	July

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).

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 in 139(1) 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 1of 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.

Where a person has not made a return of income before the end of the relevant assessment year, the Assessing Officer may serve a notice under this sub-section on him after the end of the relevant assessment year, requiring him to furnish return of income.

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 (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 / collected 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 / collected 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 loos 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)

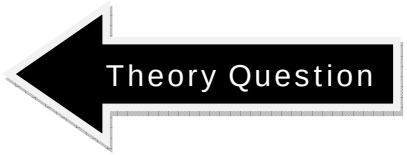
Distinction between a Defective Return and Invalid Return.

A defective return is not treated *ipso facto* as invalid return. It is only when the return contains any of the specified defects, the Assessing Officer communicates it to assessee who fails to rectify the same within the specified time, that the Assessing Officer may treat the return as invalid [Kerala State Bamboo 236 ITR 288].

Provisions of Defective Return Overrides the Provisions of Sec. 292B.

Sec. 292B provides that return furnished cannot be deemed to be invalid merely by reason of any defect or omission in such return of income if such return of income is in conformity with the intent and purpose of this Act. However, the provisions of Sec. 139(9) would override other provisions of the Act including Sec. 292B [National Ins. *v.* CIT 213 ITR 862].

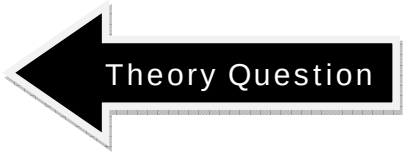
271F. PENALTY - FAILURE TO FURNISH RETURN OF INCOME.



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.

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.

Notice Under Sub-section (1) of action 142 of the Income-Tax Act 1961.

P.A.No AAKPU8906F

Office of the
Income-tax Officer - 16(3)(3),
2nd Floor, Room No.202,
Matru Mandir, Tardeo Road,
Mumbai - 400 007.

Date: 15.07.2008.

To

AMBRISH D. UDESHI
33, 420(E), 3RD FLOOR,
PRARTHANA SAMAJ, SVP ROAD,
MUMBAI – 400 004.

Sir/Madam,

In connection with the assessment for the Assessment Year 2006-07 you are required to:

(a) ** prepare a true and correct return of your income in respect of which you are assessable under the Income Tax Act 1961 during the previous year relevant to the Assessment Year mentioned above. The return should be in the appropriate form as prescribed in Rule 12 of the Income Tax Rules, 1962. It should be duly verified and signed in accordance with the provisions of section 140 of the said Act and be delivered at my office on or before _____.

(b) ** produce or cause to be produced before me at my office on ..... at.....AM/PM the accounts and / or documents specified overleaf.

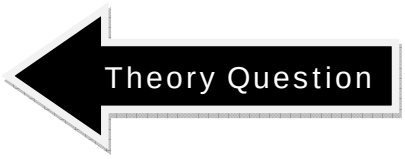
(c) ** furnish in writing and verified in the prescribed manner information called for as per annexure and on the points or matters specified therein before me at my office on 1.8.2008 at 10.45 A.M./ P.M..

AS PER ANNEXURE ENCLOSED HEREWITH

Yours faithfully,

(**NARENDRA L. SONEJI**)
Income-tax Officer - 16(3)(3),
Mumbai

TAX RETURN PREPARERS



For the purpose of enabling any specified class or classes of persons in preparing and furnishing returns of income, the Board may, without prejudice to the provisions of section 139, frame a Scheme, by notification in the Official Gazette, providing that such persons may furnish their returns of income through a Tax Return Preparer authorised to act as such under the Scheme.

It is further provided that every Tax Return Preparer shall assist the persons furnishing the return of income in such manner as may be specified in the Scheme framed under this section and affix his signature on such return.

It is also provided that a Tax Return Preparer shall be an individual (not being a person referred to in clause (*ii*) or clause (*iv*) of sub-section (2) of section 288 or an employee of the specified class or classes of persons) who has been authorized to act as a Tax Return Preparer under the Scheme framed under this section.

The Central Board of Direct Taxes is also empowered to frame the Scheme providing (*i*) the manner in which the Tax Return Preparers shall be authorised under the Scheme; (*ii*) the educational and other qualifications to be possessed, and the training and other conditions required to be fulfilled, by a person to act as a Tax Return Preparer; (*iii*) the code of conduct for the Tax Return Preparers; (*iv*) the duties and obligations of the Tax Return Preparers; (*v*) the manner in which the authorization may be withdrawn; (*vi*) any other matter which is required to be or may be specified. Every such Scheme shall be laid, as soon as may be after it is framed, before each House of Parliament.

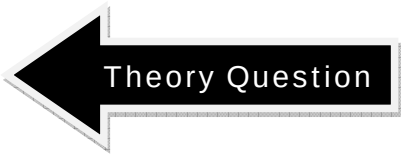
SCHEME FOR FILING OF RETURNS BY SALARIED EMPLOYEES THROUGH EMPLOYER, 2004:

An employee is eligible to furnish the return under this scheme if the following conditions are satisfied: Employee is resident in India.

- His salary income, before allowing deduction under Sec. 16, does not exceed basic exemptin limit.
- His total income does not include income from 'business or profession', or 'capital gain' or 'agriculture income',
- He is not in receipt of any income from which tax has been deducted at source during the previous year by any person other than the employer,
- PAN has been allotted to him.
- He is not serving under more than one employer.
- Return is furnished in Form No. 16AA, acompanied by TDS certificate, duly verified.

On receipt of return of income from such employee, the employer is required to furnish the return to the Assessing Officer on or before the due date under Sec. 139(1) and distribute the acknowledgment obtained from the Assessing Officer to the respective employees. The date on which the employer has furnished the return of income to the Assessing Officer is treated as the date of furnishing the return of income.

SEC 139C AND 139D CERTAIN DOCUMENTS TO BE PRODUCED ON DEMAND

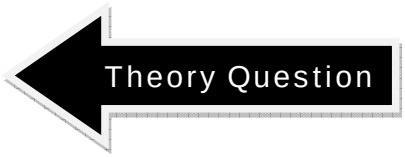


A new section 139C is inserted so as to provide that the ***Board may make rules*** providing for a class or classes of persons who may not be required to furnish documents, statements, receipts, certificate, reports of audit or any other documents, which are otherwise under any other provisions of this Act, except section 139D, required to be furnished, along with ***the return but on demand to be produced before the Assessing Officer***.

A new section 139D is also inserted so as to provide that the Board may make ***rules providing*** for the class or classes of persons who shall be required to furnish ***the return of income in electronic form***; the form and the manner in which the return of income in electronic form may be furnished; the documents, statements, receipts, certificates or reports of audit which may not be furnished along with the return of income in electronic form but shall be ***produced before the Assessing Officer on demand;*** and the computer resource or the electronic record to which the return of income in electronic form may be transmitted.

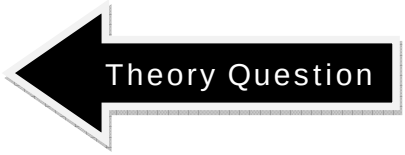
SUBMISSION OF RETURN TO EMPLOYER SEC. 139(1A)

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.



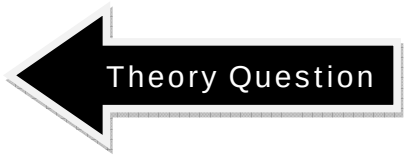
FILING OF RETURN OF INCOME IN ELECTRONIC FORM SEC. 139(1B)

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.

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.

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:

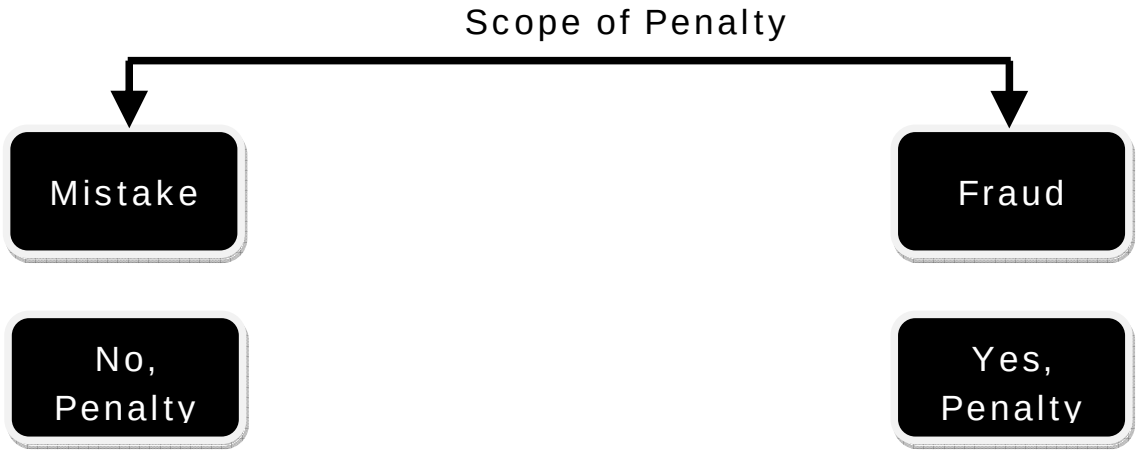
Filling of voluntary return

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 (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 al 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)

Revised Return Restores Rectification of Accidental Mistakes:

The right to file a revised return can be exercised to restore an omission or correct a wrong statement when it was inadvertent or accidental and not deliberate.

A second revised return may also be furnished correcting omission or wrong statement made in the first revised return [Niranjan Lai Ram Chandra *v.* CIT (1982) 134ITR 352 (All.)]. It is the right of the assessee to furnish a revised return and no application for permission from the Assessing Officer is necessary [Waman Padmanabh Dande *v.* CIT (1952) 22 ITR 339 (Nag.)].

Right to File Revised Return cannot be Exercised to Change the Method of Accounting:

The right to furnish a revised return cannot be exercised to rewrite the books by changing the method of accounting. For example, an assessee furnished a return disclosing profits of Rs 59,990 on the basis of accounts maintained on mercantile system. As substantial part of the receipts could not be realised, he changed the mercantile system of accounting to cash system and furnished a revised return of Rs 19,050. The assessee cannot be permitted to rewrite the books. Hence, a revised return furnished under cash system of accounting is not a valid return [Deepnarian Raju & Company *v.* CIT (1986) 157 ITR 37 (MP)].

Revised Return cannot be a Devise to Condone the Consequence of False Return:

Deliberate omissions, false and fraudulent statements fall outside the purview of revised return [Bhatia *v.* CIT 193 ITR 379].

The benefit of filing a revised return cannot be claimed by a person who has initially filed a return, knowing it to be false [Addl. CIT *v.* Radheyshiam (1980) 123 ITR 125 (All.)]

Revised return does not condone penalty and prosecution for a deliberate false return, contained under Sec. 271 and Sec. 277.

Belated Return cannot be Revised:

A belated return, furnished under Sec. 139(4), cannot be revised. Only a voluntary return under Sec. 139(1) can be revised [Kumar Jagdish Chandra Sinha *v.* CIT (1996) 86 Taxman 122 (SC)].

Revision by Firm makes the Partners liable to Revise their Returns:

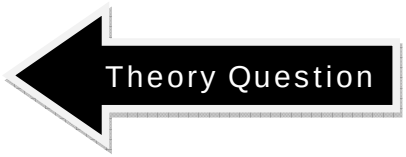
If firm files a revised return, it is necessary that its partners should also file their revised returns [Seenappa *v.* ITO (1974)97 ITR 528 (Kar.)].

Revised Return Dates Back to the Date of Original Return:

When a revised return is furnished, the original return is deemed to have been withdrawn and substituted by a fresh return. A revised return merely makes good the shortcomings in the original return from which it suffered. Therefore, a revised return must be considered as filed when the original return was filed for the purpose of calculation of interest under Sec. 234A [Dhampur Sugar Mills Ltd. *v.* CIT (1973) 90 ITR 236 (All.)].

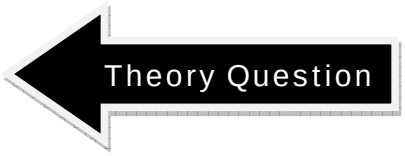
RETURNS OF SPECIFIED PERSONS

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)

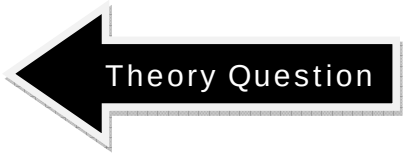
That the political parties are under a statutory obligation to file returns of income in respect of each assessment year in accordance with the provisions of the Income-tax Act. The political parties who had not been filing returns of income for several years had prima facie violated the statutory provisions of the Income-tax Act.

1) 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.

2) 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.

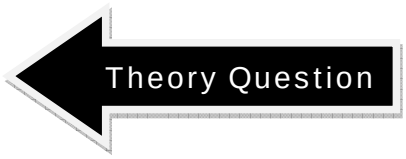
3) A political party which is not maintaining, audited and authenticated, accounts and has not filed the return of income for the relevant period, cannot, ordinarily, be permitted to say that it has incurred or authorised expenditure in connection with the election of its candidates in terms of Explanation 1 to section 77 of the Representation of the People Act, 1951.

RETURN BY SPECIFIED PERSONS SECTION 139 (4C)



Every (a) 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 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).

SECTION 139(4D)

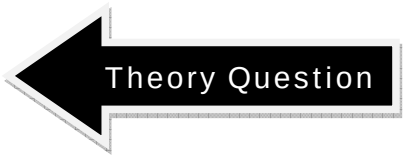


Scientific research institutions universities or educational institutes carrying on scientific research / social or statistical research are required to file return of income. This section is similar to 139(4A) in application.

Assessing officer cannot refuse exemption to the above institutions unless he recommends the withdrawal of approval to the authority concerned who granted approval and it is withdrawn by such authority [Second proviso to section 143(3)]

PERMANENT ACCOUNT NUMBER SEC. 139A

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.

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 / LLP, 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).

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).

Practical note

Signature is very important on any document. Thus, while filing any application, return, appeal, etc., one should be very careful that the concerned person who is competent to sign it has properly signed, dated and mentioned the place of signing correctly. Also check that signature is in the usual style-it is always better to have one style of signature. The clients should be advised to have one style of signature. In case of change of style, at least for the first year the signature should be in both the old and new styles unless a prior intimation as to change in style of signature has been given to the concerned authority. Besides signature, care should also be taken as to proper dating, and putting rubber stamp or seal wherever required.

Unsigned Return to be Treated as Invalid:

If a return is filed without signature and verification, it will have to be treated as invalid return [Khialdas & Sons *v.* CIT (1997) 225 ITR 960 (MP)].

Unsigned Return cannot be Validated by Issue of a Notice:

Signing and verification of a return is a mandatory requirement without which the return will be treated as invalid. A notice issued under Sec. 143(2) in response to an unsigned and unverified return does not validate such invalid return [Electrical Instrument Co. *v.* CIT(2001) 250 ITR 734 (Del.)].

On receipt of not properly signed notices

When you receive any notice, order etc., check whether it is properly dated, signed, and stamped etc. or not. If it is not signed-you have two options-either co-operate with the concerned officer and get a signed notice etc. or you may consider taking advantage of the absence of signature in case of need, in future. The author feels that the first course is better to show your sincerity, bona fides, honesty and co-operative attitude depending on all the facts and circumstances of the case. Furthermore professionals have to protect the interest of their clients and act as per their instructions.

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, such return shall be processed	10
+ or -	any arithmetical error in the return	+2
+ or -	an incorrect claim, if such incorrect claim is apparent from any information in the return • Any entry which is inconsistent with another entry of the same or some other item in such return; • in respect of which the information required to be furnished under this Act to substantiate such entry has not been so furnished; or • in respect of a deduction, where such deduction exceeds specified statutory limit which may have been expressed as monetary amount or percentage or ratio or fraction;	-1
	Computed Income	11

Refund or demand can be granted or made.

Intimation for loss

Provided that an intimation shall also be sent to the assessee in a case where the loss declared in the return by the assessee is adjusted but no tax or interest is payable by, or no refund is due to, him:

Time limit

Provided further that no intimation under this sub-section shall be sent after the expiry of one year from the end of the financial year in which the return is made.

Deemed intimation

the acknowledgement of the return shall be deemed to be the intimation in a case where no sum is payable by, or refundable to, the assessee under clause (c), and where no adjustment has been made under clause (a).

Delegated powers to board for central processing

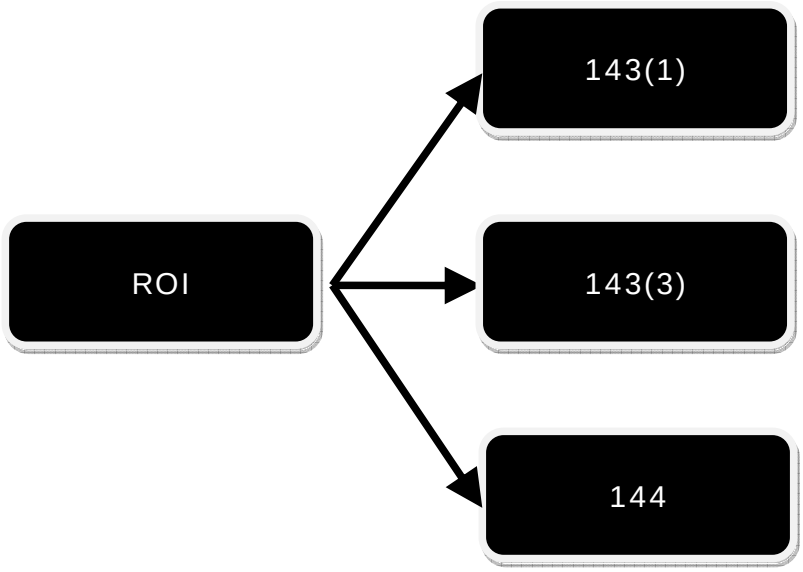
(1A) For the purposes of processing of returns the Board may make a scheme for centralised processing of returns with a view to expeditiously determining the tax payable by, or the refund due to, the assessee as required under the said sub-section.

(1B) for the purpose of giving effect to the scheme, the Central Government may, by notification in the Official Gazette, direct that any of the provisions of this Act relating to processing of returns shall not apply or shall apply with such exceptions, modifications and adaptations as may be specified in that notification.

(1C) Every notification issued, along with the scheme made under sub-section (1A), shall, as soon as may be after the notification is issued, be laid before each House of Parliament.

Intimation is not an Assessment Order:

The intimation is nothing but merely an acknowledgement slip to the effect that return filed by the assessee has been accepted and the Assessing Officer has acted upon that, and for the purpose of recovery it is deemed to be a notice of demand, as if issued under Sec. 156 [Pradeep Kumar Har Saran Lai *v*.. Assessing Officer (1998) 229 ITR (All.)].



आयकर केन्द्र
CENTRALIZED PROCESSING CENTER
INCOME TAX DEPARTMENT

Rec'd 12/7/10

Post Bag No.1, Electronic City Post Office, Bangalore-560100
पोस्ट बेग १, इलेक्ट्रानिक सिटी पोस्ट ऑफिस, बंगलोर-५६०१००
Telephone: 080-43456700 फोन: ०८०-४३४५६७००

INCOME TAX INTIMATION U/S. 143(1) आयकर अधिनियम 1961 की धारा 143(1) के अधीन पत्र

Name & Address EK121035008IN AMBARISH DHIRENDRA UDESHI 33-429[E] S.V.P ROAD PRATAHANA SAMAJ MUMBAI MAHARASHTRA 400004		**Communication Reference No.** पत्र संदर्भ संख्या CPC/0910/14/1001372022 **Demand Identification No.:** 20102009370022800 82T **PAN:** स्थायी खाता संख्या AAKPU8906F
Gender लिंग MALE	**ITR Type.** आई टी आर प्रकार ITR-4 ORIGINAL	**Dt of Order** आदेश की तिथि 24/06/2010
Status प्रास्थिति INDIVIDUAL	**Return filed under section 139(1)** धारा 139(1) के अंतर्गत 11	**A.Y.** निर्धारण वर्ष 2009-10
Residential status आवासीय स्थिति RESIDENT	**Due Dt for Filing** दाखिल करने की देय तिथि 31/07/2009	**Dt of Filing** दाखिल करने की प्राप्ति तिथि 23/07/2009

INCOME TAX COMPUTATION

Sl.No. क्र. सं.	Particulars विवरण	Reporting Heads विवरण देने वाले शीर्ष	As Provided by Taxpayer in Return of Income करदाता द्वारा आय विवरणी में दिए ब्यौरे	As Computed Under Section 143(1) धारा 143(1) के अधीन संगणित
1	HEADS OF INCOME	INCOME FROM SALARY	0	0
2		INCOME FROM HOUSE PROPERTY	0	0
3		INCOME FROM BUSINESS OR PROFESSION	2,70,249	2,70,249
4		INCOME FROM CAPITAL GAINS	0	0
5		INCOME FROM OTHER SOURCES	33,383	33,383
6	INCOME DETAILS	INTRA HEAD ADJUSTMENTS	N/A	0
7		GROSS TOTAL INCOME (AFTER INTRA HEAD ADJUSTMENTS)	1,69,095	3,03,632
8		LOSS OF CURRENT YEAR ADJUSTED	0	0
9		LOSS OF PREVIOUS YEARS ADJUSTED	1,34,537	0
10		GROSS TOTAL INCOME INCLUDING INCOME FROM OTHER SOURCES	1,69,095	3,03,632
11		DEDUCTIONS UNDER CHAPTER VIA	42,614	42,614
12		TOTAL INCOME AFTER DEDUCTIONS	1,26,481	2,61,020
13		LOSS IN CURRENT YEAR TO BE CARRIED FORWARD	0	0
14		AGRICULTURAL INCOME	0	0

*NOTE: Always quote Communication Reference Number, Date of Order and PAN.

नोट:कृपया पत्र व्यवहार में पत्र संदर्भ संख्या, आदेश की तारीख और 'पैन' जरूर लिखें

Communication Reference No. CPC/0910/I4/1001372022
पत्र संदर्भ संख्या

PAN: स्थायी खाता संख्या	Name नाम	A.Y. निर्धारण वर्ष	Date of order आदेश की तिथि
AAKPU8906F	AMBARISH DHIRENDRA UDESHI	2009-10	24/06/2010

Sl.No. क्र. स.	Particulars विवरण	Reporting Heads विवरण देने वाले शीर्ष	As Provided by Taxpayer in Return of Income करदाता द्वारा आय विवरणी में दिए ब्योरे	As Computed Under Section 143 (1) धारा 143(1)के अधीन संगणित
40	REFUND	REFUND AMOUNT	2,774	0
41		INTEREST U/S 244A ON REFUND	N/A	0
42		DELAY ATTRIBUTABLE TO TAX PAYER	N/A	0
43		**TOTAL INCOME TAX REFUND**	2,774	0
44	TAX PAYABLE	**NET AMOUNT PAYABLE**	0	10,269
	NET AMOUNT REFUNDABLE			0

Note:
1)The Refund, if any, is issued by State Bank of India on behalf of the Income Tax Department. Interest under section 244A of the Income Tax Act 1961 is computed upto the date of issue of the refund. Refunds will be issued only for amounts exceeding Rs.100.
2)In case of any difficulty or delay in receipt of Refund kindly call the State Bank of India. Call Center No.080-26599760 to know the status of Refund.
3)If you are not satisfied with the intimation under section 143(1), you may seek rectification as per section 154 with CPC or appeal under section 246A of the Income Tax Act, 1961, in your Territorial Jurisdiction.
4)In case of Demand, this intimation may be treated as Notice of Demand under section 156 of the Income Tax Act. Accordingly, you are requested to pay the entire Demand within 30 days of receipt of this intimation. The payment is to be made using the pre-printed challan enclosed. The Tax Payment challan is enclosed where the Tax Payable exceeds Rs. 100.

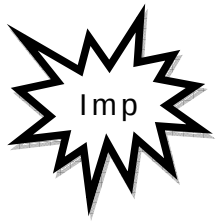
Tara Rani

Income Tax Officer (CPC)
आयकर अधिकारी (CPC)

This intimation is computer generated and may not contain signature. For any queries, please quote the Communication Reference Number and call on the telephone number provided above.

Screen clipping taken: 17/09/2010, 6:53 PM

143(3) SCRUITINY ASSESSMENT



Full scruitiny

On the day specified in the notice, issued under clause 143(2) 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.

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 - Niranjanm & Co. (P) Ltd. v. CIT 1986 159 ITR 153 (SC).

Assessment of specified persons

Provided that in the case of a (a) 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 scruitiny

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 scruitiny

No notice be served on the assessee after the expiry of 6 months from the end of the year in which the return is furnished.

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NOTICE UNDER SECTION 143(2) OF THE INCOME-TAX ACT, 1961

PAN/ NO.AAKPU8906F

Office of the
Income-tax Officer - 16(3)(3),
2nd Floor, Room No.202,
Matru Mandir, Tardeo Road,
Mumbai - 400 007.

Dated:. 15.07.2008

To,

AMBRISH D. UDESHI
33, 420(E), 3RD FLOOR,
PRARTHANA SAMAJ,
S.V.P. ROAD, GIRGAON,
MUMBAI – 400 004.

Sir/Madam,

There are certain points in connection with the return of income submitted by you on **02.08.2006** for the Assessment year **2006-07** on which I would like some further information.

2. You are hereby required to attend my office on 1.8.2008 at 1045 **A.M./P.M** either in person or by a representative duly authorised in writing in this behalf or produce or cause there to be produced at the said time any documents, accounts and any other evidence on which you may rely in support of the return filed by you.

Yours faithfully,

(**NARENDRA L. SONEJI**)
Income-tax Officer - 16(3)(3),
Mumbai.

ANNEXURE TO NOTICE U/S 142(1) FOR A.Y.2006-07

Shri. Ambrish D. Udeshi **PAN. AAKPU 8906 F**

Date of hearing : 1·8·2008 at 10·45 Am

Pl. give point-wise replies. I shall appreciate proper, complete and timely compliance, to finalize the assessment early.
Non-compliance may lead to additions for want of details & documents and ex-parte asstt., besides penalty u/s 271(1)(b) which is Rs.10,000/- per default/ non-compliance..
No adjournment will be granted on flimsy and unsubstantiated grounds.
Please furnish / Produce the following :-

1. Detailed note on nature of your business/ occupation/ activity carried out during the year AY.2006-07. Whether there is any change from last year ?; It is seen from Form-16 A that you are getting 'professional receipts'. What is your profession and What professional services you are giving/rendering ?.; – Submitted – Prof Fees & NO Change..
2. Area + ownership details of the address as shown in the return, challans, LIC receipts, Form- 16A, alongwith copies of Society bills & receipts/rent receipts and name & address of the landlord ; Name area, Rent Rupt.
3. Name & address of other concerns operating and using the address shown in the return of income. Explain your relation/ connection with them. Details of transactions with them – if any. ; -> N.A. – NA –
4. Name, address and PAN of Companies, firm, HUFs, AOPs, Trusts in which you are connected. i.e. as a Director, Partner, karta, Member etc.. Pl. furnish copy of you're a/c in their books/ ledger.; -> N.A.
5. Details of all Investments made during the year together with supporting certificates,etc. along with copies of the same. Indicate mode of payment, & explain the source of funds for each. ;
   Details of all assets acquired/ purchased during the year with supporting bills, etc alongwith copies of the same. Indicate mode of payment, & explain the source of funds for each. ;Whether all the new investments made & assets acquired during the year are reflected in your bank passbooks / statements ?. Pls. produce bank passbooks + Xerox copies of the same.; -> Submitted
6. Details of all your bank accounts with address of branch. Pls. furnish bank summary statement with narration for each debit & credit entry, explaining in brief each entry. -> Submitted – Summary
7. Details + copy of credit card and /or debit card, passport & ration card. Furnish statements relating to the said cards.; -> Submitted
8. Documents & evidences relating to exempt income. Whether, any expenses are claimed from exempt income? -> Submitted
9. Contract notes & bills relating to purchase & sale of shares during the year. – Shares – details
10. Datewise details of shares sold during the year. Specify purchase date & cost against each.
11. Your personal capital A/c & balance sheet for AY.2006-07and AY. 2005-06 ; -> Submitted (last year)
12. Details of House Property Income (SOP and or LOP) - Give area, complete address, copies of Agreements, Society maintenance bills & receipts and all electricity and telephone bills. In case it is given on rent, you must file Leave & Licence Agreement and rent receipts. You must also produce proof of the payment of BMC taxes and justify A.L.V. shown in the computation of income. -> NA
14. Un-secured Loans Rs.260960 - Furnish loan confirmation with proper name, present address, signature and I.Tax PAN of the loan givers. Explain the purpose of taking loan. What is the rate of interest paid. Furnish interest account.Explain utilization of borrowed funds; -> Submitted

Chq No. Dt PNB PAC, PBNC

15. Details of interest-free loans taken and given, during the year and in past two years. Explain justification. ; → Submitted & Pan

16. Details of motor cars & vehicles owned by you and your family members in the format – Regtn. No., Make & model, date of purchase, cost, in whose name purchased, and used by whom. ; → Submitted – Swift,

17. (i) Details of all telephones & mobiles – address of premises where installed, number, used by.
(ii) Submit a statement showing month-wise expenditure on telephones and mobiles.
(iii) Whether any log-book is kept and maintained for the use of all telephones & mobiles → Submitted

18. What is monthly total household expenditure of your family. ; Submit.

19. Your family tree in the format (i) Name & Age, (ii) Relationship with you (iii) Occupation & (iv) I.Tax PAN. Show every members contribution to household expenses- if any, with evidences.;

20. Your monthly household expenditure on food – vegetables, fruits, milk & groceries, cooking gas, Society outgoings, clothing, electricity, telephone, mobile, fax, conveyance (Local), traveling, education of children, Dhobi & ironing exps. Servants & maid's salary, medical/hospitalization, cable TV, and general expenses. ;

21. Copies of previous assessment orders u/s.143(3) & 144 ever made in your case. Also inform if any appeal is pending in your case. ;

22. Name and Address of parties from home labour charges are received and also to whom labour charges are paid. Specify mode of payment.Produce vouchers, bills, receipts, etc.; → Submitted Break-up

23. Salary paid Rs.210000- Furnish statement showing names, address, designation & monthly salary paid. Mode of payment. Produce salary register & daily attendance register. → Submitted what work done,

24. Account receivable Rs.299411 in balance sheet on asset side – Give name and address of persons. Furnish evidences in support of the same., → Submitted → all Party confirmation.

25. Nature and origin of transaction. Explain mode of payment. Produce confirmations. Explain the period of outstanding.

26. Personal Asset Rs.17500 [asset side of balance sheet] – Explain nature of asset, produce purchase bills & evidences. Explain mode of payment.; → Submitted

27. Produce bills of purchase of jewellery Rs. 310043. Explin mode of payment . Is it reflecting in your bank pass-book ?. ; → Submitted

28. For the gifts received from brother Rs.150000 and wife Rs.160000, explain mode of receipt, date of receipt & occasion of receipt. Name , address & I.Tax PAN of the Donor. Explain genuinness of gifts. ; → Submitted – wife Bank Submit.

Letter of authority on Rs.100/- stamp paper if represented by authorized representative.

[NARENDRA L. SONEJI]
Income-Tax Officer- 16 (3)(3), Mumbai.

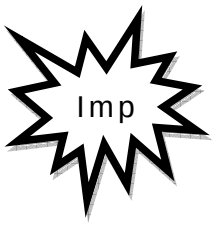
Sec. 153 time limit for completion of assessments

No order of assessment shall be made under section 143 or section 144 at any time after the expiry of two years (less 3 months) 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 or fair market value of any property referred to in 56 (2) 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 liablities 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.

Proviso provide that the Assessing Officer shall not direct the assessee to get the accounts audited unless the ***assessee has been given a reasonable opportunity*** of being heard.

(2B) The provisions of sub-section 2(A) shall have effect not withstanding 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 of 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.

A proviso is inserted in section 142(2D) so as to provide that where any direction is issued on or after 1-6-2007 by the Assessing Officer to an assessee to get the accounts audited, ***the expenses of, and incidental to,*** such audit (including the remuneration of the Accountant) shall be determined by the Chief Commissioner or Commissioner in accordance with such guidelines as may be prescribed and the expenses so determined ***shall be paid by the Central Government***.

Honest Attempt to understand the Accounts be First Made:

The power to direct the special audit should not be exercised lightly, but only after an honest and objective attempt is made to understand the accounts [Swadeshi Cotton Mills Co. Ltd. *v.*. CIT (1988) 171 ITR 634 (All.)].

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.

153 taxman 139

The Central Information Commission has declared that the income-tax assessment orders are public documents. The order from the Commission flowed in a case involving a bollywood personality.

This order means that the income-tax assessment orders of individuals are no longer private and confidential. They will be available to members of the public on application to the department for scrutiny. Anyone can ask for the assessment order of any individual, big or small, important or unimportant. The assessment orders throw light on the reasons why the income-tax authorities arrived at a certain decision in each case. In the concerned case, the Commissioner issued directions to the officials while deciding an appeal, seeking details of the income-tax returns and the assessment orders of Bhansali, producer of the film Black. According to the Commission, the assessment is an action by a public authority and that every action taken by a public authority is in the public interest and, hence, there was no basis for not disclosing such orders. In the spirit of the RTI Act, the public authority is required to adopt an open transparent process of evaluation.

Issue of summons

While proceeding under section 143(3) of the Income-tax Act, 1961, the Assessing Officer is to hear such evidence as the assessee may produce, as well as evidence on a particular point which the assessing authority requires him to produce and, in order to exercise this power, the Officer can have recourse to section 131. Non-compliance with summons can burden the person concerned with a fine or penalty, but failure to comply with such a summons does not authorise the Assessing Officer to make a best judgment assessment.

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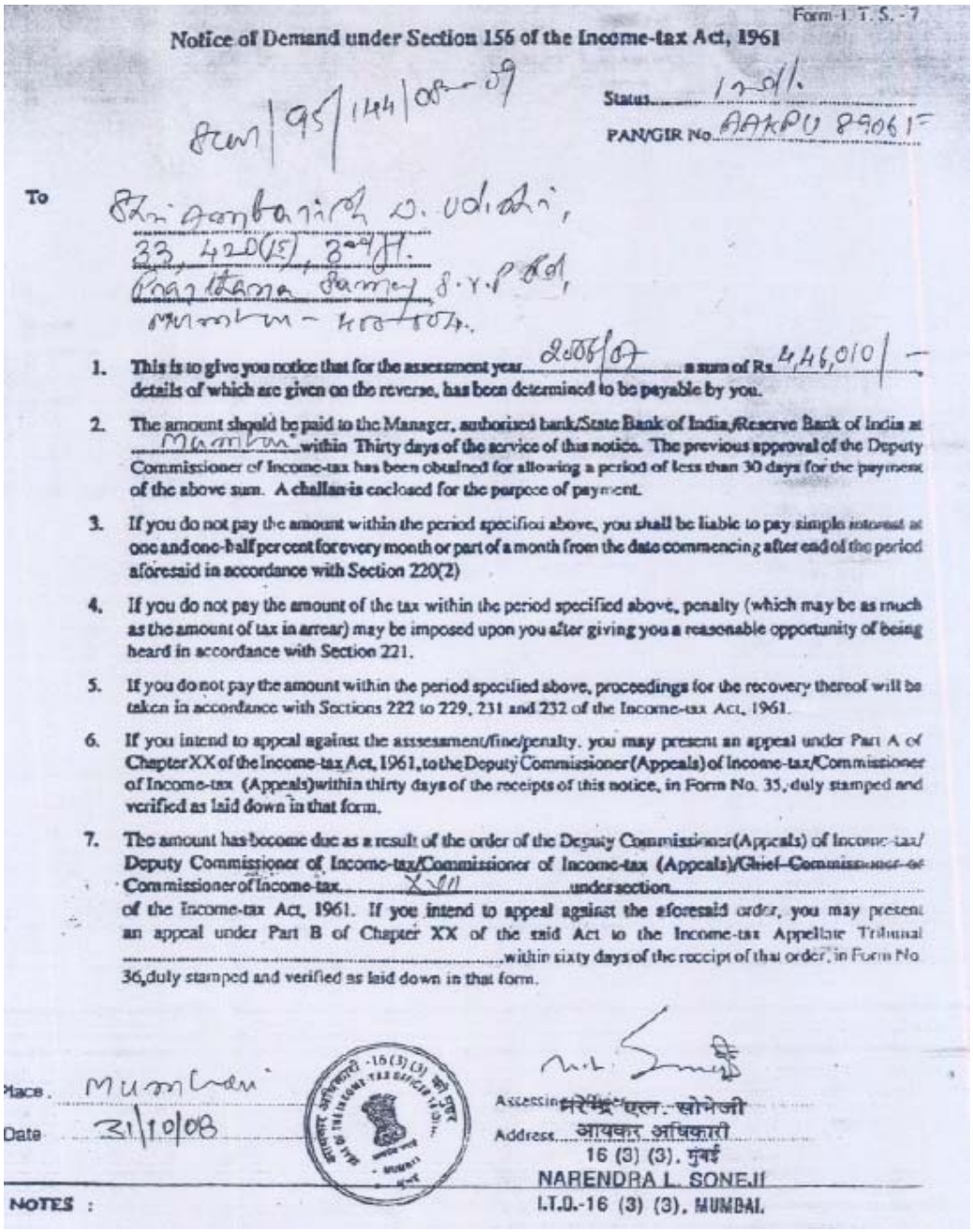


Form I. T. S. - 7

Notice of Demand under Section 156 of the Income-tax Act, 1961

Rem/95/144/08-09 Status 1201.

PAN/GIR No. AAKPU 8906 F

To Shri Janbahadur D. Udeshi,
33, 420(5), 3rd Fl.
Raghunath Bamji S.V.P. Rd,
Mumbai - 400 004.

1. This is to give you notice that for the assessment year 2006/07 a sum of Rs. 4,46,010/- details of which are given on the reverse, has been determined to be payable by you.
2. The amount should be paid to the Manager, authorised bank/State Bank of India/Reserve Bank of India at Mumbai within Thirty days of the service of this notice. The previous approval of the Deputy Commissioner of Income-tax has been obtained for allowing a period of less than 30 days for the payment of the above sum. A challan is enclosed for the purpose of payment.
3. If you do not pay the amount within the period specified above, you shall be liable to pay simple interest at one and one-half per cent for every month or part of a month from the date commencing after end of the period aforesaid in accordance with Section 220(2)
4. If you do not pay the amount of the tax within the period specified above, penalty (which may be as much as the amount of tax in arrear) may be imposed upon you after giving you a reasonable opportunity of being heard in accordance with Section 221.
5. If you do not pay the amount within the period specified above, proceedings for the recovery thereof will be taken in accordance with Sections 222 to 229, 231 and 232 of the Income-tax Act, 1961.
6. If you intend to appeal against the assessment/fine/penalty, you may present an appeal under Part A of Chapter XX of the Income-tax Act, 1961, to the Deputy Commissioner (Appeals) of Income-tax/Commissioner of Income-tax (Appeals) within thirty days of the receipts of this notice, in Form No. 35, duly stamped and verified as laid down in that form.
7. The amount has become due as a result of the order of the Deputy Commissioner (Appeals) of Income-tax/ Deputy Commissioner of Income-tax/Commissioner of Income-tax (Appeals)/Chief Commissioner of Commissioner of Income-tax XVII under section ..... of the Income-tax Act, 1961. If you intend to appeal against the aforesaid order, you may present an appeal under Part B of Chapter XX of the said Act to the Income-tax Appellate Tribunal ..... within sixty days of the receipt of that order, in Form No. 36, duly stamped and verified as laid down in that form.

Place Mumbai
Date 31/10/08

Assessing Officer नरेन्द्र एल. सोनेजी
Address आयकर अधिकारी
16 (3) (3), मुंबई
NARENDRA L. SONEJI
I.T.O.-16 (3) (3), MUMBAI.

NOTES :

Order to Charge Interest must be Specific.

Sec. 156 makes it clear that notice of demand claiming interest can be issued only when there is a clause in the assessment order levying interest. To use the expression "charge interest, if any" or "charge interest as per rules" cannot be read to mean that the Assessing Officer has passed orders to "charge interest under all the aforesaid sections". The order to charge interest has to be specific and clear. The assessee must be made to know that the Assessing Officer, after applying his mind has ordered the charging of interest and under which of the sections of the Act. When the assessment order is silent as to whether any interest is leviable, the notice of demand cannot go beyond the assessment order and the assessee cannot be served with any such notice demanding interest. Such a notice is to be quashed [Uday Mistnna Bhandar and Complex v. CIT (1996) 222 ITR 44 (Pat.)] [Affirmed by the Supreme Court in CIT v. Ranchi Club Ltd. (2001) 247ITR 209].

Demand Notice constitutes Grounds for Recovery Proceedings.

The service of the notice of demand constitutes the grounds for launching recovery proceedings and unless the notice of demand is served, neither proceedings can be instituted against a person for recovery of the amount of tax or other sum nor can the person concerned be treated as a defaulter.

If, however, the assessee is aware of the tax-liability on him and has factually moved the authorities for extension of time for payment and such he may, on default, be treated as 'defaulter' and proceedings for recovery may be launched against him.

Incorrect Notice be replaced by a New One.

If the earlier notice is wrong, a correct notice of demand in conformity with the assessment can always be issued to the assessee without a formal rectification order [CIT v. Karnani Industrial Bank Ltd. (1978) 113 ITR 380 (Cal.)].

Demand Notice issued prior to the Death of the Assessee remains Valid even after Death. If, after the service of notice of the demand, an assessee dies, it is not necessary that a fresh demand should be served on his heirs.

Demand Notice issued after the Death, issued to all Heirs of the Deceased.

If, after the service of notice of demand, an assessee dies, it is not necessary that a fresh demand should be served on his heirs. But if the assessee dies before service of the notice, it is essential that each of the heirs who is sought to be made liable for recovery is served with a notice of demand.

Variation in Tax Liability vs. Notice of Demand.

If there is an enhancement of tax over the amount mentioned in the original notice of demand in an appeal, the Assessing Officer is required to serve a fresh notice of demand only for the excess amount over what was specified and demanded in the original notice and recovery proceedings will continue. If there is reduction in the tax demand, no fresh notice need be served but the fact of reduction should be intimated to the assessee and Tax Recovery Officer [Sec. 3 of Taxation Laws (Continuation and Validation of Recovery Proceedings) Act,1964].

Time-limit to issue Demand Notice.

A notice of demand must be served within a reasonable time. No time-limit has been laid down in the Act. A notice of demand issued fourteen months after the expiry of the assessment year was held to have been issued within reasonable time. Intimation of Loss (Sec. 157). When in the course of the assessment of the total income of any assessee, it is established that a loss has occurred which the assessee is entitled to have carried forward and set-off, the Assessing Officer is required to notify to the assessee by an order in writing the amount of such loss computed by him. Where an Assessing Officer does not notify to the assessee by an order in writing the amount of loss for any year as computed by him, the assessee is entitled to have the loss redetermined in a subsequent year [CIT v. Khushal Chand Daga 42 ITR 177 (SC)].

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).

Assessment includes All Proceedings:

Assessment generally includes all proceedings. The word 'assessment' is used in the Act in a number of provisions in a comprehensive sense and includes all proceedings starting with the filing of the return or issue of notice and ending with determination of tax payable by the assessee —S. Sankappa *v.* ITO (1968) 68 ITR 760 (SC).

Principle of Natural Justice is applicable to Tax Proceedings:

The principles of natural justice are applicable to assessment proceedings. The elementary principle of natural justice is that the assessee should have knowledge of the material which is going to be used against him so that he may be able to meet it [Gargi Din Jwala Prasad *v.* CIT (1974) 96 ITR 97 (All.)].

Assessment made on Invalid Return is also Invalid:

A return of income which is not verified bv the assessee in the prescribed manner is invalid, and therefore an assessment based on such a return would also be invalid and would be liable to be cancelled [CIT *v.* Krishan Lai Goyal (1984) 148 ITR 283 (P&H)].

AO Empowered to reject Return and Evidence

In event of an assessee failing to establish the truth and correctness of the return, it is open to the Assessing Officer to reject the return. The power to reject the return and the evidence in support thereof is inherent and implied in the AO's power to enquire into the total income of the assessee [Bombay Hardware Syndicate *v.* CIT (1973) 92 ITR 160 (Mad.)].

AO to make Best Judgement Assessment in cases where Notice is not Complied With:

Where the assessee does not comply with the notice and makes a default in producing the evidence, accounts or other information on specified points, the Assessing Officer is left with no choice but to make the assessment according to the best of judgement [Sec. 144].

Notice to produce Evidence on Specified Points and production of Books of Accounts:

Where the assessee complies with the notice under Sec.143(2) and produces evidence in support of the return, but the Assessing Officer is not fully satisfied, he may issue further notices requiring the assessee to produce evidence on specified points [Re Lachmandes 2 ITC 1].

In the course of such inquiries, the Assessing Officer may issue a notice to the assessee under Sec. 142(1), asking for the production of information, accounts and documents [Mohammed Hayat *v.* CIT 5 ITC 159 (FB)].

At the assessment stage, in order to inquire into the truth of the statements made by the assessee in his return, the Assessing Officer may call for the accounts of a period of more than 3 years prior to the relevant accounting year under Sees. 143(3) and 131. [Calcutta Chromotype (P) Ltd. *v.* ITO (1974) 95 ITR 595 (Cal.)].

If the Assessing Officer is satisfied with the evidence and information produced by the assessee in support of the return, he may make the assessment on the basis of such evidence.

Private inquiries:

If the Assessing Officer is not satisfied as to the correctness of the account or evidence produced by the assessee, or he believes them to be false or unreliable, he may reject such accounts or evidence even though there may not be any direct or definite evidence to prove them incorrect. There is no rule or law compelling a judge to accept evidence, which he believes to be a pack of lies, even though it is not contradicted. The Assessing Officer cannot make best judgement assessment (Sec. 144)(3). The Assessing Officer must himself take steps to procure necessary material for assessment if it is not already in his possession.

Summons be Issued under Sec. 131 to gather Information from Private Parties:

For the purposes of gathering relevant material, the Assessing Officer can issue summons under Sec. 131 for the examination of witness and production of documents from third parties to ascertain the assessee's income. He can, for instance, secure information and guidance by examining rivals in the trade of the assessee, or experts or past employees under the assessee, or managers who are acquainted with the particular business of the assessee. He may examine his own inspectors or surveyors if they can aid him and give information.

Local Reputation, Style of Living of the Assessee and other relevant Information be taken into Account:

The Assessing Officer may also take into account the local reputation and position which the assessee occupies in the market, the style of living of the assessee and any acquisition of property by him during recent years, the increase in his total resources, the quantity of stocks carried by the assessee from year to year and whether the same is increasing or decreasing, and lastly the rate of profit earned generally in the business by other businessmen in the line.

Past History alone not Sufficient to make Assessment on that basis:

Past history might be legitimate material, but that is not sufficient by itself to justify an assessment prejudicial to the assessee. There must be some material related to the accounting year which, taken with the history, may justify such assessment.

Information be gathered from Other Relevant Sources:

The Assessing Officer may gather information from the returns of TDS submitted under Sec. 201 and Sec. 285B, mav inspect the register of members of any company (Sec. 134) and may call information in exercise of his powers under Sec. 133.

He may further seek an authority of search and seizure under Sec. 132 and requisition of book of accounts or documents under Sec. 132B. He may enter business premises for inspection of accounts and documents (Sec. 133A).

Circumstantial Evidence may be Material for Assessment:

No hard and fast rule can be laid down by the court to define the type of material on which the Assessing Officer should estimate the income of the assessee [Gangaram *v.* CIT 5 ITR 464].

The material need not be direct evidence; it may be circumstantial evidence [Homi *v.* CIT 41 ITR 135 (SC)]. Thus, from one admitted incident of suppression, the department may be entitled to infer that there were other similar incidents [Bhimraj *v.* CIT 41 ITR 221 (SC)]. Similarly, entries in the books of third parties or inference from queries from third persons or discrepancy in stock found during the course of search may be circumstantial evidence for estimating profits [CIT *v.* Southern Shipping 241 ITR 464] [CIT *v.* Golcha Properties 227 ITR 391] [CIT *v.* Kailboth 246 ITR 202],

Private sources of Inquiry:

It is open to the Assessing Officer to collect material to facilitate assessment even by private enquiry. He is not bound to disclose those sources to the assessee. However, where he proposes to use the result of private inquiry against the assessee, he should communicate to the assessee the substance of his information and provide an opportunity to him to meet it [Bhogilal *v.* CIT 74 ITR 781],

Arbitrary Additions and Guess Work be Avoided:

Arbitrary additions and guesswork must be avoided —Even if the ITO considered the material placed before him by the assessee to be unreliable keeping in view the comparative statement of accounts of the previous years, he cannot proceed to make any arbitrary addition and base his conclusion purely on guesswork. He ought to have related his estimate to some evidence or material on the record as it is now well-settled that if the profits shown by the assessee in his return are not accepted, it is for the taxing authorities to prove that the assessee has made more profits than returned [International Forest Co. *v.* CIT (1975) 101 ITR 721 (J&K)].

Benatni Transactions: Incomes be Assessed in the Hands of the Real Owner:

Where any person purchases a property with his own funds in the name of another person, keeping the beneficial interest to himself, the Assessing Officer may hold that the transaction is *benami* and not genuine and the income from such property belongs to the real owner and not to *benamidar.* The burden of proof is on the taxing authorities [Mahi'm *v.* CIT 249 ITR 71].

Res Judicata: Estoppel not applicable to Taxing Statutes:

Since the Assessing Officer is not a court, the doctrine of Res *judicata* or *Estoppel* does not apply to his decisions. A decision of an income-tax authority in one year may be departed in a subsequent year [New Jehangir Mills *v.* CIT 49 ITR 137 (SC)].

Where a method of accounting has been consistently followed in the past, it may still be rejected by the department. There is no *Estoppels* in the matter of method of accounting consistently followed. The Officer is not bound bv the method of accounting in the earlier years if correct profits cannot be deduced there from C*IT v.* British Paints 188 ITR 44 (SC)].

Protective Assessment permissible but not Protective Recovery:

If there is a doubt as to which person amongst the two is liable to be assessed in respect of certain income, parallel proceedings may be taken against both of them and an alternative assessment may be made.

Where it appears to the income-tax authorities that certain income has been received during the relevant previous year but it is not clear who has received that income, and *prima facie* it appears that the income may have been received either by A or by B or by both together, it would be open to the relevant income-tax authorities to determine the said question by taking appropriate proceedings against both A and B [Lalui Haridas *v.* ITO/Chhotalal Haridas *v.* M.D. Karnik (1961) 43 ITR 387 (SC)].

While a protective assessment is permissible, protective recovery is not allowed [Jagannath Bawri *v.* CIT 234 ITR 664].

Rejection of Incorrect Accounts:

If the accounts of an assessee are found incorrect or incomplete, the Assessing Officer may reject them and make a scrutiny assessment.

Computation of Income and Quantification of Tax may be on Separate Sheets:

The statute does not require that both the computations (that is, of the total income as well as of the sum payable) should be done on the same sheet of paper. It does not prescribe any form for the purpose [Kalyankumar Ray v. CIT (1991) 191 ITR 634 (SC)]. [See also, Karuna Rani Jain v. CIT (1989) 178 ITR 321 (P&H)].

Only one Order to be passed for a given Year:

Under the provisions of the Act, only one assessment order is contemplated for a given vear against an assessee [CIT *v.* Dhampur Sugar Mills Ltd. (1988) 170 ITR 449 (All.)].

General note

Assessing Officer should consider the evidence and such other particulars as the assessee may produce on specified points and he should take into account all relevant material, which he has gathered. When assessing under this Section, the Assessing Officer must have material on which to base his judgement or estimate. The Assessing Officer is not entitled to make a pure guesswork and make an assessment without reference to any evidence or any material at all. Where the Assessing Officer considers that the material placed before him by an assessee is not reliable, he cannot proceed to make an arbitrary assessment. If the Assessing Officer thinks that the profits shown by the assessee are not acceptable, it is for the taxing authorities to prove that the assessee had made more profits. The Assessing Officer has to relate his estimate to some evidence or material on record. An assessment based on mere conjectures, surmise or suspicion or irrelevant and inadmissible evidence and material, is invalid and unsustainable in law.

The Assessing Officer is required to make an assessment of the total income or loss. He may determine the sum payable by him or refund due to him on the basis of such assessment [Sec. 143(3)(ii)].

General note Assessment Order:

After completing the assessment, the Assessing Officer is required to pass an assessment order in writing. The assessment order must contain a clear indication of the material on which the income is computed and/ or estimated. If the order suffers from failure to indicate on what material or basis the income is assessed and tax determined, the assessment is bad and liable to be set aside.

The assessee is given due credit for any tax or interest paid by him under summary assessment [Sec. 143(1)]. The balance, if any, is deemed to be tax due from him. If no refund is due on regular assessment, the amount refunded under summary assessment is deemed to be tax payable by him. If amount refunded on summary assessment exceeds the amount refundable in regular assessment, the excess amount so refunded is deemed to be tax due from him. [Sec. 143(4)]. Accordingly, the Assessing Officer is required to issue a Demand Notice (under Sec. 156) specifying the sum payable by the assessee.

ITNS 65

INCOME TAX DEPARTMENT

Name & Address of the Assessee	:	Shri. Ambarish D. Udeshi, 33, 420(E), 3rd Floor, Prathana Samaj, S.V.P. Road, Mumbai-400 004.
Status	:	INDIVIDUAL
PAN	:	AAKPU 8906 F
Range/Ward	:	I.T.O.16(3)(3), MUMBAI.
Assessment Year	:	2006-07
Whether Resident/Resident but not Ordinarily resident /Non Resident	:	RESIDENT
Method of Accounting	:	Mercantile
Previous year	:	31.03.2006
Nature of Business	:	Job work on sheets, foam, paper board, Capital Gain & Other Sources.
Date(s) of hearing	:	As per order sheet
Date of Order	:	31.10.2008
Section and Sub-section under which the Assessment is made.	:	U/s. 143(3) of the I.T.Act.

ASSESSMENT ORDER

Return of Income declaring total income of Rs.118886 has been filed on 02-08-2006. The said return was processed u/s. 143(1).

As the case was selected for scrutiny through CASS, statutory notices u/s. 143(2) and 142(1) alongwith Annexure/ Questionnaire were issued and served upon the assessee.

In response to the said notices, the assessee's representative Shri Kalpesh Sanghavi, CA, attended the proceedings on behalf of the assessee, from time to time and filed the necessary details and written submissions. The CASS/ITS details have been checked & verified. Books of accounts were never produced, though the assessee was

asked to produce the same vide notice u/s.142(1) dtd.15.7.2008. The case was discussed and the following points emerge.

During the year the assessee has shown income under the heads – business and Other sources.

In the Profit & Loss a/c assessee has shown his entire receipts as 'labour charges" and no any kind of sales are shown. During the course of asstt proceedings, on perusal of invoices issued by the assessee it came to light that the assessee is a proprietor of M/s. Udeshi Arts. The nature of business infact is Printers, stastioners & dealing in computer peripherals. The assessee's AR was questioned why this income is not shown in the return of income and accompanying accounting statements. It was stated that labour charges is inclusive of all this business.

The assessee was asked to file name and address of parties to whom labour charges Rs. 1258009 are paid (vide questionnaire to notice u/s.142(1) dtd.15.7.08).From the details filed, it is seen that the same include purchases amounting to Rs.1151871 and addresses of purchase parties are not given. It was stated that there are partly cash purchases also. Assessee's AR could not give full details of actual labour charges paid . The assessee has not kept and maintained any third - party vouchers and proper vouchers bearing serial no., address of the receipient, etc in respect of labour charges paid. Neither purchase register is kept & maintained and produced nor any books of account were produced. The assessee is also not keeping & maintaining any stock register. Therefore, in absence of reliable evidence and books of acoount, the genuineness of the said expenditure cannot be verified and it cannot be accepted that the same has been wholly & exclusively incurred for assessee's business purpose only. Hence, labour charges paid Rs.1258009 as claimed by the assessee cannot be allowed fully. Accordingly, 15 % thereof i.e. Rs. 188700 is being disallowed and added back to the total income declared.

It is noticed that assessee has claimed Sales tax paid Rs.35311. As already mentioned hereinabove that the assessee has not shown any 'sales' in the P & L a/c filed alongwith the return of income, the assessee's claim of sales tax apparently appears to be irrelevant, and there being no nexus of this expenditure with assessee's receipts, the said expense cannot be allowed. Therefore, the said amount is being disallowed and added back to the total income declared.

The assessee has claimed mobile and telephone expenses Rs.39322. The assessee has not maintained any log book for the use of the same. Personal use of mobiles and telephones is not ruled out and neither denied by the assessee's A.R. Therefore, 25% thereof (Rs.9830) is being disallowed and added back to the total income declared.

It is seen that assessee has shown STCL Rs.43229 to be carried forward to subsequent year and LTCG on shares Rs.10702 as exempt. The assessee was asked to file contract notes and bills for purchase and sale of shares. The assessee's A.R stated that he is unable to submit the same (Order sheet entry dtd.9.9.08). Therefore, the same cannot be allowed. In absence of any shred of details and evidence, the same cannot be allowed as claimed. Accordingly, STCL is not allowed, and the said amount of Rs.43229 is treated as income of the assessee (business income). Similarly, LTCG Rs.10702 is also treated as income – business income.

During the course of the assessment proceedings, assessee's A.R. was apprised of the abovementioned additions.

In the last and final hearing on 29.9.08 the assessee's A.R, Kalpesh Sanghvi, C.A after going through the Order Sheet and signing it, requested for Xerox copy of the "proceedings sheet" called 'order sheet' in Income-Tax parlance. From the angle of natural justice and fair play, copy of order-sheet from pg. 1 to pg.5 [both inclusive] were provided to him without any cost – [Order–sheet entry dtd 29.9.2008]. Although more than 30 days have passed, the assessee's AR has not filed any objection on any issue / point.

Subject to the above remarks the total income of the assessee is computed as under:-

Total Income declared		Rs. 118886
ADD :- Additions as discussed above :-		
- Out of labour charges claimed	Rs. 188700	
- Sales tax on no Sales	Rs. 35311	
- Out of mobile & Tel exps.	Rs. 9830	
- Share loss debited	Rs. 43229	
- Out of Salaries paid	Rs. 31500	
- Non-genuine gifts [u/s.68]	Rs. 310000	
- Un-explained Asset & Jewellery	327543	
- Low withdrawals	Rs. 50000	
- STCL treated as income	Rs. 43229	
- LTCG treated as income	Rs. 10702	
		Rs. 1050044
TOTAL INCOME ASSESSED		**Rs. 1168930**

29 DEC 2008

KALPESH SANGHAVI Memb. No 101836

TRUE COPY

Assessed accordingly u/s.143(3). Give credit for the taxes paid after due verification. Charge interest u/s.234-A, 234-B & 234-C as applicable. Issue Demand Notice and challans, alongwith the tax calculation sheet, to the assessee.

[NARENDRA L. SONEJI]
Income-Tax Officer- 16(3)(3)
Mumbai

नरेन्द्र एल. सोनेजी
आयकर अधिकारी
16 (3) (3), मुंबई
NARENDRA L. SONEJI
I.T.O.-16 (3) (3), MUMBAI

Copy to :- The assessee.



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 company 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 (less 3 months) 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 arbitary 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 sub-stance 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 9SC).

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).

Best Judgement Assessment v. Scrutiny Assessment:

The difference between scrutiny assessment under Sec. 143(3) and best judgement assessment under Sec.144 is that under scrutiny assessment the Assessing Officer has to assess to the best of judgement on the basis of evidence before him whilst under best judgement assessment he has often to assess to the best of his judgement in the[1] absence of such evidence [CIT *v.* EinShin 15 ITR 290].
Under the former, the Assessing Officer goes into more details while in the latter he acts in a summary manner due to the deliberate default of the assessee [Gunda *v.* CIT 7 ITR 21]; [Dhanalakshmi *v.* CIT 144 ITR 452],

Underlying Principles to make Best Judgement Assessment:

There are no provisions in the statue book, which can serve as a guide for making best judgement assessment. Based on judicial pronouncements, the following norms may be followed in making the best judgement assessment:

Local Repute of the Assessee, Knowledge of Previous Returns and Comparable Cases be taken into Account for estimating Total Income:

In making a best judgement, the Assessing Officer need not conduct a local inquiry and record the details and result of that inquiry [CIT v. Laxminarain 5 ITR 170]; [Singh v. CIT 24 ITR 93].
He may gather material from the assessee's account books of the relevant year or preceding years Qotramt;. CIT 2 ITR 129].
He may compute the income of the assessee on the basis of a flat rate of profit, arrived at from comparable cases [CIT v. Sen 17 ITR 355].
He is not bound to confine himself to any special kind of material, in making the assessment [Kissendas v. CIT 2 ITC 324 (FB)]. He need not take any evidence [Gopinath v. CIT4 ITR 1].

Estimation of Income must be Honest and Fair:

The authority making a best judgement 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 [Brij Bhushan Lai Parduman Kumar *v.* CIT(1978) 115 ITR 524 (SC)].

Guesswork be connected to Available Material:

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).

Power is not Arbitrary:

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 [State of Orissa *v.* Maharaja Shri B.P. Singh Deo (1970) 76 ITR 690 (SC)].

Rules of Justice, Equity and Good Conscience be the Guiding Spirit:

In making best judgement, the Assessing Officer should not act dishonestly, vindictively or capriciously. He must exercise judgement in the matter [CIT *v.* Laxminarain Badridas (1937) 5 ITR 170 (PC)].

In making the best judgement assessment, the Assessing Officer should not be influenced by a desire to punish the assessee for the default, however culpable such default might be. He must not act dishonestly or vindictively or capriciously because he must exercise judgement in the matter. He must make what he honestly believes to be a fair estimate of the proper figure of assessment.

In making a best judgement assessment the Assessing Officer does not possess absolutely arbitrary authority to assess at any figure he likes and, that although he is not bound by strict judicial principles, he should be guided by rules of justice, equity and good conscience.

Where the best judgement assessment power has been conferred, the limits of the power are implicit in the expression 'best of his judgement'. Judgement is a faculty 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, it should not be a wild one, but should have reasonable nexus to the available material and the circumstances of each case.

Opportunity of being Heard to be Allowed to the Assessee:

The Assessing Officer is statutorily bound to provide such opportunity to the assessee before best judgement assessment is concluded [First Proviso to Sec. 144 (1)].

However, no such opportunity is allowed in cases where the Assessing Officer has issued a notice under Sec. 142(1) before making the assessment to furnish the return of income or to produce the books of accounts or documents or to furnish information on specified points [Second Proviso to Sec. 144(1)].

Assessment order:

The Assessing Officer is required to make the best judgement assessment after taking into account all relevant material, which he has gathered. He should assess the total income or loss to the best of his judgement and determine the sum pavable by the assessee or refund due to him on the basis of such assessment.

Due credit is given for anv tax or interest paid by the assessee. If no refund is due on best judgement, assessment or the amount refunded under summary assessment [Sec. 143(1)] exceeds the amount refundable on such assessment, the whole or the excess amount so refunded is deemed to be tax payable by the assessee [Sec. 143(4)(b)].

Return submitted in Response to a Notice under Sec. 142 (1) but not accepted by the AO as Correct and Complete

Where the Assessing Officer does not accept the return as correct and complete, he is bound to serve a notice under Sec. 143 (2) giving the assessee a chance to justify his return by producing evidence in support of the return. Best judgement assessment cannot be made in such a case.

Returns of Branches not submitted to the AO having Jurisdiction at the Principle Place of Business;

Where the Assessing Officer, having jurisdiction on the principal place of business, served a notice on the assessee to submit the return of branches to him, any default in compliance with the notice would result in best judgement assessment even though the returns might have been submitted to the Assessing Officer having jurisdiction at the branches [Mohan Lai *v.* CIT E-5 ITC 127]. The Assessing Officer cannot be expected to wait for such returns being forwarded to him by his counterparts, having jurisdiction at branches.

Failure to produce Books of Account or to furnish Necessary Information [Sec. 144(1)(B)]

Even partial default in compliance with the terms of the notice justifies best judgement assessment. For example, where an assessee fails to produce books of accounts on the ground that they were lost **but** does not produce any evidence in support of his contention despite several opportunities given to him, the best judgement assessment is justified.

Books of Accounts, Requisitioned by the AO, have to be produced even if the Assessee considers them as Irrelevant:

It is for the Assessing Officer to determine what account books and documents are necessary to enable him to make an estimate of the total income.

Where an assessee does not comply with a notice to produce books of accounts, the assessment made on account of such default cannot be held as invalid merely because some of the accounts were irrelevant in the opinion of the assessee [Tulsidas *v.* CIT 6 ITR 385].

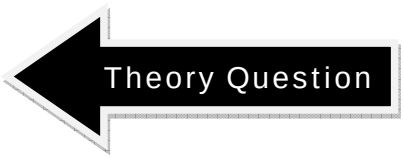
Failure to produce Books of Accounts to the AO, exercising Jurisdiction at the Principal Place of Business, would entail Best Judgement Assessment:

If the accounts of a branch are not produced in response to a notice under Sec. 142(1), issued by the Assessing Officer having jurisdiction at the principal place of company's business, the Assessing Officer is justified in making a best judgement assessment. It is immaterial that such accounts were produced before and considered by the Assessing Officer exercising jurisdiction at the branch officer [Lachmandas *v.* CIT 4 ITC 61].

Appeal against Best Judgement Assessment.

The assessee can appeal against best judgement assessment under Sec. 246A. He can object to the amount of income assessed, or the amount of tax determined, or the amount of loss computed or to the status under which he is assessed. It would be in the larger interests of the asses- sees to maintain proper books of accounts, records and papers. In these days of skyrocketing prices where litigation has become costly, it would be in the good and in the long-term interest of the assessees to keep all the necessary documents and books ready, so that if any information or clarification or explanation is sought by the department the same may be given without any difficulty. It is a healthy practice. Suppression is ruinous. If the accounts are fabricated with a view to pay less tax, it tantamounts to wilful evasion of tax. Here one is tempted to quote Justice Holmes "taxes are what we pay for civilized society. I like to pay taxes. With them I buy civilization." One can strongly commend this to all assessees, without any reservations.

POWER OF COMMISSIONER TO ISSUE DIRECTIONS– SEC. 144A.

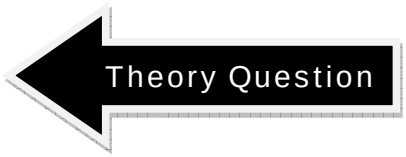


A Commissioner may, on his own motion or on a reference being made to him by the Officer or on the application of an assessee, call for and examine the record of any proceeding in which an assessment is pending and, if he considers that, having regard to the nature of the case or the amount involved 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.

NOTICE OF DEMAND (SEC. 156)



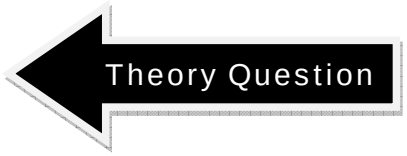
When any tax, interest, penalty, fine or any other sum is payable in consequence of any order passed under this Act, the Assessing Officer is required to serve upon the assessee notice of demand in the prescribed form specifying the sum so payable. It is only when notice of demand is served on the assessee that the tax or any other sum of money covered by the notice becomes amount due to the government.

Demand Notice be Issued in the Prescribed Form.

Notice of demand must in a form prescribed by the rules [ITO v. Bucharah Setty (1964) 52 ITR 538 (SC)]. Notice of demand for tax liability on assessment should be issued in Form No. 7 (Rule 15) and demand notice for advance tax liability should be issued in Form No. 28 (Rule 38). If a notice of demand is not in the proper form, the assessee cannot be regarded as a defaulter and no question of recovery under Sec. 220 arises.

Penalty Provisions			
Section	Nature of Default	Minimum penalty	Maximum Penalty
140A(3)	Failure to pay whole or any part of income-tax or interest or both in accordance with the provisions of section 140A(1).	Such amount as the Assessing Officer may impose [Sec. 221(1)]	Tax in arrears
271(1)(b)	Failure to comply with a notice under section 142(1), 143(2) or with a direction issue under section 142(2A)	Rs. 10,000 for each failure	Rs. 10,000 for each failure
271FA	Failure to furnish annual information return	Rs. 100 for each day of default	-
272AA	Failure to comply with the provisions of section 133B	Upto Rs. 1,000	Rs. 1,000
271F	Failure to furnish return of income under proviso to section 139 on or before the end of the assessment year	Rs. 5,000	-
272B	Failure to comply with the provisions of section 139A	Rs. 10,000	-

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.

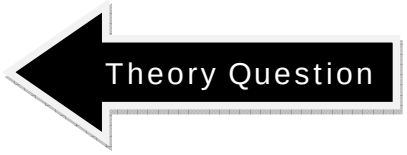
(2) The Central Government may notify in the Official Gazette from time to time accounting standards to be followed by any class of assessees or in respect of any class of income.

(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.

OPPORTUNITY OF BEING HEARD

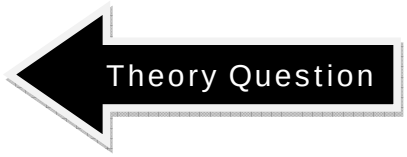
It is a pre condition of both the sections that the IAC's directions under either section will not issue without the assessee being given an opportunity of being heard by him, if such directions are prejudicial to the assessee.

PROVISIONS OF SECTION 144A



As far as section 144A is concerned it could come into play (i) where the ITO is in doubt as to how to decide a particular issue and seeks the guidance of the IAC, whether it be on a point of law or of fact or principle of accounting; (ii) where the IAC, on his own, feels that directions ought to issue for the guidance of the ITO because of the complexity of the matter or because of his apprehension that a proper and lawful assessment may not be framed by the ITO ; and (iii) where the assessee approaches the IAC with an application under section 144A(1) because he fears that the ITO may proceed arbitrarily, unreasonably or contrary to law to his prejudice. There is nothing that compels the ITO to make a reference under section 144A and the section does not even provide that if an application of the assessee under that section is pending with the IAC, the ITO shall not proceed to finalize the assessment before receipt of the directions of the IAC envisaged under section 144A(1). Possibly, this is administratively capable of being ensured.

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.".

Interest on enhanced compensation

interest received by an assessee on compensation or on enhanced compensation, as the case may be, shall be deemed to be the income of the year in which it is received.

In the case of income of the nature above, a deduction of a sum equal to fifty per cent of such income and no deduction shall be allowed u/s 57.

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 - Kedarnat6h 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, 33ITR 182 (SC).

Power to examine accounting method is statutory

The words ' in the opinion of the Income-tax Officer are not 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 de deduced there from - CIT v. Mcmillan & Co.

Non-exercise of power by ito is also a decision

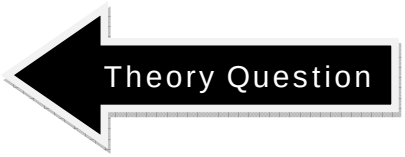
It is not correct to say that only when the ITO determines that the method of accounting adopted by the assessee is unacceptable, there is a decision, and that where he does not so decide, there is no decision but a mere non-exercise of the power. Non-exercise of the power under section 145 is also decision 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 contractor is determined on the value of the contract as a whole and cannot be determined by considering several items that goes 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 - Briji Bhushan Lal Parduman Kumar v. CIT 1978 115 ITR 524 (SC).

SERVICE OF NOTICE.

SERVICE OF NOTICE GENERALLY. SEC. 282



The service of a notice or summon or requisition or order or any other communication under this Act (hereafter in this section referred to as "communication") may be made by delivering or transmitting a copy thereof, to the person therein named,

(a) by post or by such courier services as may be approved by the Board; or

(b) in such manner as provided under the Code of Civil Procedure, 1908 (5 of 1908) for the purposes of service of summons; or

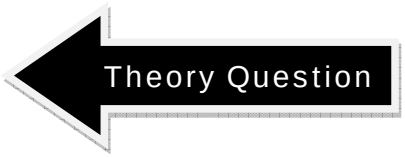
(c) in the form of any electronic record as provided in Chapter IV of the Information Technology Act, 2000 (21 of 2000);

(d) by any other means of transmission of documents as provided by rules made by the Board in this behalf.

The Board may make rules providing for the addresses (including the address for electronic mail or electronic mail message) to which the communication may be delivered or transmitted to the person therein named.

Sec.	SITUATION	NOTICE TO BE SERVED ON
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,

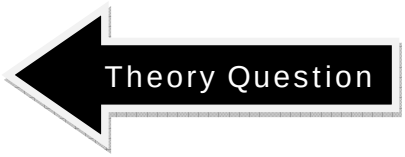
AUTHENTICATION OF NOTICES AND OTHER DOCUMENTS. 282A



(1) Where this Act requires a notice or other document to be issued by any income-tax authority, such notice or other document shall be signed in manuscript by that authority.

(2) Every notice or other document to be issued, served or given for the purposes of this Act by any income-tax authority, shall be deemed to be authenticated if the name and office of a designated income-tax authority is printed, stamped or otherwise written thereon.

DOCUMENT IDENTIFICATION NUMBER – DIN 282B



(1) Every income-tax authority shall allot a computer generated Document Identification Number in respect of every notice, order, letter or any correspondence issued by him to any other income-tax authority or assessee or any other person and such number shall be quoted thereon.

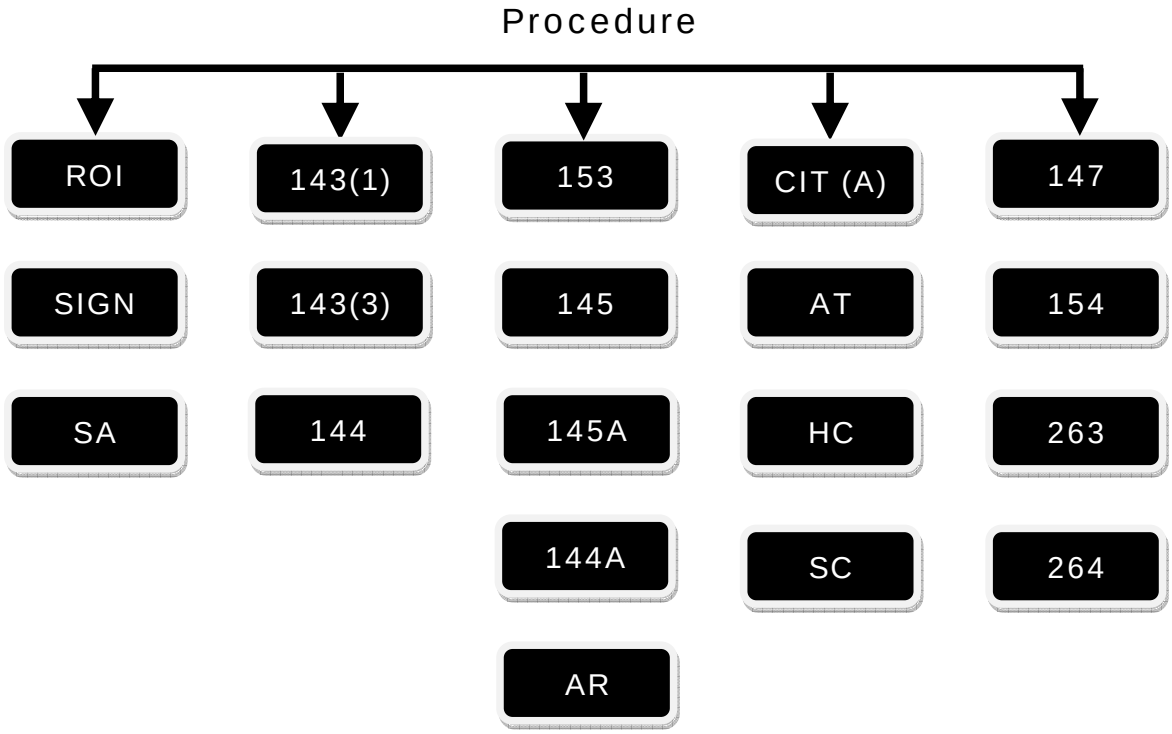
(2) Where the notice, order, letter or any correspondence, issued by any income-tax authority, does not bear a Document Identification Number such notice, order, letter or any correspondence shall be treated as invalid and shall be deemed never to have been issued.

(3) Every document, letter or any correspondence, received by an income-tax authority or on behalf of such authority, shall be accepted only after allotting and quoting of a computer generated Document Identification Number.

(4) Where the document, letter or any correspondence received by any income-tax authority or on behalf of such authority does not bear the Document Identification Number referred to in sub-section (3), such document, letter or any correspondence shall be treated as invalid and shall be deemed never to have been received.

INCOME ESCAPING ASSESSMENT

Scheme of taxation taxes an income in the relevant assessment year in the hands of that person who has earned it. If an income is not taxed in the earning hands in the assessment year, relevant to the year of income, it has escaped from assessment. For this purpose, it is immaterial that it has been taxed in some other assessment year or it has been charged to tax in the hands of some other person [C1T *v.* Narsee no ITR307(SC)].



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.

Matters not decided in appeal

Provided further that the Assessing Officer may assess or reassess such income, other than the income involving matters which are the subject matters of any appeal, reference or revision, which is chargeable to tax and has escaped assessment.

Re-assessment of other matter

For the purpose of assessment or reassessment, the Assessing Officer may assess or reassess the income in respect of any issue, which has escaped assessment, and such issue comes to his notice subsequently in the course of the proceedings under this section, notwithstanding that the reasons for such issue have not been included in the reasons recorded

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).

Concept of "Reason to Believe" AO not to Act on mere Suspicion:

Re-assessment proceedings can be started provided the Assessing Officer has reason to believe that taxable income has escaped assessment [Investors Industrial Corpn. *v.* CIT 194 ITR 548].

The words 'reason to believe' suggest 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 does not exist [Sheo Nath Singh *v.* AAC (1971) 82 ITR 147 (SC)].

The Assessing Officer started re-assessment proceedings against an Ex-Minister in the Central Government on the ground that the assessee's expenses, as conjectured by the Assessing Officer himself, would not have been met within the income originally declared and assessed. The Assessing Of-

ficer has not set out any material on the basis of which he had formed the belief that the income had escaped assessment.

Held: Assessing Officer cannot re-open the assessment on mere suspicion, gossip or rumour [Ashok Sen *v.* ITO (1981) 5 Taxman 29B (Del.)].

Similarly, the return of a company, containing loan transactions and confirmatory letters, as accepted. Subsequently, appraisal report of the Assistant Director indicated that a number of persons shown as creditors were merely name lenders and re-assessment was started on the basis of the said report. The re-assessment was set aside because the appraisal report did not disclose who were the name lenders and whether they made any statement before any authority to the effect that their transactions with the company were not genuine. The Assessing Officer cannot conclude that income has escaped assessment [Technocraft Industries and others *v.* Second ITO and others (1990) 185 ITR 465 (Bom.)].

Belief must be Based on Certain Facts:

There must be a nexus between the material in his possession and the escapement of income. Take an example. While assessing the income of a company for the assessment year 1990-1991, the Assessing Officer allowed a deduction of Rs 2,00,000 for the construction of approach road from the factory gate to the main road. Subsequently, expenditure for the construction of approach road was held by the Supreme Court to be of capital nature [Travancore Cochin Chemicals Ltd. *v.* CIT (1977) 106 ITR 900 (SC)]. Following this decision, re-assessment proceedings were started against the company for the assessment year 1990-1991. The re-assessment proceedings are valid because the Assessing Officer has some material to believe that income has escaped assessment.

Take another example. The coal mines of the assessee company were jointly inspected by the Chief Mining Officer to ascertain the quantity of coal raised by the company. The joint-inspection report revealed that the company raised more coal than disclosed in the return. Thus, there was under-reporting of the quantity of the coal raised. The Assessing Officer started re-assessment proceedings on the basis of inspection report, submitted by the officers of the Mining Department. Re-assessment notice was held valid [ITO *v.* Selected Dalurbrand Coal Pvt. Ltd. (1966) 217 ITR 597 (SC)].

Similarly, where interest on loan taken from the company is allowed as deduction and subsequently, the director of the company denies the loan, re-assessment is valid. The assessee cannot get away by wilfully making a false statement at the time of the original assessment and when that falsity comes to notice, the assessee cannot be allowed to say "you accepted my lie, now your hands are tied and you cannot do anything" [Phool Chand Bajrang Lai *v.* CIT (1993) 203 ITR 456 (SC)].

Mere Change of Opinion not Permissible:

The Assessing Officer cannot take action under this section merely because he happens to change his opinion or he happens to hold an opinion different from that of his predecessor, on the same set of facts [CIT *v.* Dinesh Chandra 82 ITR 367 (SC)]. Where the Assessing Officer had considered the material on record and formed an opinion on the said material in the original assessment itself, he would be powerless to start re-assessment proceeds on mere change of opinion [ALA *v.* ITR 447 (SC)].

Thus, where the Assessing Officer computed the income of an assessee by applying one of the different legally permissible methods, he cannot re-open the assessment to apply another permissible method which would result in larger income [CIT *v.* Siman 105 IR 212 (SC)]; [Swadesh East Asia *v.* IAC 180 ITR 47].

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)

Disclosure of Material Facts Fully and Truely:

The assessee is bound to disclose fully and truly all material facts necessary for his assessment. What facts are material and necessary will differ from case to case. There can be no doubt that the duty of disclosing all primary facts relevant to the decision on the question before the assessing authority lies on the assessee [Indian Oil Corporation *v.* CIT (1986) 159 ITR 956 (SC)].

Material Facts refer only to Primary

Facts which are necessary for assessment. What facts are material and necessary for assessment will differ from case to case. Thus, showing the sale, purchase and profits, supported by the account books are material facts [Oriental Carpet Mfrs. (India) Ltd. *v.* ITO (1987) 168 ITR 296 (P&H)]. The status of the assessee, whether resident or non-resident, is a material fact which should be disclosed [Surmukh Singh *v.* CIT 144 ITR 191].

Primary Facts vs. Collateral Facts:

A distinction has to be made between primary facts and collateral facts. Where full details are filed by the assessee of the interest account of a creditor including interest paid to such creditor in the relevant accounting year, mere non-production of the loan account of the creditor which constituted merely an evidence of the primary transaction of the loan could not amount to non-disclosure of primary facts [Dinesh Kumar Gordhandas *v.* CIT (1983) 140 ITR 211 (MP).

No Duty to suggest the Inference from the Primary Facts:

The duty of the assessee is only to disclose truly and fully the primary facts, known to the assessee. He has not to further suggest what factual or legal inference be drawn from the primary facts [CIT *v.* Bhanji 79 ITR 582 (SC)]; [IOC *v.* ITO 159 ITR 956].

So far as primary facts are concerned, it is the assessee's duty to disclose all of them, including particular entries in account books, particular portions of documents as well as documents and other evidences which could have been discovered by the assessing authority from the documents and other evidence disclosed.

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.

Mere Production before the AO of Books/Documents/Evidence is not enough [Explanation 1 to Sec. 147]:

Mere production of evidence before the ITO is not enough. There may be omission or failure to make a true and full disclosure, if some material for the assessment lay embedded in the evidence which the assessee could have uncovered but did not. Then it is the duty of the assessee to bring it to the notice of the assessing authority. The assessee knows all the material and relevant facts, the assessing authority may not. In respect of the failure to disclose, the omission to disclose may be deliberate or inadvertent. That is immaterial. But if there is omission to disclose the material facts, then subject to other conditions, jurisdiction to re-open is attracted [Indo-Aden Salt Mfg. & Trading Co. (P) Ltd. *v.* CIT (1986) 159 ITR 624 (SC)].

Thus, the nature of a *benami* transaction may not be clear from the evidence produced unless disclosed. It is the duty of the assessee to disclose the nature of the *benami* transaction, failing which it amounts to non-disclosure of primary facts.

Similarly, where books of accounts are produced before the Assessing Officer, it is the duty of the assessee to bring to the notice of the Assessing Officer particular items in the books of accounts or portion of documents which are relevant. If the assessee fails to do this, it amounts to non-disclosure of primary facts. This is so despite the fact that the Assessing Officer could have discovered the truth with due diligence from the books and documents produced before him. It is specifically provided by Explanation 1 to Sec. 147.

If the assessee has not disclosed primary facts necessary for the assessment or has not furnished a return, the longer time-limit is justified for re-assessment. For example, an assessee was a shareholder in a company. He borrowed money from the company and filed a copy of the loan account with the company at the time of original assessment. He claimed the deduction of interest (payable to the company), in computing income from "other sources". Subsequently, the Assessing Officer scrutinised the balance sheet of the said company and noticed the existence of accumulated profits which could be deemed to be dividend under Sec. 2(22) of the Act. Since the assessee did not furnish the balance sheet of the company at the time of original assessment, the dividend income had escaped assessment on account of failure on the part of the assessee to disclose fully and truly primary facts relevant to the assessment. Re-assessment can be made in such a case even after the expiry of four years.

Take one more example. B Ltd. effected purchases of stock-in-trade of the value of Rs 2,50,000 from Shah & Co., during the financial year 1994-1995. Vouchers in support of the purchases were

produced before the Assessing Officer who accepted the claim. Subsequently, the A.O. received specific information that the said purchases were not genuine and Shah & Co. had denied the transaction. The A.O. thereafter re-opened the assessment under Sec. 147. B Ltd. challenged the validity of the re-assessment on the ground that it had disclosed all the primary facts and the A.O. ought to have verified the genuineness of the claim at the time of the original assessment. Explanation 1 to Sec. 147 provides that the 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 within the meaning of the First Proviso. The Assessing Officer is justified in reopening of the assessment because some fresh facts (i.e. denial of Shah & Company) have come to light.

Books of Account vs. Balance Sheet:

The Explanation deals onlv with account books or other evidence, which are produced before the Assessing Officer. It does not cover the "balance sheet" which the assessee is obliged to file along with the return of income. Therefore, the Assessing Officer cannot invoke the Explanation when he has failed to notice an entrv or statement in the balance sheet.

Issue of Notice vs. Service of Notice:

The word 'issued' in Sec. 149 should be given its natural meaning and not the strained wider meaning of 'served'. Consequently, where the notice was issued within time but was served on the assessee after the expiry of the time-limit, it could not be held to be invalid R.K. Upadhvava *v.* Shanabhai P. Patel [(1987) 166 ITR 163 (SC)]; [CIT *v.* Shiv Kumari Debi (1986) 157 ITR 13 (Pat.) (FB)MJai Hanuman Trading Co. (P) Ltd. *v.* CIT (1977) 10 ITR 36 (Punj & Har) (FB)].

Some of apex judgements

(*i*) *Calcutta Discount Co. Ltd.* v. *ITO* [1961] 41 ITR 191.

Before the ITO could issue a notice, two conditions precedent must co-exist, namely, that he must have reason to believe (*a*) that income, profits or gains had been under-assessed and (*b*) that such under-assessment was due to non-disclosure of material facts by the assessee.

Although what facts would be necessary and material for the assessee in a particular case must depend on the facts of that case, yet there could be no doubt that the burden of disclosing all the primary facts must invariably be on the assessee.

The *Explanation* to section made it clear that burden could not be fully discharged by simply producing the account books and other documents, but that the assessee must also disclose such specific items or portions thereof as are relevant to the assessment. But, once he has done so, it is for the Income-tax Officer to draw the proper inference of fact and law therefrom. The *Explanation* does not enlarge the scope of the section so as to include 'the disclosure' of such inferences.

(*ii*) *S. Narayanappa* v. *CIT* [1967] 63 ITR 219.

The ITO had reasonable grounds for thinking that there was non-disclosure of material facts on the part of the appellant and that there was under-assessment caused by the assessee's failure to submit the return.

The existence of the belief and whether the reasons for the belief of the ITO have a rationale, connection with or a relevant bearing on the formation of the belief, are open to examination by

the Court. But if there are, in fact, some reasonable grounds for the Officer to believe that there had been a non-disclosure as regards any fact which could have a material bearing on the question of under-assessment that would be sufficient to give him jurisdiction to issue the notice under section 34, and their sufficiency cannot be challenged by the assessee.

The scheme of section 34 is that if the conditions of the main section are satisfied, a notice has to be issued to the assessee. But before issuing the notice, the proviso requires that the officer should record his reasons and obtain the sanction of the Commissioner for initiating action under the section. But there is no requirement in the Act that the reasons which induced the Commissioner to accord sanction, should also be communicated to the assessee.

(*iv*) *P. Jayappan* v. *S.K. Perumal, First ITO* [1984] 149 ITR 696/19 Taxman 1.

On a careful consideration of the relevant provisions of the Act, this Court is of the view that the pedency of the reassessment proceedings cannot act as a bar to the institution of the criminal prosecution for the offences punishable under section 276C and section 277 of the Act. The institution of criminal proceedings cannot in the circumstances also amount to an abuse of the process of the court.

(*v*) *Indian Oil Corporation* v. *ITO* [1986] 159 ITR 956/26 Taxman 336.

To confer jurisdiction under clause (*a*) of section 147 of the Act beyond the period of four years but within a period of eight years from the end of the relevant year under section 148 of the assessment, two conditions were required to be fulfilled : first is that the ITO must have reason to believe that the income profits or gains to tax had been under-assessed or escaped assessment; the second was that he must have reason to believe that the income profits or gains chargeable to tax had been under-assessed or escaped assessment and that such escapement or under-assessment was occasioned by reason so far as relevant for the present purpose to disclose fully and truly all material facts necessary for the assessment of that year. Both these conditions are conditions precedent to be satisfied. The obligation, therefore, of the assessee primarily was to disclose fully and truly all material and relevant facts, that the obligation was only of disclosing the basic facts but not obligation to disclose what inference had to be drawn from such facts.

(*vi*) *Trustees of H.E.H. the Nizam's Supplemental Family Trust* v. *CIT* [2000] 242 ITR 381/109 Taxman 193

It is not disputed that the return filed with the refund application under section 237 of the Act is a valid return and the ITO can initiate proceedings for assessment on the basis of the return so filed.

It is settled law that unless the return of income already filed is disposed of, notice for reassessment under section 148 cannot be issued, *i.e.,* no reassessment proceedings can be initiated so long as assessment proceedings pending on the basis of the return already filed are not terminated.

Return of income filed in the form prescribed along with an application for refund under section 237 is a valid return. There is no stopping the ITO to complete the assessment on the basis of the return so filed. It may be that the ITO may limit the scope of examination of the return to satisfy himself regarding the correctness of the amount claimed as refund. For that purpose, he will examine if the tax paid by the assessee exceeds the amount of the tax for which he is chargeable. If it is found that the income was '*nil*' he will direct the refund to be granted to the assessee for any amount of tax paid. That will certainly be assessment. Filing of return in the

form prescribed under section 139 of the Act along with the application for refund, is no empty formality.

The Supreme Court was thus of the opinion that during the pendency of the return filed under section 139 along with refund application under section 237, action could not have been taken under section 147/148.

(*vii*) *Asstt. CIT* v. *Rajesh Zaveri Stock Brokers (P.) Ltd.* [2007] 161 Taxman 316/291 ITR 500.If the Assessing Officer has cause or justification to know or suppose that income has escaped assessment, it can be said that he had 'reason to believe' that income had escaped assessment. The expression cannot be read to mean that the Assessing Officer should have finally ascertained the fact by legal evidence or conclusion. So long as the ingredients of section 147 are fulfilled, the Assessing Officer is free to initiate proceedings under section 147 and failure to take steps under section 143(3) will not render the Assessing Officer powerless to initiate reassessment proceedings even when initiation under section 143(1) has been issued.

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)

Recording of Reasons [Sec. 148].

The Assessing Officer is required to record his reasons for reopening the back assessment or for making assessment of any income which has escaped assessment. Recording of reasons is a condition precedent to the starting of tlie proceedings under Sec. 147. If no reasons have been recorded, the notice is invalid and assessment is null and void.

The assessee is not entitled to get a copy of the reason recorded by the Assessing Officer for the issue of notice under Sec. 148. But they may have to be disclosed to the court in appropriate proceedings, otherwise the court may quash the assessment. Therefore, the Assessing Officer must state basic facts which constitute concealment [KCP *v.* ITO 146 ITR 284]. If the reasons are mechanically recorded or are factually incorrect and misleading the notice and assessment both would be vitiated [CIT *v.* Agarwalla 189 ITR 786]; [Sugamchand v. ITO 105 ITR 743].

Reasons not to be Disclosed to the Assessee at the Initial Stage:

Such reasons need not be communicated to the assessee [Narayanappa *v.* CIT 63 ITR 219 (SC)] or mentioned in the notice issued [ITO *v.* Biju Patnaik 188 ITR 247 (SC)], but they may have to be disclosed to the assessee once the return is filed in response to the notice [GKN Driveshafts *v.* ITO

259 ITR 19 (SC)], or to the appellate authority under this Act [Divaker *v.* CIT 157 ITR 629] or to the court [ITO *v.* Madnani 118 ITR 1 (SC)].

Sanction of Notice [Sec. 151].

Sec. 151 guards that the sword of Sec. 147 may not be used against the assessee to harass him unnecessarily unless a superior officer is satisfied that the Assessing Officer has good and adequate reasons to invoke the provisions of Sec. 147 and that his belief regarding escapement of the income is reasoned and *bona fide.*

Mechanical sanction by Commissioner not Valid:

The Commissioner cannot accord sanction for issue of notice under Sec. 148 mechanically, without applying his mind to the material relied on by the ITO [S.P. Agarwalla alias Sukhdeo Prasad Agarwalla *v.* ITO (1983) 140 ITR1010 (Cal.)].

The satisfaction of the Commissioner, based on a non-existent ground, would be wholly mechanical and without application of mind. The same, not being a real satisfaction, cannot be treated as satisfaction of the Commissioner as contemplated under Sec. 151(2) [Ladhuram Laxmi Narayan *v.* ITO (1976) 102 ITR 595 (Gau.)].

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 (less 3 months) 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 Raoy'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).

Whole Assessment gets Re-opened:

Once an assessment is re-opened by issuing a notice, the previous under-assessment is set aside and the whole assessment proceedings start afresh. Once the re-assessment proceedings are validly initiated, the jurisdiction of the ITO is not restricted to the portion of the income that escaped assessment. Once valid proceedings are started under Sec. 147, the ITO not only has the jurisdiction but it is his duty to levy tax on the entire income that has escaped assessment during that year [V. Jaganmohan Rao *v.* CIT/ CEPT(1970) 75 ITR 373 (SC)].

Re-assessment Proceedings are for the Benefit of Revenue:

In re-assessment proceedings, which are always for the benefit of revenue, the assessee cannot claim that assessment should be completed and loss should be determined to enable him to claim the benefit of carry forward and set-off against income of the subsequent years. In such a case, the proper course for the ITO would be to drop the proceedings under Sec. 147 [CIT *v.* State Agro Development Corporation (2001) 248 ITR 487 (J&K)].

If in re-assessment proceedings it is found that the assessee's total income is actually less than the income escaped, the assessee would not be entitled to have the assessment revised to get any refund [State Bank of Hyderabad *v.* CIT 171 ITR 232 (AP)] or it is found that actually there is a loss which

the assessee could have carried forward, the assessee would not be entitled to claim that the Assessing Officer should assess the total income in re-assessment proceedings and pass an order (Sec. 157) to notify the loss [CIT *v.* Sun Engineering Works (P) Ltd. (1992) 198 ITR 297 (SC)].

Valuation Report cannot be the Basis of Revision:

Where apart from the valuation report which was relied upon by the ITO there was no material before him to come to the *prima facie* conclusion that the assessee had received a higher consideration than what had been stated in the sale deed, re-assessment would not be justified [ITO *v.* Santosh Kumar Dalmia (1994) 208 ITR 337 (Cal.)].

Cash credits and Loans:

Where cash credits were accepted in the original assessment as genuine, the claim may be re-investigated in re-assessment proceedings if there is any live link or close nexus between the material coming to the knowledge of the Assessing Officer and formation of his belief that credit is not genuine. If there is a specific confession by the creditor that the loan stated to have been given by him to the assessee is not genuine, such cash credit may be re-assessed as concealed income of the assessee [ITO *v.* Lakhmani 103 ITR 437 (SC)].

Income Assessed in the Hands of Wrong Person:

Where income was assessed in the hands of a wrong person, re-assessment proceedings may be started against the person properly chargeable to tax [Mangi *v.* CIT 60 ITR (SC)]. Thus, where income was earlier assessed in the hands of individual member of a Hindu Undivided Family, its re-assessment in the hands of the HUF was held valid on the facts of the case [ITO *v.* Banchulal Kapoor 60 ITR 74 (SC)]. However, the revenue is bound to make appropriate adjustments in respect of the tax on the income of the family realised under the assessment on the individual members [Mehendra *v.* ITO103ITR688].

Expenditure or Exemption relating to Concealed Income to be Allowed:

In re-assessment proceedings, the assessee is entitled to make a claim for deduction in respect of any expenditure which is relaxable to the income which is sought to be assessed as escaped income [CIT *v.* Caixa Economic De God (1994) 119 ITR 250 (Bom.)]. Similarly, the assessee is entitled to claim exemption, if any, available to him in respect of concealed income.

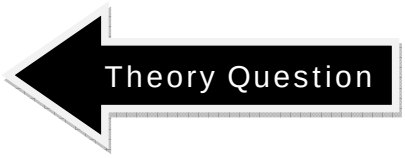
Assessee is entitled to Rebut the Concealment:

In re-assessment proceedings, assessee is not entitled to seek credit in respect of some items which have been over-assessed. However, it is open for him to show that the income alleged to have escaped assessment has in truth and in fact not escaped assessment but has been brought to tax under some inappropriate head [Mathavjee Thakersay *v.* CIT 3 ITR 457].

Tax rates [sec. 152(1)].

In an assessment or re-assessment made under Sec. 147, the tax is to be charged at the rate in force in the relevant assessment year, that is, the year to which the assessment or re-assessment relates, and not the year in which the assessment or re-assessment is made.

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.

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TIME LIMIT FOR COMPLETION OF ASSESSMENTS. SEC. 153

The general time limit for completion of an assessment, as laid down is 21 months for assessment and 9 months 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. S3ection 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.]

RECTIFICATION OF MISTAKE.154

The power to rectify the mistake has been conferred on the tax authorities to ensure justice to both the assessee and the Revenue. It is not discretionary. It must be exercised if the requisite conditions are satisfied. An income-tax authority may amend any order passed by it or any intimation or deemed intimation under Sec/l43(l).

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.

The Supreme Court in a recent decision delivered on January 4, 2007 in the case of *CIT* v. *Ralson Industries Ltd.* reported in [2007] 288 ITR 322 has laid down an important proposition of law. The Supreme Court in this case held that the power of review and/or rectification is not akin to administrative power. An administrative function and a judicial function operate in two different fields. Whereas a judicial function must be exercised by the authority invested therewith in terms of the provisions of the statute and on the basis of the materials on record, an administrative order, although it may have to be passed by a statutory authority, must be confined within the four corners of the statute. There may, however, be an element of discretion. An order by a judicial functionary is subject to appeal or revision. An administrative order may or may not be. An order of assessment is subject to revisional jurisdiction under section 263 of the Act. The doctrine of merger in such a case will have no application.

Mistake sought to be Rectified, must be Apparent from the Record

The mistake to be rectified must be one which is apparent from the record [Jessaram *v.* CIT- 2 ITC 342]. The plain meaning of the word "apparent" is that it must be something which appears to be so *ex facie* that it is incapable of argument or debate. Therefore, a mistake can be regarded as apparent only when it is glaring, obvious or self-evident mistake and not something which can be established by a long-drawn process of reasoning on points or in respect of which there may be two opinions [CIT *v.* Lakshmi Prasad Lahkar (1994) 74 Taxman 112 (Gau.)].

It would thus be seen that rectification of an assessment order by the Assessing Officer under section 154/155 does not take away or curtail the revisional jurisdiction of the Commissioner of Income-tax

acting under section 263. It is always open to the Commissioner to exercise his revisionary powers and the assessee can put forth all his contentions including subsequent events if any, before the Commissioner once the proceedings are initiated by the Commissioner under section 263.

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).

South India Steel Rolling Mills v. CIT [1997] 224 ITR 654

The Supreme Court in the case of *South India Steel Rolling Mills* v. *CIT* [1997] 224 ITR 654 has held merely because the Assessing Officer could have rectified the order under section 155, the Commissioner could not be precluded from exercising the power conferred on him under section 263. The power of rectification conferred on the Assessing Officer under section 155 and the power of revision conferred on the Commissioner under section 263 are distinct powers. The principle that one is a special provision and the other is a general provision has no application. The revisional power conferred on the Commissioner under section 263 is of wide amplitude. It enables the Commissioner to revise an order passed by the Assessing Officer, if he considers it to be erroneous and prejudicial to the interest of the Revenue. There is, therefore, no reason to limit this power by reference to section 155.

Panna knitting industries [2002] 253 itr 656

The Gujarat High Court in the case of *CIT* v. *Panna Knitting Industries* [2002] 253 ITR 656 held that if out of four claims made, three were allowed by the Assessing Officer and the fourth was disallowed by the Assessing Officer and the assessee had gone on appeal before the Commissioner of Income-tax (Appeals) in respect of the fourth item and the Commissioner of Income-tax (Appeals) had confirmed the fourth item, the Commissioner of Income-tax acting under section 263 has jurisdiction to revise the assessment in respect of the other three items against which no appeal was filed by the assessee. The High Court held that it is only with a view to empower the revisional authority to exercise the powers of the appellate authority in respect of matters which have escaped the attention of the appellate authority that *Explanation (c)* has been added to section 263. The Gujarat High Court followed the decision of the Supreme Court in the case of *CIT* v. *Shri Arbuda Mills Ltd.* [1998] 231 ITR 50.

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 therefore 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 PERMISIBLE 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 on Instruction from Superior Officers not Permissible:

The Assessing Officer should apply his independent mind to the facts of the case and should not be influenced or guided in the matter by any instruction of the Commissioner or any other superior authority. A rectification based on a notice which indicated that the rectification was proposed as per Commissioner's instructions would be invalid [Rajputana Mining Agencies v. ITO (1979) 118 ITR 585 (Raj.)]; ITO v. Eastern Scales (P) Ltd. (1978) 115 ITR 323 (Cal.)].

Power of Successor in Office to rectify Mistake:

Where an incumbent of the office has changed, the successor in office may pass rectification order [Sushil v. ITO 35 ITR 386].

When an Assessing Officer had exercised his jurisdiction under Sec. 154 and rectified the assessment order, his successor, ITO could not sit in appeal over that order and cancel the same by exercising powers again under Sec. 154 [Addl. CIT v. Chemical Limes (1984) 149ITR 325 (Raj.)].

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 / collected 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.

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SECTION 263 REVISION

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

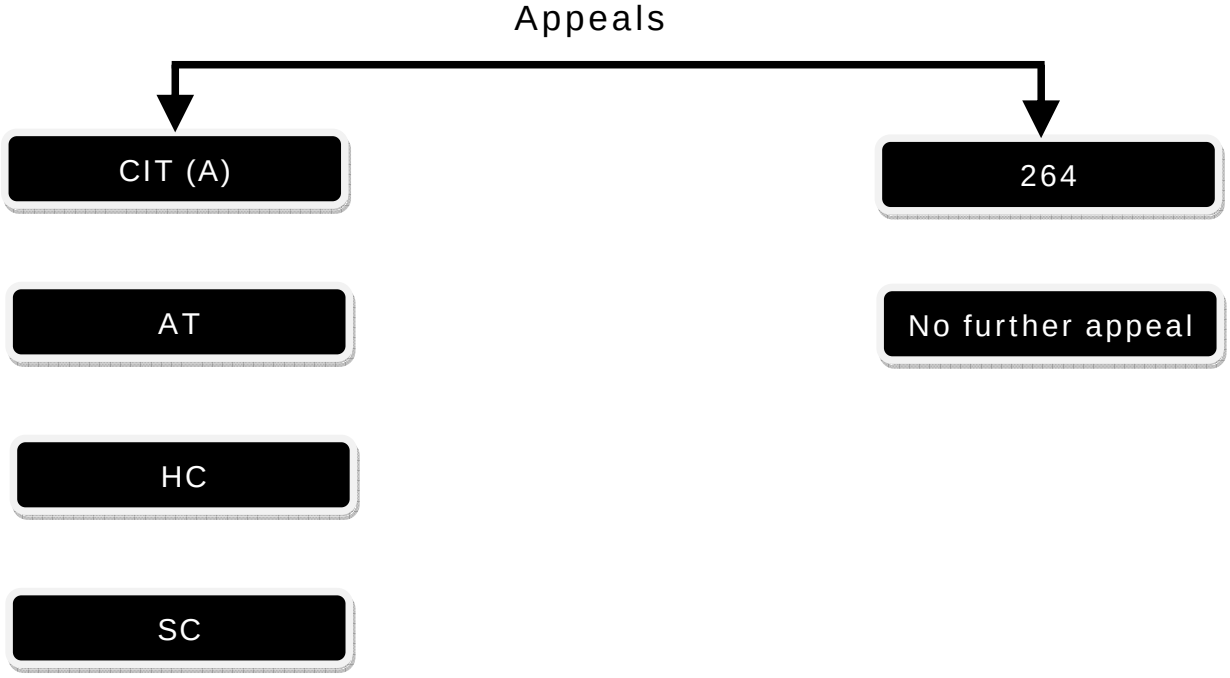
Section 263 does not in express terms require a notice to be served as in the case of section, 147. Section 263 merely requires that an opportunity of being heard should be given to the assessee and the stringent requirement of service of notice under section 147 cannot therefore be applied to a proceeding 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.

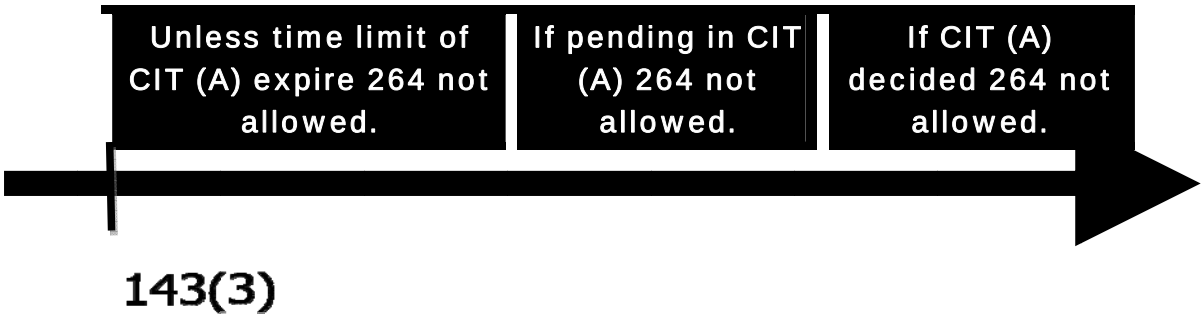


Time limit for application u/s 264

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-mater 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)

	Refund	Demand
143(1)	Yes	Yes
143(3)	Yes	Yes
144	No	Yes
147	No	Yes
154	Yes	Yes
263	No	Yes
264	Yes	No

APPEALS

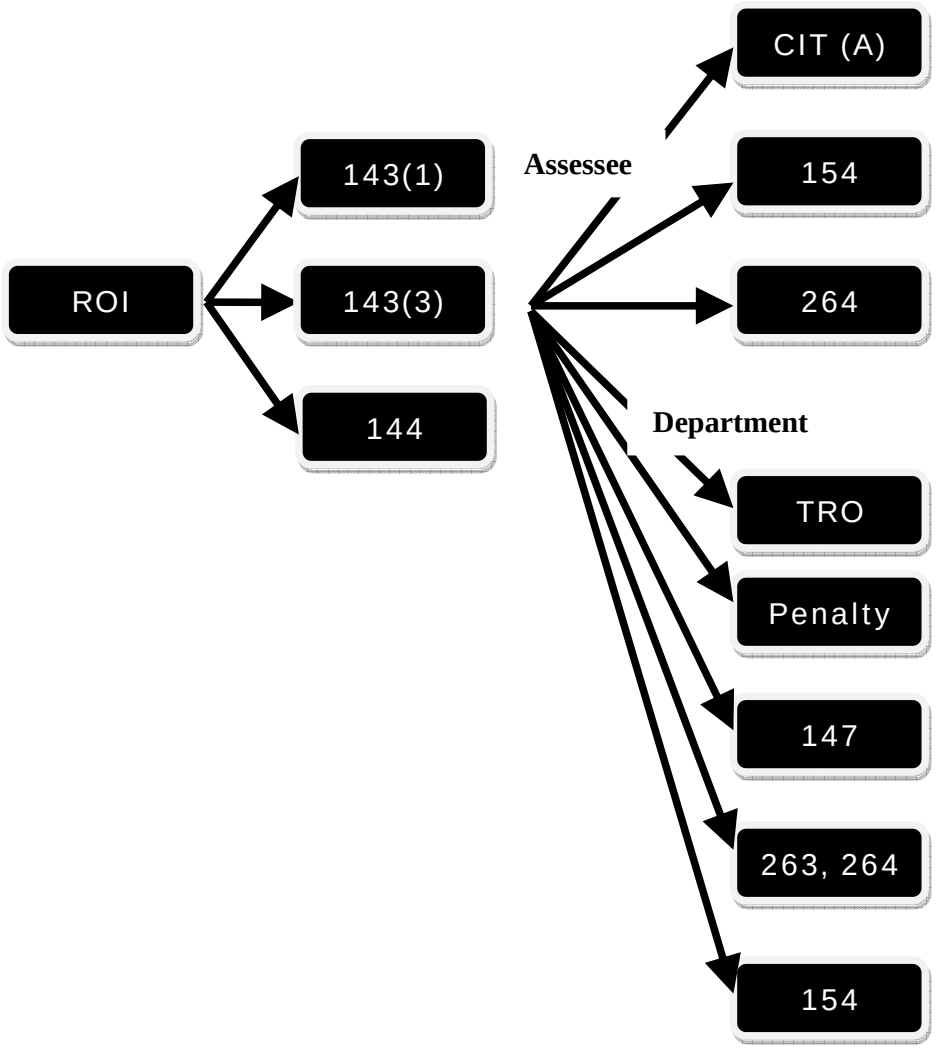
The meaning of the word 'appeal' is the removal of a cause or suit from an inferior to a superior Judge or Court for re-examination or review. It is a proceeding taken to rectify an erroneous decision of a Court by submitting the question to a higher Court, or Court of Appeal. It amounts in essence to a complaint to a higher Forum that the decision of the subordinate officer or Tribunal is erroneous and liable to be set aside. It embraces all proceedings whereby a Superior Court is called upon to review, revise, affirm, reverse or modify the decision of an inferior Court.

Right of appeal

The essential criterion of appellate jurisdiction is that it revises and corrects the proceedings in a cause already instituted and does not create that cause. There is no inherent right of appeal by a person and its existence must depend on the terms of the statute. The right of appeal is a statutory right and it is a creature of statute. It cannot be claimed as a matter of right. It is open to the Legislature to give or not to give a right of appeal against decisions made by the authorities under the Act. No appeal would, therefore, lie unless provided by the statute. The absence of a provision for appeal in a taxing statute may be a vitiating factor - Kannathat Thathunni Moopil Nair v. State of Kerala AIR 1961 SC 552. The Supreme Court in the case of Express Hotel (P.) Ltd. v. State of Gujarat [1989] 178 ITR 151 held that the absence of a provision for a corrective machinery, by way of appeal or revision, to rectify an adverse order made by an authority on whom power is conferred, might indicate that the power so conferred is unreasonable or arbitrary. But the corrective machinery may itself take several forms and be inherent or found in the provisions for conferment of the power themselves.

A right of appeal is a substantive right and it is a creature of the statute. A right of appeal is not merely a matter of procedure but it is a substantiveright which becomes vested in a party and such a vested right cannot be taken away, except by express enactment or necessary intendment. It is a settled law that the language of a provision conferring the right of appeal should be construed liberally and in case of an ambiguity, the relevant provisions must be construed in favour of the existence of the right. The right of appeal is, therefore, a valuable right and unless expressly taken away or abandoned, it cannot be held that the assessee has abandoned or lost such right by implication. A right of appeal is one of the modes by which a decision which would otherwise be final can be challenged. Therefore, it is not a procedural but a substantive right. The essential criterion of appellate jurisdiction is that it revises and corrects the proceedings in a cause already instituted and does not create that cause. Thus, an appeal, which is a creature of the statute, is subject to conditions and restrictions imposed by the statute - Gujarat Agro Industries Co. Ltd. v. Municipal Corpn. of the City of Ahmedabad [1999] 4 SCC 468. An appeal is a continuation of assessment proceedings. The substantive right of appeal conferred by the statute upon the assessee cannot in any way be curtailed or restricted by the language of rules made under subordinate legislative powers. If a rule attempts to so curtail or restrict the right of appeal, such rule to that extent is ultra vires. The Supreme Court in National Insurance Co. Ltd. v. Nicolletta Rohtagi [2002] 7 SCC 456 overruling its earlier decision in United India Insurance Co. Ltd. v. Bhushan Sachdeva [2002] 2 SCC 265 held that the right of appeal is not an inherent right or common law right, but it is a statutory right. If the law provides that an appeal can be filed on limited grounds, the grounds of challenge cannot be enlarged. The Supreme Court also held that the view taken in United India Insurance Co. Ltd.'s case (supra), that a right to contest would also include the right to file an appeal is contrary to well-established law

that creation of a right of appeal is an act which requires legislative authority and no Court or the Tribunal can confer such right, it being one of limitation or extension of jurisdiction.



APPEAL TO CIT

Appealable orders before Commissioner (Appeals). 246A

Any assessee aggrieved by any of the following orders (whether made before or after the appointed day) may appeal to the Commissioner (Appeals) against

(a) an order passed by a Joint Commissioner under clause (ii) of sub-section (3) of section 115VP or an order against the assessee where the assessee denies his liability to be assessed under this Act or an intimation under sub-section (1) or sub-section (1B) of section 143, where the assessee objects to the making of adjustments, or any order of assessment under sub-section (3) of section 143 except an order passed in pursuance of directions of the Dispute Resolution Panel or section 144, to the income assessed, or to the amount of tax determined, or to the amount of loss computed, or to the status under which he is assessed;

(aa) an order of assessment under sub-section (3) of section 115WE or section 115WF, where the assessee, being an employer objects to the value of fringe benefits assessed;

(ab) an order of assessment or reassessment under section 115WG;

(b) an order of assessment, reassessment or recomputation under section 147 58a[except an order passed in pursuance of directions of the Dispute Resolution Panel] or section 150;

(ba) an order of assessment or reassessment under section 153A;

(c) an order made under section 154 or section 155 having the effect of enhancing the assessment or reducing a refund or an order refusing to allow the claim made by the assessee under either of the said sections;

(d) an order made under section 163 treating the assessee as the agent of a non-resident;

(e) an order made under sub-section (2) or sub-section (3) of section 170;

(f) an order made under section 171;

(g) an order made under clause (b) of sub-section (1) or under sub-section (2) or sub-section (3) or sub-section (5) of section 185 in respect of an assessment for the assessment year commencing on or before the 1st day of April, 1992;

(h) an order cancelling the registration of a firm under sub-section (1) or under sub-section (2) of section 186 in respect of any assessment for the assessment year commencing on or before the 1st day of April, 1992 or any earlier assessment year;

(ha) an order made under section 201;

(hb) an order made under sub-section (6A) of section 206C;

(i) an order made under section 237;

(j) an order imposing a penalty under

(A) section 221; or

(B) section 271, section 271A, 63[section 271AAA,] section 271F, 64[section 271FB,] section 272AA or section 272BB;

(C) section 272, section 272B or section 273, as they stood immediately before the 1st day of April, 1989, in respect of an assessment for the assessment year commencing on the 1st day of April, 1988, or any earlier assessment years;

(ja) an order of imposing or enhancing penalty under sub-section (1A) of section 275;

(k) an order of assessment made by an Assessing Officer under clause (c) of section 158BC, in respect of search initiated under section 132 or books of account, other documents or any assets requisitioned under section 132A on or after the 1st day of January, 1997;

(l) an order imposing a penalty under sub-section (2) of section 158BFA;

(m) an order imposing a penalty under section 271B or section 271BB;

(n) an order made by a Deputy Commissioner imposing a penalty under section 271C , section 271CA, section 271D or section 271E;

(o) an order made by a Deputy Commissioner or a Deputy Director imposing a penalty under section 272A;

(p) an order made by a Deputy Commissioner imposing a penalty under section 272AA;

(q) an order imposing a penalty under Chapter XXI;

(r) an order made by an Assessing Officer other than a Deputy Commissioner under the provisions of this Act in the case of such person or class of persons, as the Board may, having regard to the nature of the cases, the complexities involved and other relevant considerations, direct.

Appealable orders

The Act specifically enumerates in great detail the orders which are appealable to the first appellate authority. The said authority, therefore, cannot have jurisdiction to entertain appeals which fall outside the specific grounds and orders mentioned in the section. On the other hand, if an order is appealable under this section, an appeal would lie even though the Assessing Officer making the order had no jurisdiction to make the order - CIT v. Bhikaji Dadabhai [1961] 42 ITR 123 (SC).

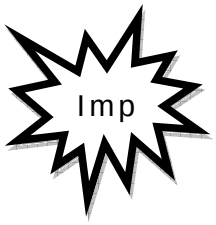
Section 246A gives a right of appeal to 'any assessee aggrieved' of any orders specified in that section. Any person who feels disappointed with the result of the case is not a 'person aggrieved'. He must be disappointed of a benefit which he would have received if the order had gone the other way. The order must cause him a legal grievance by wrongfully depriving him of something. Under section 246, any person who really is aggrieved by the assessment order and on whom the burden of tax will fall will be entitled to prefer an appeal, so that tax burden can be entirely reduced or lessened. In the case of an individual, he himself is enabled to file an appeal. If, however, the individual dies after being assessed, etc., his legal representatives are, under section 159(3) of the Act, deemed to be the assessees. Thus, they are competent to file an appeal against such assessment order. Similarly, where an assessment is made on a representative assessee as defined under section 160, section 166 of the Act reserves the right of the revenue to recover the tax from the beneficiary although the assessment may be on the representative assessee. Section 160(2) deems every representative assessee to be the 'assessee' for the purposes of the Act. Therefore, an appeal against such assessment may be filed either by the representative assessee assessed as such, or by the beneficiary, if the latter is otherwise sui juris. In the case of a HUF, the karta is competent to prefer

an appeal on its behalf. After disruption, if a prejudicial order is made against the HUF, the erstwhile coparceners are entitled to prefer an appeal against such order. A member of an AOP which has been assessed to tax is not a stranger to such proceedings. Any such member is competent to maintain any appeal filed by him. This section gives the right of appeal to the 'assessee'. The department cannot prefer an appeal against any of the orders specified in section 246. This is so because the Commissioner has got revisional power over all such orders under section 263.

Composite appeal

There is nothing in section 246 to debar an assessee to file a common or composite appeal against more than one order made against him if such orders are specifically enumerated under this section. Whether one appeal or more will have to be filed is entirely a procedural matter and not one dealing with the right to appeal. Thus, a composite appeal against two orders passed on the same date, namely, refusal to grant continuation of registration of the assessee-firm and computing the total income in the status of unregistered firm, would be competent because the two orders would be interconnected. The Act nowhere contemplates that even against a composite order passed by the Assessing Officer pursuant to the powers vested in him under different sections of the Act, separate appeals have to be preferred with reference to the sections under which the Assessing Officer has sought to exercise his jurisdiction. If appeals are made to the same authority against two or more orders passed by the Assessing Officer, then merely because different clauses of section 246(1) provide these appeals, it would be too technical to say that for that reason, separate appeals should be filed or that if a composite appeal is filed, it would be regarded as incompetent.

Appeals for TDS matters 248.



Where under an agreement or other arrangement, the tax deductible on any income, other than interest, under section 195 is to be borne by the person by whom the income is payable, and such person having paid such tax to the credit of the Central Government, claims that no tax was required to be deducted on such income, he may appeal to the Commissioner (Appeals) for a declaration that no tax was deductible on such income.

Form of appeal and limitation 249.

Every appeal under this Chapter shall be in the prescribed form and shall be verified in the prescribed manner and shall, in case of an appeal made to the Commissioner (Appeals) be accompanied by a prescribed fee

The appeal shall be presented within thirty days.

Commissioner (Appeals) may admit an appeal after the expiration of the said period if he is satisfied that the appellant had sufficient cause for not presenting it within that period.

No appeal under this Chapter shall be admitted unless at the time of filing of the appeal,

(a) where a return has been filed by the assessee, the assessee has paid the tax due on the income returned by him; or

(b) where no return has been filed by the assessee, the assessee has paid an amount equal to the amount of advance tax which was payable by him:

on an application made by the appellant in this behalf, the Commissioner (Appeals) may, for any good and sufficient reason to be recorded in writing, exempt him from the operation of the provisions for payment of tax.

Annexure - A - IV - II

Computer generated receipt	
Name of the bank collecting tax	BANK OF BARODA
Full name of Taxpayer	AMBARISH D UDESHI
PAN of Taxpayer	AAKPU8906F
Amount deposited :	
(i) Income Tax	1000
(ii) Surcharge	--
(iii) Education Cess	--
(iv) Penalty	--
v) Interest amount	--
vi) Other amount	--
Total amount deposited : (in figure)	1000
Mode of deposit of tax (by cash / debit to account / by cheque bearing No.)	CASH
Date of encashment of cheque (dd/mm/yy)	23/12/08
On account of Income Tax Deducted / collected from Companies (0020) / Other than Companies(0021)	0021-INCOME TAX
Minor head - Type of payment	300-SELF ASSESMENT TAX
Assessment Year (yyyy - yy)	2006-07
Challan Identification Number (CIN)	
BSR code of collecting bank branch	0201095
Date of tender of cheque (dd/mm/yyyy)	23/12/2008
Challan Serial Number	00007
Signature & seal of authorised signatory of collecting bank branch	

Taxpayers Counterfoil (To be filled up by tax payer)

PAN A A K P U 8 9 0 6 F

ived from Ambarish. D. Udeshi
(Name)

/Debit to A/c /Cheque No. For Rs. 1000=00

n words) One Thousand Only.

n on
(Name of the Bank and Branch)

ount of Companies/Other than Companies/Tax
e Tax on (Strike out whichever is not applicable)

of Payment CIT Appeals (To be filled up by person making the payment)

Assessment Year 2006 - 07

SPACE FOR BANK SEAL

Pratibha Samaj Branch
B.S.R. Code No. 0201095
Date of Tender
23 DEC 2008
Rs 1000/-
Date of Realisation
Trial No. 7

Rs.

Conditions as to payment of tax and fees

Admitted tax has to be paid for an appeal to be entertained, vide section 249(4) of the Act, even where a return of income has not been filed. The appellate authority has power to admit an appeal notwithstanding non-filing of a return. The stay of disputed taxes can be granted by the appellate authority as was held in Prem Prakash Tripathi v. CIT [1994] 208 ITR 461/75 Taxman 107 (All.) and Paulsons Litho Works v. ITO [1994] 76 Taxman 294 (Mad.).

Grounds of appeal should concisely set out what the assessee challenges in the order. The fees prescribed for filing an appeal before the Commissioner (Appeals) is Rs. 250, Rs. 500 or Rs. 1,000 based upon whether the total income computed by the Assessing Officer is Rs. 1 lakh or less or more than Rs. 1 lakh and Rs. 2 lakhs or above Rs. 2 lakhs. Similarly the fees prescribed for filing an appeal before the Appellate Tribunal is Rs. 500 if the total income of the assessee as computed by the Assessing Officer, in the case to which the appeal relates is one hundred thousand rupees, Rs. 1,500 if exceeds two hundred thousand rupees and 1 per cent of the assessed income subject to a maximum of Rs. 10,000 if the assessed income exceeds more than two hundred thousand rupees. No fee shall be payable in the case of a memorandum of cross objections. An

Procedure in appeal. 250

Commissioner (Appeals)] shall fix a day and place for the hearing of the appeal, and shall give notice of the same to the appellant and to the Assessing Officer against whose order the appeal is preferred.

The following shall have the right to be heard at the hearing of the appeal—

(a) the appellant, either in person or by an authorised representative;

(b) the Assessing Officer, either in person or by a representative.

Commissioner (Appeals) shall have the power to adjourn the hearing of the appeal from time to time.

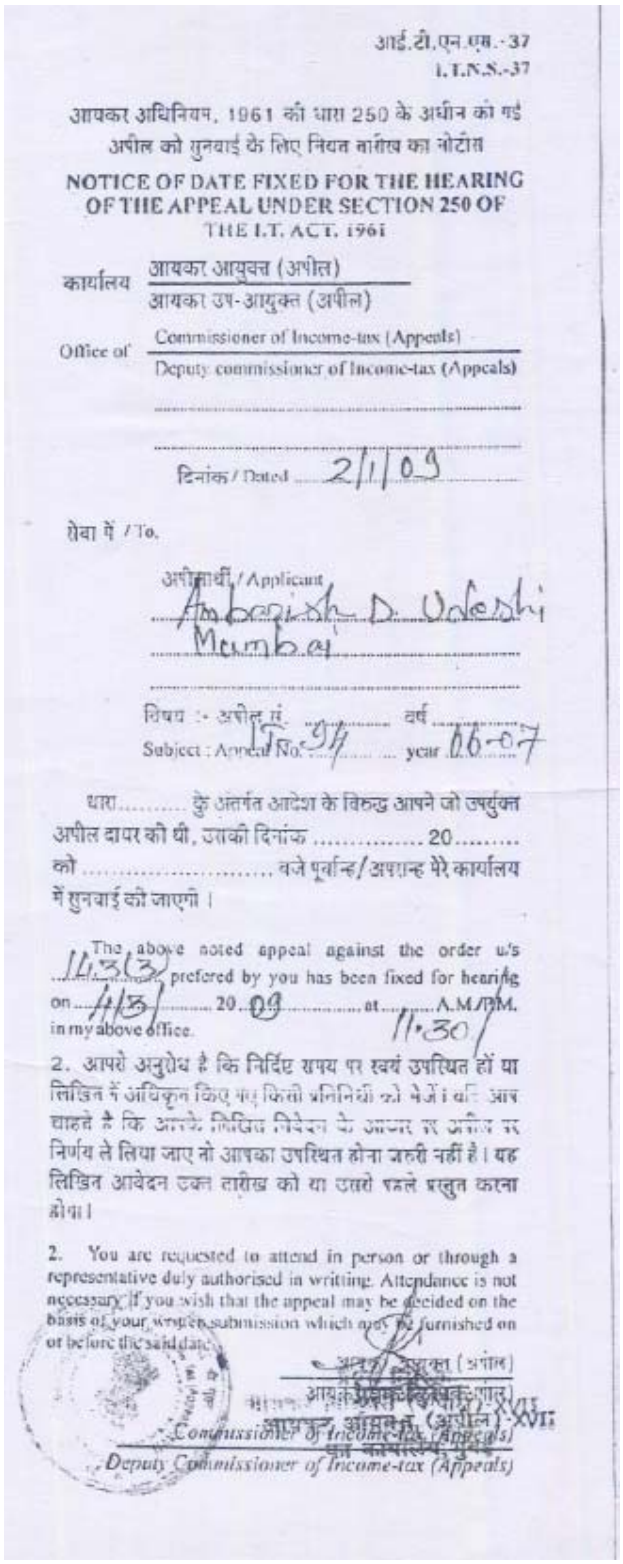
Commissioner (Appeals) may, before disposing of any appeal, make such further inquiry as he thinks fit, or may direct the Assessing Officer to make further inquiry and report the result of the same to the Commissioner (Appeals)

Commissioner (Appeals) may, at the hearing of an appeal, allow the appellant to go into any ground of appeal not specified in the grounds of appeal, if the is satisfied that the omission of that ground from the form of appeal was not wilful or unreasonable.

The order of the Commissioner (Appeals) disposing of the appeal shall be in writing and shall state the points for determination, the decision thereon and the reason for the decision.

In every appeal, the Commissioner (Appeals), where it is possible, may hear and decide such appeal within a period of one year from the end of the financial year in which such appeal is filed before him.

On the disposal of the appeal, the Commissioner (Appeals) shall communicate the order passed by him to the assessee and to the Chief Commissioner or Commissioner.



आई.टी.एन.एस.-37
I.T.N.S.-37

आयकर अधिनियम, 1961 की धारा 250 के अधीन की गई अपील की सुनवाई के लिए नियत तारीख का नोटिस

NOTICE OF DATE FIXED FOR THE HEARING OF THE APPEAL UNDER SECTION 250 OF THE I.T. ACT, 1961

कार्यालय आयकर आयुक्त (अपील)
आयकर उप-आयुक्त (अपील)

Office of Commissioner of Income-tax (Appeals)
Deputy commissioner of Income-tax (Appeals)

दिनांक / Dated 2/1/09

सेवा में / To,

अपीलार्थी / Applicant
Ambarish D. Udeshi
Mumbai

विषय :- अपील सं. 95 वर्ष 06-07
Subject : Appeal No. ..... year

धारा..... के अंतर्गत आदेश के विरुद्ध आपने जो उपर्युक्त अपील दायर की थी, उसकी दिनांक ..... 20..... को ..... बजे पूर्वाह्न/अपराह्न मेरे कार्यालय में सुनवाई की जाएगी।

The above noted appeal against the order u/s 143(3) prefered by you has been fixed for hearing on 4/3/09 20..... at 11.30 A.M./P.M. in my above office.

2. आपसे अनुरोध है कि निर्दिष्ट समय पर स्वयं उपस्थित हों या लिखित में अधिकृत किए गए किसी प्रतिनिधि को भेजें। यदि आप चाहते हैं कि आपके लिखित निवेदन के आधार पर अपील पर निर्णय ले लिया जाए तो आपका उपस्थित होना जरूरी नहीं है। यह लिखित आवेदन उक्त तारीख को या उससे पहले प्रस्तुत करना होगा।

2. You are requested to attend in person or through a representative duly authorised in writing. Attendance is not necessary if you wish that the appeal may be decided on the basis of your written submission which may be furnished on or before the said date.

आयकर आयुक्त (अपील)
आयकर उप-आयुक्त (अपील)
Commissioner of Income-tax (Appeals)
Deputy Commissioner of Income-tax (Appeals)

FORM NO. 35

[See rule 45]

Appeal to the Commissioner of Income-tax (Appeals)

Designation of the Commissioner (Appeals)

*No. _____ of _____

Name and address of the appellant	AMBARISH DUDESHI.
Permanent Account Number	AAKPU 8906F
† Assessment year in connection with which the appeal is preferred	2006-07
Assessing Officer/Valuation Officer passing the order appealed against	I.T.O. 16(3)(3)
Section and sub-section of the Income-tax Act, 1961, under which the Assessing Officer/Valuation Officer passed the order appealed against and the date of such order	143(3)
Where the appeal relates to any tax deducted under section 195(1), the date of payment of the tax	-NA-
Where the appeal relates to any assessment or penalty, the date of service of the relevant notice of demand	-NA-
In any other case, the date of service of the intimation of the order appealed against	28/11/08.
Section and clause of the Income-tax Act, 1961, under which the appeal is preferred	246
Where a return has been filed by the appellant for the assessment year in connection with which the appeal is preferred, whether tax due on the income returned has been paid in full (if the answer is in the affirmative, give details of date of payment and amount paid)	-NA-
Where no return has been filed by the appellant for the assessment year in connection with which the appeal is preferred, whether an amount equal to the amount of advance tax payable by him during the financial year immediately preceding such assessment year has been paid (If the answer is in the affirmative, give details of date of payment and amount paid)	-NA-
‡Relief claimed in appeal	
Where an appeal in relation to any other assessment year is pending in the case of the appellant with any Commissioner (Appeals), give the details as to the-	-NA-
(a) Commissioner (Appeals), with whom the appeal is pending;	
(b) assessment year in connection with which the appeal has been preferred;	
(c) Assessing Officer passing the order appealed against;	
(d) section and sub-section of the Act, under which the Assessing Officer passed the order appealed against and the date of such order	
Address to which notices may be sent to the appellant	33, 429(E), 3rd Floor, Prathana Samaj S.V.P. Road, Mumbai - 400004.



Printed from www.taxmann.com

Signed
(Appellant)

‡ STATEMENT OF FACTS

‡ GROUNDS OF APPEAL

Signed
(Appellant)

Form of Verification

I, AMBARISH UDESHI., the appellant, do hereby declare that what is stated above is true to the best of my information and belief.

Place : MUMBAI
Date : 23/2/08.

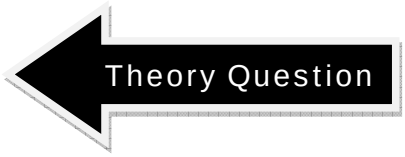
Signature

Status of appellant

Notes :

1. The form of appeal, grounds of appeal and the form of verification appended thereto shall be signed by a person in accordance with the provisions of rule 45(2).
2. The memorandum of appeal, statement of facts and the grounds of appeal must be in duplicate and should be accompanied by a copy of the order appealed against and the notice of demand in original, if any.
3. Delete the inappropriate words.
4. *These particulars will be filled in in the office of the Commissioner (Appeals).
5. †Not to be filled in if the appeal relates to tax deducted under section 195(1).
6. ‡If the space provided herein is insufficient, separate enclosures may be used for the purpose.
7. If appeals are pending in relation to more than one assessment year, separate particulars in respect of each assessment year may be given.
8. The memorandum of appeal shall be accompanied by a fee of,-
   (a) where the total income of the assessee as computed by the Assessing Officer in the case to which the appeal relates is one hundred thousand rupees or less, two hundred fifty rupees;
   (b) where the total income of the assessee, computed as aforesaid, to which the appeal relates is more than one hundred thousand rupees but not more than two hundred thousand rupees, five hundred rupees;
   (c) where the total income of the assessee, computed as aforesaid, in the case to which the appeal relates is more than two hundred thousand rupees, one thousand rupees.
9. The fee should be credited in a branch of the authorised bank or a branch of the State Bank of India or a branch of the Reserve Bank of India after obtaining a challan from the Assessing Officer and a copy of challan sent to the Commissioner of Income-tax (Appeals).

Production of additional evidence Rule 46A.



The appellant shall not be entitled to produce before the Deputy Commissioner (Appeals) [or, as the case may be, the Commissioner (Appeals)], any evidence, whether oral or documentary, other than the evidence produced by him during the course of proceedings before the Assessing Officer, except in the following circumstances, namely

(a) where the Assessing Officer has refused to admit evidence which ought to have been admitted ; or

(b) where the appellant was prevented by sufficient cause from producing the evidence which he was called upon to produce by the Assessing Officer ; or

(c) where the appellant was prevented by sufficient cause from producing before the Assessing Officer any evidence which is relevant to any ground of appeal ; or

(d) where the Assessing Officer has made the order appealed against without giving sufficient opportunity to the appellant to adduce evidence relevant to any ground of appeal.

No evidence shall be admitted unless the Deputy Commissioner (Appeals)[or, as the case may be, the Commissioner (Appeals) records in writing the reasons for its admission.

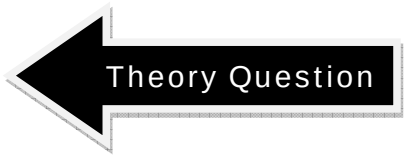
The Deputy Commissioner (Appeals) or, as the case may be, the Commissioner (Appeals) shall not take into account any evidence produced unless the Assessing Officer has been allowed a reasonable opportunity

(a) to examine the evidence or document or to cross-examine the witness produced by the appellant, or

(b) to produce any evidence or document or any witness in rebuttal of the additional evidence produced by the appellant.

Nothing contained in this rule shall affect the power of the Deputy Commissioner (Appeals) or, as the case may be, the Commissioner (Appeals) to direct the production of any document, or the examination of any witness, to enable him to dispose of the appeal, or for any other substantial cause including the enhancement of the assessment or penalty whether on his own motion or on the request of the Assessing Officer or the imposition of penalty under section 271.

Additional evidance



Lawmakers perhaps thought that the unfettered powers of the Commissioner (Appeals) to admit additional evidence would lead to the leakage of the revenue. The Commissioner (Appeals) may permit an appellant to produce evidence, which could not be produced before the Assessing Officer. Armed by the said power, CBDT framed rule 46A in the Income-tax Rules, 1962 w.e.f. 1-4-1993. Under the said rule, the Commissioner (Appeals) was permitted to admit fresh evidence only under the following circumstances

(a) where the Income-tax Officer has refused to admit evidence which ought to have been admitted; or

(b) where the appellant was prevented by sufficient cause from producing the evidence which he was called upon to produce by the Income-tax Officer; or

(c) where the appellant was prevented by sufficient cause from producing before the Income-tax Officer any evidence which is relevant to any ground of appeal;

(d) where the Income-tax Officer has made the order appealed against without giving sufficient opportunity to the appellant to adduce evidence relevant to any ground of appeal."

Under sub-rule (3) to rule 46A, a condition was imposed that such evidence shall not be taken into account by the Commissioner (Appeals), unless the Assessing Officer was confronted with the same.

Rule 46A - Whether ultra vires the Act

The validity to rule 46A was under challenge before the Allahabad High Court in Smt. Mohindar Kaur v. Central Govt. [1976] 104 ITR 120. The Court analysed the provisions of section 250(4) and section 250(5) of the Act and observed that no part of rule 46A whittles down or impairs the power to make further inquiry conferred upon the first appellate authority by section 250(4). Similarly, section 250(5) confers power upon Commissioner (Appeals) to permit the appellant to raise a fresh point, which has not been even touched by rule 46A. The Court finally held that rule 46A is not ultra vires section 250 or 251. On the contrary, it gives a right to the appellant to produce additional evidence which was earlier not available to him.

In a large number of cases, the Commissioner (Appeals) grants relief to the assessee by admitting additional evidence in violation of rule 46A, i.e., without giving an opportunity to the Assessing Officer to rebut the evidences produced by the assessee. Even in cases where he is admitting additional evidences pursuant to inquiries made by him, such facts are not properly brought on record or in his order. Therefore, the relief granted to the assessee by him remains on paper only inasmuch as the revenue invariably challenges such orders before the Tribunal taking the ground of violation of rule 46A. The Tribunal in such cases has no option but to restore the issues back to the Assessing Officer's file for examination. The assessee is a great sufferer in such cases not only in terms of cost but also because it becomes difficult for him to substantiate the evidences after a time lag. And all this happens to him for no fault on his part.

Time limit for passing order

Where it is possible, may hear and decide an appeal within a period of one year from the end of the financial year in which the appeal is filed before him. The time-limit set out is, of course, not mandatory; even so, it may happen that the Commissioner (Appeals), sensing some kind of invisible pressure in the provision, may act in haste to dispose of an appeal within that time-limit, even if it means shutting one's eyes to well-settled legal norms and principles. In this article, the author notices that certain Commissioners (Appeals), after giving a very short notice to the appellant-assessee, dismissed the appeal before them as unadmitted and uncontested when the appellant-assessee failed to appear before him either personally or through an authorised representative, although an employee of the appellant did appear and asked for adjournment which request was rejected by the Commissioner (Appeals). There is no provision in the Act under which the Commissioner (Appeals) can dismiss an appeal as unadmitted and that such an appeal has always to be decided on merits after giving an effective opportunity of hearing to the appellant.

Powers of the Commissioner (Appeals) 251

In disposing of an appeal, the Commissioner (Appeals) shall have the following powers

a) in an appeal against an order of assessment, he may confirm, reduce, enhance or annul the assessment
b) in an appeal against the order of assessment in respect of which the proceeding before the Settlement Commission abates under section 245HA, he may, after taking into consideration all the material and other information produced by the assessee before, or the results of the inquiry held or evidence recorded by, the Settlement Commission, in the course of the proceeding before it and such other material as may be brought on his record, confirm, reduce, enhance or annul the assessment;
c) in an appeal against an order imposing a penalty, he may confirm or cancel such order or vary it so as either to enhance or to reduce the penalty;
d) in any other case, he may pass such orders in the appeal as he thinks fit.

Commissioner (Appeals) shall not enhance an assessment or a penalty or reduce the amount of refund unless the appellant has had a reasonable opportunity of showing cause against such enhancement or reduction.

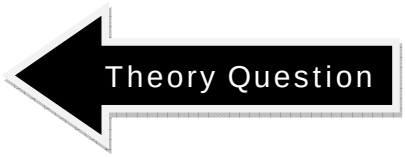
In disposing of an appeal, it may consider and decide any matter arising out of the proceedings in which the order appealed against was passed, notwithstanding that such matter was not raised before the Commissioner (Appeals) by the appellant.

Appealable order must be written and speaking order

A right of appeal is one of the modes by which a decision which could otherwise be final can be challenged. It is not a procedural right but a substantial right. Indeed, it is a vested right. And such a right to enter the Superior Court accrues to the litigant and exists as on and from the date the lis commences; and although it may be actually exercised when the adverse situation comes into play, the record must disclose that such an order has been passed so that the aggrieved person may exercise his vested right of appeal and obtain redress. Thus, an appealable order must be a written and speaking order.

APPEALS TO ITAT

Constitution of Appellate Tribunal 252.



The Central Government shall constitute an Appellate Tribunal consisting of as many judicial and accountant members as it thinks fit to exercise the powers and discharge the functions conferred on the Appellate Tribunal by this Act.

- A judicial member shall be a person who has for at least ten years held a judicial office in the territory of India or who has been a member of the Indian Legal Service and has held a post in Grade of that Service or any equivalent or higher post for at least three years or who has been an advocate for at least ten years.
- An accountant member shall be a person who has for at least ten years been in the practice of accountancy as a chartered accountant under the Chartered Accountants Act, 1949 (38 of 1949), or as a registered accountant under any law formerly in force or partly as a registered accountant and partly as a chartered accountant, or who has been a member of the Indian Income-tax Service, Group A and has held the post of Additional Commissioner of Income-tax or any equivalent or higher post for at least three years.

The Central Government shall appoint the Senior Vice-President or one of the Vice-Presidents of the Appellate Tribunal to be the President thereof.

The Central Government may appoint one or more members of the Appellate Tribunal to be the Vice-President or, as the case may be, Vice-Presidents thereof.

The Central Government may appoint one of the Vice-Presidents of the Appellate Tribunal to be the Senior Vice-President thereof.

The Senior Vice-President or a Vice-President shall exercise such of the powers and perform such of the functions of the President as may be delegated to him by the President by a general or special order in writing.

Appeals to the Appellate Tribunal. 253.

Any assessee aggrieved by any of the following orders may appeal to the Appellate Tribunal against such order

- an order passed by a Commissioner (Appeals)
- an order passed by an Assessing Officer under section 158BC, in respect of search initiated under section 132 or books of account, other documents or any assets requisitioned under section 132A,
- an order passed by an Assessing Officer under section 115VZC for registration of tonnage tax company
- an order passed by a Commissioner under section 12AA section 80G or section 263 section 271 or 272A
- an order passed by an Assessing Officer section 143 or section 147 in pursuance of the directions of the Dispute Resolution Panel

Every appeal shall be filed within sixty days of the date on which the order sought to be appealed against is communicated to the assessee or to the Commissioner. Provided that in respect of any appeal under section 158BC it shall have effect as if for the words "sixty days", the words "thirty days" had been substituted.

The Assessing Officer or the assessee, as the case may be, on receipt of notice within thirty days file a memorandum of cross-objections, verified in the prescribed manner, against any part of the order. The Appellate Tribunal may admit an appeal or permit the filing of a memorandum of cross-objections after the expiry of the relevant period if it is satisfied that there was sufficient cause

An appeal to the Appellate Tribunal shall be in the prescribed form and shall be verified in the prescribed manner and shall pay presecribed amount of fees. No fees for memorandum of cross objection. An application for stay of demand shall be accompanied by a fee of five hundred rupees.

Orders of Appellate Tribunal.

The Appellate Tribunal may, after giving both the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit.

The Appellate Tribunal may, at any time within four years from the date of the order, with a view to rectifying any mistake apparent from the record 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 Appellate Tribunal has given notice to the assessee of its intention to do so and has allowed the assessee a reasonable opportunity of being heard.

Where it is possible, may hear and decide such appeal within a period of four years from the end of the financial year in which such appeal is filed

The cost of any appeal to the Appellate Tribunal shall be at the discretion of that Tribunal.

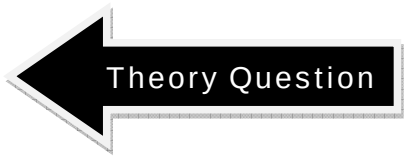
The Appellate Tribunal shall send a copy of any orders passed under this section to the assessee and to the Commissioner

Save as provided in the National Tax Tribunal Act, 2005, orders passed by the Appellate Tribunal on appeal shall be final.

Time-limit for disposal of appeals by tribunal

It is in the nature of an advisory (not mandatory) provision and stipulates that in every appeal, the Tribunal, wherever it is possible, may hear and decide an appeal within a period of 4 years from the end of the financial year in which such appeal is filed under section 253(1). It may be mentioned that fixing advisory time-limit for disposal of appeals by the Tribunal is a meaningless exercise because of licentious discretion vested in the Tribunal itself in the expression 'wherever it is possible'. This neutralizes the desired impact in enacting such a provision.

Stay by appellate tribunal



Appellate Tribunal may, after considering the merits of the application made by the assessee, pass an order of stay in any proceedings relating to an appeal for a period not exceeding one hundred and eighty days from the date of such order and the Appellate Tribunal shall dispose of the appeal within the said period of stay specified in that order. Where such appeal is not so disposed of

within the said period of stay as specified in the order of stay, the Appellate Tribunal may, on an application made in this behalf by the assessee and on being satisfied that the delay in disposing of the appeal is not attributable to the assessee, extend the period of stay, or pass an order of stay for a further period or periods as it thinks fit; so, however, that the aggregate of the period originally allowed and the period or periods so extended or allowed shall not, in any case, exceed three hundred and sixty-five days and the Appellate Tribunal shall dispose of the appeal within the period or periods of stay so extended or allowed:

If such appeal is not so disposed of within the period allowed under the first proviso or the period or periods extended or allowed under the second proviso, which shall not, in any case, exceed three hundred and sixty-five days, the order of stay shall stand vacated after the expiry of such period or periods, even if the delay in disposing of the appeal is not attributable to the assessee.

Power of tribunal to grant stay of demand during pendency of appeals before it

The law on this matter was pronounced by the Supreme Court in the case of ITO v. M.K. Mohammed Kunhi [1969] 71 ITR 815. The issue raised in this case was whether the Tribunal has the power, under the relevant provisions of the Act, to stay the recovery or the realization of the penalty imposed by the departmental authorities on an assessee during the pendency of an appeal before it.

The Apex Court, accepting the position that there can be no manner of doubt that by the provisions of the Act or the Income-tax Appellate Tribunal Rules, 1963, powers have not been expressly conferred upon the Tribunal to stay proceedings relating to the recovery of penalty or tax due from an assessee, has held that the right of appeal is a substantive right and the questions of fact and law are at large and are open to review by the Tribunal. If the Tribunal is entirely helpless in the matter of stay of recovery, the entire purpose of the appeal can be defeated if the orders of departmental authorities are set aside. It could be well said that when section 254 confers appellate jurisdiction, it impliedly grants the power of doing all such acts, or employing such means, as are essentially necessary to its execution and statutory powers carry with them the duty in proper cases to make such orders for staying proceedings as will prevent the appeal, if successful, from being rendered nugatory. It will only be when a strong prima facie case is made out that the Tribunal will consider whether to stay the recovery proceedings, and on what condition and stay will be granted in most deserving appropriate case, where the entire purpose of appeal will be frustrated or rendered nugatory by allowing the recovery proceeding to continue during the pendency of the appeal.

Thus, the Court confirmed the Kerala High Court's decision in the case of M.K. Mohd. Kunhi v. ITO [1966] 59 ITR 171, holding that the Tribunal has the power to grant stay of demand during the pendency of appeals before it and the Court has not mentioned any time-limit for which stay can be granted.

255 Procedure of Appellate Tribunal.

The powers and functions of the Appellate Tribunal may be exercised and discharged by Benches constituted by the President of the Appellate Tribunal from among the members thereof. A Bench shall consist of one judicial member and one accountant member.

The President or any other member of the Appellate Tribunal authorised in this behalf by the Central Government may, sitting singly, dispose of any case which has been allotted to the Bench of which he is a member and which pertains to an assessee whose total income as computed by the Assessing

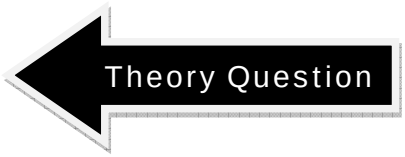
Officer in the case does not exceed five hundred thousand rupees, and the President may, for the disposal of any particular case, constitute a Special Bench consisting of three or more members, one of whom shall necessarily be a judicial member and one an accountant member.

If the members of a Bench differ in opinion on any point, the point shall be decided according to the opinion of the majority, if there is a majority, but if the members are equally divided, they shall state the point or points on which they differ, and the case shall be referred by the President of the Appellate Tribunal for hearing on such point or points by one or more of the other members of the Appellate Tribunal, and such point or points shall be decided according to the opinion of the majority of the members of the Appellate Tribunal who have heard the case, including those who first heard it.

The Appellate Tribunal shall have power to regulate its own procedure and the procedure of Benches thereof in all matters arising out of the exercise of its powers or of the discharge of its functions, including the places at which the Benches shall hold their sittings.

The Appellate Tribunal have all the powers which are vested in the income-tax authorities referred to in section 131, and any proceeding before the Appellate Tribunal shall be deemed to be a judicial proceeding.

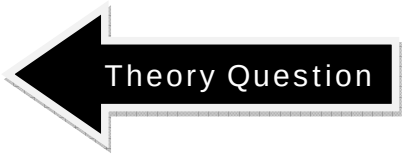
3rd member decission



The institution of Third Member Bench is in fact working very well in the Tribunal. The Third Member in the Tribunal is like Third Umpire in cricket. For Members of the Tribunal it has achieved independence in making judicial decisions, and for litigants, it has smoothened the process for clear, considered and quick verdict. The institution of Third Member is recognized also for the Settlement Commission in section 245BD of the Act, and rule 13(3) of the Settlement Commission (Procedure) Rules, 1997.

If the Members of the Special Bench are equally divided, they shall state the point or points on which they differ and make a reference to the Chairman who shall refer the case for hearing on such point or points by one or more of the other Members of the Settlement Commission and such point or points shall be decided according to the opinion of the majority of the Members of the Settlement Commission who have heard the case. However 3rd member can not take the 3rd view, the 3rd member will have to decide based on the available recordes of earlier hearing.

Special Bench meant for disposal of any particular case



It is obvious from a pure reading of the above provisions that the powers conferred upon the Hon'ble President to constitute the so-statutorily-termed "Special Bench", is only for the purpose of disposal of any particular case. The legislative intent behind these provisions would seem to be only that whereas all other cases will ordinarily be disposed of by the Hon'ble President or any one member sitting singly or by a Division Bench constituted of a judicial member and an accountant member, the extraordinary nature of a particular case owing to the complexities of the points at issue, the volume of facts and evidence requiring examination or any other relevant considerations, may justify its disposal by a Special Bench specially constituted by the Hon'ble President of the Tribunal.

Now Special Benches are being constituted to pronounce an authoritative judicial opinion on questions which might arise in several cases in different parts of country-However, it has to be noticed that this procedural power was exercised in rare cases in the past and that too only with respect to the disposal of a particular case which could not and did not lay down a precedent for all the Benches of the Tribunal dealing with cases of different assessees. However, now this power is being frequently exercised not for the purpose of disposing of a particular case but with the objective of pronouncing an authoritative judicial opinion of the Tribunal, functioning in the whole country as one appellate authority, on certain questions of law which might arise in good many cases coming up before different Benches of the Tribunal sitting in different parts of the country. Such a growing practice is sought to be justified perhaps on grounds of administrative prudence and perhaps also with the objective of evolving and attaining uniformity in the matter of pronouncements of the Tribunal on important questions of law, functioning as an All India Administrative Tribunal, notwithstanding that a large number of Benches scattered all over the country are constituted of personnel of diverse experience and qualifications disposing of thousands of important appeals.

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Membership Type	1	2	3
Membership Name	**Free**	**DT**	**IDT**
Description	***Wealth Tax (excluding valuation rules and questions / answers.)***	***Direct Taxes for CA final (Includes membership type 3) (also included 130 + Class work problems and solution)***	***Indirect taxes of CA final. (included +100 Class work problems and solution)***
Hours of video access Granted	5 Hrs	100 Hrs	75 Hrs
Membership commence (May 2011 Exam)	16th May	16th May	16th May
Fair Usage of Hours for attending all lectures for given subject once. *(approximately in this many hours once all lectures can be attended, some extra time is given considering revision of any chapters that may be required. Particularly for DT if students attend basic topics of IPCC lectures also when we post from time to time then students will have to buy more hours at additional cost.)*	5 Hrs	100 Hrs	65 Hrs
Time of Access / Viewing *(You can access the lectures any time with user name and password. Subject to your membership expiry date and hours of usage.)*	24/7	24/7	24/7
Download of video files *(Video files are copy right protected, It is not allowed to be downloaded. User must not copy or distribute it any manner what so ever, audio or video or both.)*	Yes (Selected Files Only)	No	No
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Maximum time each video can be Logged in. *(This limit is kept for security purposes. Video Logged in for less then 3 min is not counted for this purpose.)*	10	10	10
Fees (Including taxes if any) ***(Not Refundable in any circumstances.)***	Rs. Nil	Rs. 15,500	Rs. 12,500
Charges for additional hours (if required).	Not available	100 P/hr	100 P/hr

Membership Activation time. *(You can Commence online lectures any time, you are never too late for classes.)*	automatic	48 Hours of payment.	48 Hours of payment.
Study notes in softcopy provided for download. *(*likely to be provided.)*	No	Yes	No*
Membership expiry for May 2011 exam (Respective hours or this date whichever is earlier.)	No	18th May	18th May
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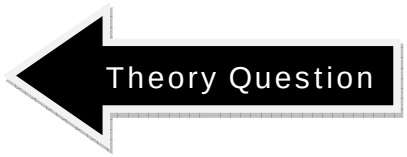
SEC. 158A AVOIDANCE OF REPETITIVE APPEAL



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

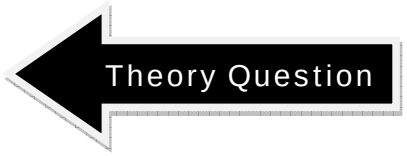
(a) The Assessing Officer or, as the case may be, the appellate authority may make an order disposing of the relevant case without awaiting the final decision on the question of law in the other case; and

(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 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.

PART K

SELECTED EXEMPTIONS / DEDUCTIONS

AGRICULTURAL INCOME

(1A) "agricultural income" means-

(a) any rent or revenue derived from land which is situated in India and is used for agricultural purposes ;

(b) any income derived from such land by-

i. agriculture ; or

ii. the performance by a cultivator or receiver of rent-in-kind of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render the produce raised or received by him fit to be taken to market ; or

iii. the sale by a cultivator or receiver of rent-in-kind of the produce raised or received by him, in respect of which no process has been performed other than a process of the nature described in paragraph (ii) of this sub-clause ;

(c) any income derived from any building owned and occupied by the receiver of the rent or revenue of any such land, or occupied by the cultivator or the receiver of rent-in-kind, of any land with respect to which, or the produce of which, any process mentioned in paragraphs (ii) and (iii) of sub-clause (b) is carried on :

Provided that -

(i) the building is on or in the immediate vicinity of the land, and is a building which the receiver of the rent or revenue or the cultivator, or the receiver of rent-in-kind, by reason of his connection with the land, requires as a dwelling house, or as a store-house, or other out-building, and

(ii) the land is either assessed to land revenue in India or is subject to a local rate assessed and collected by officers of the Government as such or where the land is not so assessed to land revenue or subject to a local rate, it is not situated-

(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 :

Explanation 1.- For the removal of doubts, it is hereby declared that revenue derived from land shall not include and shall be deemed never to have included any income arising from the transfer of any land of this section ;

Explanation 2.- For the removal of doubts, it is hereby declared that income derived from any building or land referred to above arising from the use of such building or land for any purpose (including letting for residential purpose or for the purpose of any business or profession) other than agriculture shall not be agricultural income.

Explanation 3.—For the purposes of this clause, any income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income ;



Tests in a nutshell – land is agricultural or not

In *CIT* v. *Siddharth J. Desai* [1983] 139 ITR 628, the Gujarat High Court took stock of the various principles laid down by it in its earlier decisions and observed in a nutshell that the major factors which will have a bearing on the question whether a particular land is agricultural land, are :

a. whether the land is classified in the revenue records as agricultural and whether it was subject to the payment of land revenue, but this factor alone will not be conclusive ;

b. whether the land was actually or ordinarily used for agricultural purposes at or about the relevant time ;

c. whether such user of the land was for a long period or only by way of stop-gap arrangement ;

d. whether income derived from agricultural operations on the land bore any rational proportion to the investment made in purchasing the land ;

e. whether the land had ceased to be put to agricultural use on the relevant date; if so, whether it was put to an alternative user ; whether such a cesser and/or alternative user was permanent or temporary ;

f. whether the land, though entered in revenue records, had never been actually used for agriculture ; whether the owner meant and intended to use the land for agricultural purposes ;

g. the situs of the land - whether in a developed area ; its physical characteristics, surrounding situation and use of lands in adjoining area, whether suggestive of the land being agricultural ;

h. whether the land itself was developed by plotting and providing roads and other facilities ;

i. whether there was any previous sale of portions of the land for non-agricultural user ;

j. whether permission under local Tenancy Act was obtained, for sale or intended sale to a non-agriculturist ; if so, whether the sale or intended sale to such non-agriculturist was for non-agricultural or agricultural user ;

k. whether a prudent agriculturist would purchase the land for agricultural purposes at the price at which land was sold ;
l. whether the owner would have even sold the land, valuing it as a property yielding agricultural produce on the basis of its yield ;
m. whether the land was sold on yardage or on acreage basis.

Dividend from company with agricultural income – not agricultural

Assessee was a shareholder in certain tea companies 60% of whose income was exempt from tax as agricultural income. The assessee claimed that 60% of the dividend income received by her on her shares in those companies was also exempt from tax as agricultural income: Held, that the dividend income received by the assessee was not agricultural income. Agricultural income as defined in the Act is intended to refer to the revenue received by direct association with the land which is used for agricultural purposes and not by indirectly extending it to cases where that revenue or part thereof changes hands either by way of distribution of dividends or otherwise. In fact and truth dividend is derived from the investment made in the shares of the company and the foundation of it rests on the contractual relations between the company and the shareholders. Bacha F. Guzdar (Mrs.) v. Commissioner of Income-tax (SC). A shareholder who buys shares does not buy any interest in the property of the company which is a juristic person entirely distinct from the shareholders. The true position of a shareholder in a company is that on buying shares he becomes entitled to participate in the profits of the company if and when the company declares, subject to the articles of association, that the profits or any portion thereof should be distributed by way of dividends among the shareholders. He has a further right to participate in the assets of the company which would be left over after winding up.

The declaration of dividend by the company is not the source of the dividend income. The right of a shareholder to participation in the profits exists independently of any declaration of dividend by the company with the only difference that the enjoyment of profits is postponed until dividends are declared. English decisions resting upon the peculiarities of the English income-tax law cannot be a safe guide in determining upon the language of the Indian Income-tax Act the true meaning of the word "agricultural income." Division of the Bombay High Court in Mrs. Bacha F. Guzdar v. Commissioner of Income-tax, Bombay City [1952] (22 I.T.R. 158) affirmed. Bacha F. Guzdar (Mrs.) v. Commissioner of Income-tax (SC)

Agricultural income:-income from nurseries

An important decision has been rendered by the Madras High Court as regards income of nurseries or sale of seeds grown and sold in pots in the case of CIT v. Soundarya Nursery [2000] 241 ITR 530 (Mad). Agricultural income is defined to mean any rent or revenue derived from land which is situate in India and is used for agricultural purposes. It also includes any income derived from such land by agriculture or performance of any agricultural processes ordinarily employed by an agriculturist or sale of the agricultural produce raised or received after processing other than the process ordinarily employed by agriculturists rendering the produce fit to be taken to the market. Income from any building occupied by the agriculturist or for processing, if it is in the immediate vicinity of the land requiring use in connection with the land, will also be agricultural income.

The locus classicus on the subject is the decision of the Supreme Court in CIT v. Raja Benoy Kumar Sahas Roy [1957] 32 ITR 466 (SC), which has laid down the guidelines on the subject after elaborate review of the precedents and the law lexicons. Agriculture in its primary sense means cultivation of

land. Cultivation involves both basic and subsequent operations. Basic operations are tilling, sowing, planting etc. involving application of human labour and skill upon the land itself. Subsequent operations are weeding, protection from insects and pests, tilling, pruning and harvesting. Mere rendering of subsequent operations by themselves would not lead to the inference of agricultural income. The nature of the produce itself would also not be a relevant factor, so that even income from growth of commercial crops would not take away the character of agricultural income. It is not all activities connected with land which can give rise to the inference of agricultural income, so that income from live- stock breeding, dairy farming, poultry farm etc. cannot constitute agricultural income. It had earlier been decided that agricultural income should relate to the vegetable kingdom and not the animal kingdom, so that income from fisheries would not be agricultural income as held in CIT v. V. T. S. Sevuga Pandia Thevar [1933] 1 ITR 78 (Mad). Income from sale of spontaneous forest produce could not be treated as agricultural income, because no cultivation is involved. It is in the light of these established guidelines already available that, the issue as to whether income from sale of plants grown in pots could be treated as agricultural income came for consideration in Soundarya Nursery's case.

The finding of the Tribunal on the facts was that there were several operations carried out on the land, before they were transplanted in suitable containers including pots and thereafter kept in a greenhouse or in shade for further growth. The activities involved are layering, gootying or marcotage, inarching, cutting and hybridisation, all relating to land with considerable application of labour on scientific lines in preparation of seedlings, grafting etc. with further input in the nature of agricultural operations like manuring, etc. The High Court felt that Raja Benoy Kumar Sahas Roy's case would support the assessee's claim, since the basic operations are on the land so that nurturing of the plant in a pot and rendering of subsequent operations should not rule out the treatment as agricultural income.

The High Court considered the objection of the Revenue based on certain observations in H. H. Maharaja Vibhuti Narain Singh v. State of U. P. [1967] 65 ITR 364 (All), which was actually concerned with the issue under the U.P. Agricultural Income-tax Act, 1948, as to the manner of treatment of income from nurseries, which was the business in that case. The High Court in that case referred to the decision in Raja Benoy Kumar Sahas Roy's case and made a distinction between nurseries maintained by farmers and those run independently of agriculture in the following words (page 369):

"It may be that applying the above-mentioned tests laid down by their Lordships of the Supreme Court, cases may arise in which a nursery may be maintained by a farmer as an aid or necessary adjunct to the primary process of agriculture carried on by him. But usually nurseries are maintained and run as businesses quite independently of agriculture, and there may be no process carried on upon the land at all in running a nursery."

It further observed as follows:

> "In the present case, we do not find any discussion of the type of nursery involved. Even if the keeping of a nursery necessarily means the use of some land and earth for the purposes of rearing plants, that would not by itself amount to carrying on a primary agricultural operation in the sense of cultivating fields. Moreover, plants or seeds are not considered `produce ready for the market'; in the ordinary sense. We do not also know the facts upon which the income-tax authorities have treated the income from the nursery as income from a business. It is only clear that the materials before the agricultural income-tax authorities in the case before us were wholly insufficient to justify the conclusion that the income from the nursery was agricultural income. No facts which could give rise to an inference that there was a nursery

were discussed. Perhaps the income-tax authorities went into the matter in a more satisfactory manner before they determined the income from the nursery to be income from a business. However, we have not even got any order or judgment of the income-tax authorities before us. All we can say with certainty is that the materials before the agricultural income-tax authorities could not justify the conclusion that the income from the nursery in this case constituted agricultural income."

The Madras High Court in Soundarya Nursery's case met the argument of the Revenue based upon the decision of the Allahabad High Court relating to nursery by pointing out that it is in the nature of an obiter. Actually it is an observation which is also inconclusive because as mentioned therein none of the facts were available to the High Court. The observation in the case could, therefore, only mean that there could be nurseries the income of which may wholly not be agricultural.

Where the income of the nursery arises out of basic operations on land, the character of the income, when the further operations are carried out in pots, cannot rule out the inference of agricultural income. This decision in Soundarya Nursery's case should be useful for coming to a proper conclusion in the case of not only income from nurseries but also from pot cultivation, which is becoming increasingly prevalent. The easy inference, that is often taken in assessments both for purposes of the Central and State income tax laws that income from sale of plants in pots from nurseries even where it is maintained as part of an agricultural farm is not agricultural, should no longer be possible, if the guidelines in this case are followed.



Fundamental of agricultural income

(a) Some basic operations, prior to germination, involving expenditure of human skill and labour on the land itself and not merely on the growths from the land, are essential to constitute agriculture; illustrative instances of such basic operations are tilling of the land, sowing or disseminating of seeds, and planting.

(b) Subsequent operations, i.e., operations performed after the produce sprouts from the land, e.g., weeding, digging the soil around the growth, removal of undesirable undergrowths,

tending, pruning, cutting, felling and preservation of the plants from insects, pests and other animals by themselves would not constitute agriculture. But in cases where the subsequent operations are combined with the basic operations, the subsequent operations would also constitute part of the integrated activity of agriculture.

(c) Agriculture connotes not merely the raising of grain and food products for men and animals but also the raising of all commercial crops e.g., the cultivation of a casuarinas plantation, tea, coffee, tobacco, cotton, sugarcane, toddy trees, rubber, jute, hemp and indigo.

(d) Activities not involving any basic operation on the land would not constitute agriculture merely because they have relation to or connection with the land. For instance, breeding and rearing of livestock, dairy farming, butter and cheese making and poultry farming would not by themselves be agricultural purposes.

Eucalyptus oil

In the case of CIT v. Stanes Amalgamated Estates Ltd. [1998] 232 ITR 443 (Mad.), it was observed that, "Even under processing the produce should not lose its identity and the assessee must establish the agricultural produce itself has got no market and only by converting the same into some other product there can be a market. In the present case, the oil extracted from the eucalyptus leaves lost its original identity. According to the assessee, the eucalyptus leaves themselves have got no market, but, in the order passed by the Commissioner it is clearly stated that the leaves also have ready market as evidenced by contract allowed by the Forest Department for cutting green leave by private merchants. Even though the assessee contended that the leaves themselves have got no market, but it was not substantiated before the Tribunal. In view of the foregoing reasons, the order passed by the Tribunal in coming to the conclusion that eucalyptus oil extracted from the eucalyptus leaves is also agricultural produce is not acceptable. The Tribunal was not right in holding that the sale proceeds of eucalyptus oil extracted by the assessee from the leaves of the eucalyptus trees grown by it was in the nature of agricultural income and, hence, it was not assessable to tax. Dooars Tea Co. Ltd. v. Commr. of Agrl. Ltd. [1962] 44 ITR 6 (SC), South Arcot District Co-operative Marketing Society Ltd. v. CIT [1974] 97 ITR 500 (Mad.), Seth Banarsidas Gupta v. CIT [1977] 106 ITR 804 (All.), CIT v. H.G. Date [1971] 82 ITR 71 (Bom.) and CIT v. Woodland Estates Ltd. [1965] 58 ITR 612 (Ker.) relied on. Thus Oil extracted from eucalyptus leaves is not agricultural produce and sale proceeds of eucalyptus oil extracted by assessee from leaves of trees grown by it was not in the nature of agricultural income."

Agricultural income from non agricultural land

Tribunal in the case of Ramesh Batta v. Dy. CIT [2007] 11 SOT 427 (Delhi) which deals with the taxability of income derived from sale of fruits collected from orchard. In the instant case, the orchard, which was let out to the assessee, was situated in the residential complex of IGNFA. The assessee had not proved that it was agricultural land. It had also not been shown that the rent or revenue was paid or payable in respect of this land. Neither before the Assessing Officer nor before the Commissioner (Appeals), the assessee could show and prove the character of the land from the revenue records. It had also not been shown that in past the land was treated as agricultural land and fruits taken from the orchard were covered within the meaning of 'agricultural produce'. Further, the department had never treated the income derived from fruits as income on account of agricultural operations or as agricultural income. Therefore, the lower authorities had rightly held the income in question derived by the assessee as business income.

Forests - Whether agricultural land

If the growth of grass or trees on a piece of land is spontaneous, then such land cannot be called agricultural land. If there are no agricultural operations or no cultivation, then it cannot be said that the land concerned is agricultural land. This view has been taken by their Lordships of the Supreme Court in the case of CED v. Venugopala Varma Rajah [1976] 105 ITR 593. The same view has been taken by their Lordships of the Andhra Pradesh High Court in the case of Smt. Manyan Meenakshamma v. CWT [1967] 63 ITR 534.

RULE-7 COMPOSITE INCOME

In the case of income which is partially agricultural income as defined in section 2 and partially income chargeable to income-tax under the head "Profits and gains of business", in determining that part which is chargeable to income-tax the market value of any agricultural produce which has been raised by the assessee or received by him as rent-in-kind and which has been utilised as a raw material in such business or the sale receipts of which are included in the accounts of the business shall be deducted, and no further deduction shall be made in respect of any expenditure incurred by the assessee as a cultivator or receiver of rent-in-kind.

(2) For the purposes of sub-rule (1) "market value" shall be deemed to be:--

(a) where agricultural produce is ordinarily sold in the market in its raw state, or after application to it of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render it fit to be taken to market, the value calculated according to the average price at which it has been so sold during the relevant previous year;

(b) where agricultural produce is not ordinarily sold in the market in its raw state or after application to it of any process aforesaid the aggregate of--

(i) the expenses of cultivation;

(ii) the land revenue or rent paid for the area in which it was grown; and

(iii) such amount as the Assessing Officer finds, having regard to all the circumstances in each case, to represent a reasonable profit.

RULE-7A. INCOME FROM THE MANUFACTURE OF RUBBER.

35% - TAXABLE
65% - NOT TAXABLE

Income derived from the sale of centrifuged latex or cenex or latex based crepes (such as pale latex crepe) or brown crepes (such as estate brown crepe, re-milled crepe, smoked blanket crepe or flat bark crepe) or technically specified block rubbers manufactured or processed from field latex or coagulum obtained from rubber plants grown by the seller in India shall be computed as if it were income derived from business, and thirty-five per cent. of such income shall be deemed to be income liable to tax.



Latex being collected from rubber tree



Transform latex into firm solid block of rubber.

RULE-7B. INCOME FROM THE MANUFACTURE OF COFFEE.

Coffee grown and cured

25% - TAXABLE
75% - NOT TAXABLE

Coffee grown, cured, roasted and grounded

40% - TAXABLE
60% - NOT TAXABLE

(1) Income derived from the sale of coffee grown and cured by the seller in India shall be computed as if it were income derived from business, and twenty-five per cent. of such income shall be deemed to be income liable to tax.

(1A) Income derived from the sale of coffee grown, cured, roasted and grounded by the seller in India, with or without mixing chicory or other flavouring ingredients, shall be computed as if it were income derived from business, and forty per cent. of such income shall be deemed to be income liable to tax.

Explanation - "curing" shall have the same meaning as assigned to it in Coffee Act, 1942





Drying coffee cherries to coffee beans is curing

(2) In computing the incomes referred to in sub-rules (1) and (1A), an allowance shall be made in respect of the cost of planting coffee plants in replacement of plants that have died or become permanently useless in an area already planted, if such area has not previously been abandoned, and for the purpose of determining such cost, no deduction shall be made in respect of the amount of any subsidy which, under the provisions of clause (31) of section 10, is not includible in the total income.

RULE-8 GROWING AND MANUFACTURING OF TEA RULE 8

Tea grown and manufactured

40% - TAXABLE
60% - NOT TAXABLE

(1) Income derived from the sale of tea grown and manufactured by the seller in India shall be computed as if it were income derived from business, and forty per cent. of such income shall be deemed to be income liable to tax.
(2) In computing such income an allowance shall be made in respect of the cost of planting bushes in replacement of bushes that have died or become permanently useless in an area already planted, if such area has not previously been abandoned, and for the purpose of determining such cost, no deduction shall be made in respect of the amount of any subsidy which, under the provisions of clause (30) of section 10, is not includible in the total income.





Tea leaves to Manufacturing process.

Liability of tea estates:

Where the assessee grows green tea leaves and also processes them, rule 8 under the Income-tax Rules, 1962, would deem 60 per cent. of the income as agricultural income. The claim of the assessee that computation should be different for agricultural income-tax under the State law has been rejected by the Supreme Court in Union of India v. Belgachi Tea Co. Ltd. [2008] 304 ITR 1. Income has to be computed under the Central Act and 60 per cent. of such income would be assessable as was decided in Tata Tea Ltd. v. State of West Bengal [1988] 173 ITR 18 (SC), irrespective of the language of the State legislation in view of the fact that agricultural income under the Constitution is what is left unassessed in the light of the requirement that agricultural income is what is defined under the Central law. The liability cannot be less with reference to any provision under the State Act.
That income by sale of green tea leaves could not be called income assessable under the Income-tax Act, 1961, for the purpose of the 40 per cent. and 60 per cent. share between the Centre and the State. The income from sale of green tea leaves was purely income from agricultural product and

was not assessable. In case the assessee directly sold the green tea leaves it could not be taken to be incidental to the business and whatever income was derived from the sale of the green tea leaves was assessable.

AGRICULTURAL INCOME INCLUDED FOR RATE PURPOSE

Agricultural income is exempt from tax under section 10 of the income-tax Act. However, for computation of income tax, the agricultural income is aggregated with non-agricultural income if:

(i) Assessee is an individual, HUF, AOP/BOI (taxable at normal rates applicable to an individual)
(ii) Assessee has non-agricultural income which exceeds the taxable limit.
(iii) Agricultural income exceeds Rs. 5,000/-.

The aggregation of agricultural income with non-agricultural income and computation of income tax shall be in the following manner:

- Step 1: Net agricultural income is to be computed as if it were income chargeable to income-tax. In case of as assessee engaged in business of growing and manufacturing tea, 60% of income computed is agricultural income.
- Step 2: Agricultural and non-agricultural income of the assessee will then ne aggregated and income-tax is calculated on the aggregate income as if such aggregate income were the total income.
- Step 3: The net agricultural income is then increased by the first slab of income on which tax is charged at nil rate and income tax is calculated on net agricultural income, so increased, as if such income were the total income of the assessee.
- Step 4: The amount of income-tax determined at step-2 will be reduced by the amount of income-tax determined under step-3.
- Step 5: Find out the balance. Add education cess and secondary and higher education cess.
- Step 6: The amount so arrived at is the income-tax payable by the assessee.

EXEMPTIONS TO CERTAIN BUSINESS

Note		10A	10B	10AA
	Nature of business	Note A1	Note A2	Note A3
	Years and amount of Deduction	5-100% 2-50% 3-50%	10-100%	5-100% 5-50% 5-50%
(3)	Reserve Creation & Conditions	Yes (Last 3 yrs. only)	No	Yes (Last 5 yrs. only)
(4)	Violations of reserve (conditions)	Deemed	-	Deemed
(5)	Additional Conditions (for New P/M - 80I (2) expl 1 & 2)	S/R New P/M ROI	S/R New P/M ROI	S/R New P/M ROI
(6)	- Sale proceeds to be brought in India. - Proportionate Benefit.	6m Yes (S/S-3,4)	6m Yes (S/S-3,4)	-- Yes (S/S-7)
(7)	Report of Accountant	Yes (S/S-5)	Yes (S/S-5)	Yes (S/S-8)
(8)	Depreciation allowed Deduction VIA C/F & Set off	Yes No No (S/S-6)	Yes No No (S/S-6)	Yes No No (S/S-6) (S/S-8)
(9)	80IA (8) / (10) (captive consumption)	Yes (S/S-7)	Yes (S/S-7)	Yes (S/S-9)
(10)	Amalgamation / Demerger	Friendly (S/S-7A)	Friendly (S/S-7A)	Friendly (S/S-5)
(11)	Option to not apply (for all the years)	Yes (S/S-8)	Yes (S/S-8)	-
(12)	A.Y. from which deduction not allowed	AY 12-13	AY 12-13	-

S/S = sub section

Note A1

An undertaking from the export of articles or things or computer software.

Where an undertaking initially located in any free trade zone or export processing zone is subsequently located in a special economic zone by reason of conversion of such free trade zone or export processing zone into a special economic zone, the period of ten consecutive assessment years referred to in this sub-section shall be reckoned from the assessment year relevant to the previous year in which the undertaking began to manufacture or produce such articles or things or computer software in such free trade zone or export processing zone :

The profits and gains derived from on site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India.

Note A2

A deduction of such profits and gains as are derived by a hundred per cent. export-oriented undertaking from the export of articles or things or computer software beginning with the assessment year relevant to the pervious year in which the undertaking begins to manufacture or produce articles or things or computer software, as the case may be. "computer software" means,-

(a) any computer programme recorded on any disc, tape, perforated media or other information storage device ; or

(b) any customized electronic data or any product or service of similar nature, as may be notified by the Board,

which is transmitted or exported from India to any place outside India by any means ;

"hundred per cent. export-oriented undertaking" means an undertaking which has been approved as a hun-dred per cent. export-oriented undertaking by the Board appointed in this behalf by the Central Government

The profits and gains derived from on site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India.

"manufacture or produce" shall include the cutting and polishing of precious and semiprecious stones.

Note A3

An assessee, being an entrepreneur as referred to in clause (j) of section (2) of the Special Economic Zones Act, 2005, from his unit, who begins to manufacture or produce articles or things or provide any services during the previous year relevant to any assessment year commencing on or after the 1st day of April, 2006.

“Special Economic Zone” and “unit” shall have the same meanings as assigned to them under clauses (za) and (zc) of section 2 of the Special Economic Zones Act, 2005.

The profits and gains derived from on site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India.

Note 3 and 4

The amount credited to the Special Reserve Account is to be utilised

I. for the purposes of acquiring new machinery or plant which is first put to use before the expiry of a period of three years next following the previous year in which the reserve was created ; and

II. until the acquisition of new machinery or plant as aforesaid, for the purposes of the business of the undertaking other than for distribution by way of dividends or profits or for remittance outside India as profits or for the creation of any asset outside India ;

The particulars, as may be prescribed in this behalf, have been furnished by the assessee in respect of new machinery or plant along with the return of income for the assessment year relevant to the previous year in which such plant or machinery was first put to use.

VIOLATION of reserve

(a) has been utilised for any purpose other than those referred to in sub-section (1B), the amount so utilised ; or

(b) has not been utilised before the expiry of the period specified he amount not so utilised,

Shall be deemed to be the profits.

Note 5

Any machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose, if the following conditions are fulfilled, namely

(a) such machinery or plant was not, at any time previous to the date of the installation by the assessee, used in India ;

(b) such machinery or plant is imported into India from any country outside India ; and

(c) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of this Act in computing the total income of any person for any period prior to the date of the installation of the machinery or plant by the assessee.

Where in the case of an industrial undertaking, any machinery or plant or any part thereof previously used for any purpose is transferred to a new business and the total value of the machinery or plant or part so transferred does not exceed twenty per cent. of the total value of the machinery or plant used in the business, then, for the purposes section, the condition specified therein shall be deemed to have been complied with.

Note 6

This section applies to the undertaking, if the sale proceeds of articles or things or computer software exported out of India are received in, or brought into, India by the assessee in convertible foreign exchange, within a period of six months from the end of the previous year or, within such further period as the competent authority may allow in this behalf.

Explanation 1.-For the purposes of this sub-section, the expression "competent authority" means 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.

Explanation 2.-The sale proceeds referred to in this sub-section shall be deemed to have been received in India where such sale proceeds are credited to a separate account maintained for the purpose by the assessee with any bank outside India with the approval of the Reserve Bank of India.

The profits derived from export of articles or things or computer software shall be the amount which bears to the profits of the business of the undertaking, the same proportion as the export turnover in respect of such articles or things or computer software bears to the total turnover of the business carried on by the undertaking.

Note 7

The deduction under this section, shall not be admissible for any assessment year unless the assessee furnishes in the prescribed form, along with the return of income, the report of an accountant (CA), certifying that the deduction has been correctly claimed in accordance with the provisions of this section.

Note 8

Notwithstanding anything contained in any other provision of this Act, in computing the total income of the assessee

(i) section 32, section 32A, section 33, section 35 and clause (ix) of sub-section (1) of section 36 shall apply as if every allowance or deduction referred to therein and relating to or allowable for any of the relevant assessment years ending before the 1st day of April, 2001, in relation to any building, machinery, plant or furniture used for the purposes of the business of the undertaking in the previous year relevant to such assessment year or any expenditure incurred for the purposes of such business in such previous year had been given full effect to for that assessment year itself and accordingly sub-section (2) of section 32, clause (ii) of sub-section (3) of section 32A, clause (ii) of sub-section (2) of section 33, sub-section (4) of section 35 or the second proviso to clause (ix) of sub-section (1) of section 36, as the case may be, shall not apply in relation to any such allowance or deduction ;

(ii) no loss referred to in sub-section (1) of section 72 or sub-section (1) or sub-section (3) of section 74 in so far as such loss relates to the business of the undertaking, shall be carried forward or set off where such loss relates to any of the relevant assessment years 4ending before the 1st day of April, 2001 ;

(iii) no deduction shall be allowed under section 80HH or section 80HHA or section 80-I or section 80-IA or sec-tion 80-IB in relation to the profits and gains of the undertaking ; and

(iv) in computing the depreciation allowance under section 32, the written down value of any asset used for the purposes of the business of the undertaking shall be computed as if the assessee had claimed and been actually allowed the deduction in respect of depreciation for each of the relevant assessment year.

Note 9

Where any goods or services held for the purposes of the eligible business are transferred to any other business carried on by the assessee, or where any goods or services held for the purposes of any other business carried on by the assessee are transferred to the eligible business and, in either case, the consideration, if any, for such transfer as recorded in the accounts of the eligible business does not correspond to the market value of such goods or services as on the date of the transfer, then, for the purposes of the deduction under this section, the profits and gains of such eligible business

shall be computed as if the transfer, in either case, had been made at the market value of such goods or services as on that date. Provided that where, in the opinion of the Assessing Officer, the computation of the profits and gains of the eligible business in the manner hereinbefore specified presents exceptional difficulties, the Assessing Officer may compute such profits and gains on such reasonable basis as he may deem fit.

Where it appears to the Assessing Officer that, owing to the close connection between the assessee carrying on the eligible business to which this section applies and any other person, or for any other reason, the course of business between them is so arranged that the business transacted between them produces to the assessee more than the ordinary profits which might be expected to arise in such eligible business, the Assessing Officer shall, in computing the profits and gains of such eligible business for the purposes of the deduction under this section, take the amount of profits as may be reasonably deemed to have been derived therefrom.

Note 10

Where any undertaking of an Indian company which is entitled to the deduction under this section is transferred, before the expiry of the period specified in this section, to another Indian company in a scheme of amalgamation or demerger,

(a) no deduction shall be admissible under this section to the amalgamating or the demerged company for the previous year in which the amalgamation or the demerger takes place ; and

(b) the provisions of this section shall, as far as may be, apply to the amalgamated or the resulting company as they would have applied to the amalgamating or the demerged company if the amalgamation or demerger had not taken place.

Note 11

Notwithstanding anything contained in the foregoing provisions of this section, where the assessee, before the due date for furnishing the return of income under section 139, furnishes to the Assessing Officer a declaration in writing that the provisions of this section may not be made applicable to him, the provisions of this section shall not apply to him for any of the relevant assessment years.

Note 12

No deduction under this section shall be allowed to any undertaking for the assessment year beginning on the 1st day of April, _____ and subsequent years.

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Membership Name	**Free**	**DT**	**IDT**
Description	***Wealth Tax (excluding valuation rules and questions / answers.)***	***Direct Taxes for CA final (Includes membership type 3) (also included 130 + Class work problems and solution)***	***Indirect taxes of CA final. (included +100 Class work problems and solution)***
Hours of video access Granted	5 Hrs	100 Hrs	75 Hrs
Membership commence (May 2011 Exam)	16th May	16th May	16th May
Fair Usage of Hours for attending all lectures for given subject once. *(approximately in this many hours once all lectures can be attended, some extra time is given considering revision of any chapters that may be required. Particularly for DT if students attend basic topics of IPCC lectures also when we post from time to time then students will have to buy more hours at additional cost.)*	5 Hrs	100 Hrs	65 Hrs
Time of Access / Viewing *(You can access the lectures any time with user name and password. Subject to your membership expiry date and hours of usage.)*	24/7	24/7	24/7
Download of video files *(Video files are copy right protected, It is not allowed to be downloaded. User must not copy or distribute it any manner what so ever, audio or video or both.)*	Yes (Selected Files Only)	No	No
Viewing online *(You must be connected to internet with at least broadband connection. You can also access these lectures with help of smart mobile phone if it supports Java and gives you speed of 384 kbps minimum.)*	Yes	Yes	Yes
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E-mail support for handling queries *(generally accepted response time of 48 hours.)*	No	Yes	Yes
Maximum time each video can be Logged in. *(This limit is kept for security purposes. Video Logged in for less then 3 min is not counted for this purpose.)*	10	10	10
Fees (Including taxes if any) ***(Not Refundable in any circumstances.)***	Rs. Nil	Rs. 15,500	Rs. 12,500
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Study notes in softcopy provided for download. *(*likely to be provided.)*	No	Yes	No*
Membership expiry for May 2011 exam (Respective hours or this date whichever is earlier.)	No	18th May	18th May
New Batch for Nov 2011 Online lectures commence for May 2011 students of CA final.	20th May	20th May	20th May
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DEDUCTIONS UNDER CHAPTER VI-A

Sections	Particulars	Assessee to whom allowed	Quantum of deduction
1	2	3	4
80C	Deduction in respect of life insurance premia, deferred annuity, contributions to provident fund, subscription to certain equity shares or debentures, etc	Individuals or HUF	Maximum Rs. 1,00,000
80CCC	Deduction in respect to contribution of certain pension funds	Only individuals	Max. Rs. 1,00,000
80CCD	Deduction in respect of contribution to notified pension scheme	Individual who is self employed or employed by the Central Government or by any other employer	The amount of contribution not exceeding 10% of salary or 10% of GTI, as the case may be
80CCE	Limit on deductions under section 80C, 80CCC and 80CCD	N.A.	Deduction u/s 80C, 80CCC and 80CCE cannot exceed Rs. 1,00,000
80CCF	Contribution to long term infrastructure bond notified.	Individuals or HUF	20,000
80D	Deduction in respect of medical insurance premia or CGHS	Individual of HUF whether resident or non-resident For senior citizen	In case of individual- maximum Rs. 15,000 + Rs. 15,000. In case of HUF – maximum of Rs. 15,000 Addl. Rs. 5,000
80DD	Deduction in respect of maintenance including medical treatment of a dependent who is a person with disability	Individual or HUF resident in India	Rs. 50,000 or Rs. 1,00,000 in case of a person with severe disability
80DDB/ Rule 11DD	Deduction in respect of medical treatment, etc.	Individual or HUF resident in India For senior citizen	Max. Rs. 40,000 Addl. Rs. 20,000
80E	Deduction for entire amount of interest paid on a loan taken for pursuing higher education	Individual whether resident or not	Entire amount of interest paid during the previous year

80G/Rules 11AA & 18AAA	Deduction in respect of donations to certain funds, charitable institutions, etc.	All assesses	(a) 100% or 50% of eligible donations, without applying qualifying limit in certain cases (b) 100% or 50% of eligible donations, after applying qualifying limit of 10% of adjusted GTI.
80GG	Deductions in respect of rent paid	Individual only	Maximum Rs. 2,000 p.m.
80GGA	Deduction in respect of certain donations for research association or rural development, etc.	All assesses not having business income	100% of sum donated
80GGB	Deduction in respect of contribution given by companies to political parties or an electoral trust	Company assessee	Amount so contributed
80GGC	Deduction in respect of contribution given by any person to political parties or an electoral trust	Any assessee other than local authority and every artificial judicial person wholly or partly funded by the Government	Amount so contributed
80-IA/ Rules 18BBA & 18BBE	Deduction in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development, etc.	Industrial undertaking or enterprises engaged in infrastructure development, etc.	30% to 100% profits
80-IAB	Deduction in respect of profits and gains from industrial undertakings or enterprises engaged in development of Special Economic Zone	Undertaking/enterprises engaged in development of Special Economic Zone	100% of profits for 10 consecutive assessment years
80-IB/ Rules 18AAB, 18BBC & 18DA	Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development, etc.	All assessees engaged in the business of industrial undertakings/hotels/ships/ infra-structure development/ scientific and industrial research and development.	25% to 100% for prescribed no. Of years

80-IC	Deduction in respect of certain undertakings or enterprises in certain special category States	All assessees deriving income from an undertakings or enterprises situated in special category. States which begin manufacturing/production between specified dates	25% to 100% for profits
80-ID	Deduction in respect of profits and gains from business of hotels and convention centres in specified area	All assessees deriving income from the business of hotels and convention centres in specified area	100% of the profit for 5 consecutive years
80-IE	Special provisions in respect of certain undertakings in North Eastern States	All assessees deriving income from eligible undertaking in North Eastern States	100% of the profit for 10 consecutive years
80JJA	Deduction in respect of profits and gains from business of collecting and processing of bio degradable waste	All assessees	100% of profit for 5 years
80JJAA/ Rule 19AB	Deduction in respect of employment of new workmen	Only Indian companies	30% of additional wages of 3 years
80LA	Deduction in respect of certain incomes of Offshore Banking Units and International Financial Services Centre	Only Scheduled Banks owning offshore banking units in a special economic zone	100% of income for first five years and 50% for next five years
80P	Deduction in respect of income of co-operative societies	Co-operative societies	100% of profit but in some cases amount is fixed at Rs. 40,000/Rs. 20,000
80QQB	Deduction in respect of royalty income, etc., of authors of certain books other than text books	Individuals who are residents in India and are authors	100% of such income or Rs. 3,00,000 whichever is less
80RRB	Deduction in respect of royalty on patents	Individual who is resident in India and is a patentee	100% of such income or Rs. 3,00,000 whichever is less

80U/Rule 11D	Deduction in the case of a person with disability	Resident individuals	Rs. 50,000 in case of a person with disability and Rs. 1,00,000 in case of a person with severe disability

DEDUCTIONS IN RESPECT TO SPECIFIED BUSINESS

Nature of business	Develop / maintain / operate / Infrastructure facility 80(IA)4(i)	Telecom Services. 80(IA) 4(ii)	SEZ/IP 80(IA)(iii)	Generation / distribution/ transmission/ of Power 80(IA)(iv)	reconstruction or revival of a power generating plan 80(IA)(v)
Years and amount of Deduction	10-100%	5-100% 3-30%	10-100%	10-100%	10-100%
Initial AY	20	15	15	15	15
Begins	01-04-95	01-04-95 To 01-04-05	01-04-97 To 01-04-11	01-04-93 To 01-04-11	01-04-07
Additional conditions	A1 & A2	A1 & A2	A1 & A2	A1 & A2	A1 & A2
Computation exclusive 80IA(5)	Yes	Yes	Yes	Yes	Yes
Report of Accountant 80IA(7)	Yes	Yes	Yes	Yes	Yes
Captive consumptions 80IA(8)	M V	M V	M V	M V	M V
Exclusive deduction 80IA(9)	Yes	Yes	Yes	Yes	Yes
Close connection 80IA(10)	RP	RP	RP	RP	RP
Powers of government 80IA(11)	Yes	Yes	Yes	Yes	Yes
Amalgamation / demerger 80IA(12)	Friendly	Friendly	Friendly	Friendly	Friendly
NOTES	B1	B2	B3	B4	B5

RP = Reasonable Profits
MV = market value

NOTE B1

Any enterprise carrying on the business of developing or operating and maintaining and operating or developing, operating and maintaining any infrastructure facility which fulfils all the following conditions, namely :

(a) it is owned by a company registered in India or by a consortium of such companies ;
(b) it has entered into an agreement with the Central Government or a State Government or a local authority or any other statutory body for (i) developing or (ii) operating and maintaining or (iii) developing, operating and maintaining a new infrastructure facility;
(c) it has started or starts operating and maintaining the infrastructure facility on or after the 1st day of April, 1995 :

Explanation. For the purposes of this clause, "infrastructure facility" means

(a) a road including toll road, a bridge or a rail system ;
(b) a highway project including housing or other activities being an integral part of the highway project ;
(c) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system ;
(d) a port, airport, inland waterway or inland port 9inland port or navigational channel in the sea.

Where housing or other activities are an integral part of the highway project and the profits of which are computed on such basis and manner as may be prescribed, such profit shall not be liable to tax where the profit has been transferred to a special reserve account and the same is actually utilised for the highway project excluding housing and other activities before the expiry of three years following the year in which such amount was transferred to the reserve account ; and the amount remaining unutilised shall be chargeable to tax as income of the year in which such transfer to reserve account took place.

NOTE B2

Any undertaking which has started or starts providing telecommunication services whether basic or cellular, including radio paging, domestic satellite service, network of trunking, broadband network and internet services on or after the 1st day of April, 1995, but on or before the 631st day of March, 2005;

Explanation.--For the purposes of this clause, "domestic satellite" means a satellite owned and operated by an Indian company for providing telecommunication service.

NOTE B3

Any undertaking which develops, develops and operates or maintains and operates an industrial park or special economic zone notified by the Central Government in accordance with the scheme framed and notified by that Government for the period beginning on the 1st day of April, 1997 and ending on 3the 31st day of March, 2006 (2011 for industrial park) :

Provided that in a case where an undertaking develops an industrial park on or after the 1st day of April, 1999 or a special economic zone on or after the 1st day of April, 2001 and transfers the operation and maintenance of such industrial park or such special economic zone, as the case may be, to another undertaking (hereafter in this section referred to as the transferee undertaking), the deduction under sub-section (1) shall be allowed to such transferee undertaking for the remaining period in the ten consecutive assessment years as if the operation and maintenance were not so transferred to the transferee undertaking :

NOTE B4

An undertaking which,

(a) is set up in any part of India for the generation or generation and distribution of power if it begins to generate power at any time during the period beginning on the 1st day of April, 1993 and 3ending on the 31st day of March, 2010 ;

(b) starts transmission or distribution by laying a network of new transmission or distribution lines at any time during the period beginning on the 1st day of April, 1999 and 3ending on the 31st day of March, 2010 ; Provided that the deduction under this section to an undertaking under sub-clause (b) shall be allowed only in relation to the profits derived from laying of such network of new lines for transmission or distribution.

(c) undertakes substantial renovation and modernisation of the existing network of transmission or distribution lines at any time during the period beginning on the 1st day of April, 2004 and ending on the 31st day of March, 2010.

"substantial renovation and modernisation" means an increase in the plant and machinery in the network of transmission or distribution lines by at least fifty per cent. of the book value of such plant and machinery as on the 1st day of April, 2004 :

NOTE B5

An undertaking owned by an Indian company and set up for reconstruction or revival of a power generating plant, if

(a) such Indian company is formed before the 30th day of November, 2005, with majority equity participation by public sector companies for the purposes of enforcing the security interest of the lenders to the company owning the power generating plant and such Indian company is notified before the 31st day of December, 2005, by the Central Government for the purposes of this clause ;

(b) such undertaking begins to generate or transmit or distribute power before the 31st day of March, 2011.

Nature of business	Industrial Undertaking with specified business, notified. OR SSI with / without cold storage plant 80(IB)3	Backward State in VIII schedule 80(IB)4 (from 01/04/2012 it is 80 IC.)	Backward district A 80(IB)5	Backward district B 80(IB)5
Years and amount of Deduction	<u>Company</u> 10 – 30% <u>Any other</u> 10 - 25% <u>Co-op sct</u> 12 - 25%	<u>Company</u> 5 – 100% 5 – 30% <u>Any other</u> 5 – 100% 5 – 25% <u>Co-op sct</u> 5 – 100% 7 – 25%	<u>Company</u> 5 – 100% 5 – 30% <u>Any other</u> 5 – 100% 5 – 25% <u>Co-op sct</u> 5 – 100% 7 – 25%	<u>Company</u> 5 – 100% 3 – 30% <u>Any other</u> 5 – 100% 3 – 25% <u>Co-op sct</u> 5 – 100% 7 – 25%
Initial AY	Year of commencement.	Year of commencement.	Year of commencement.	Year of commencement.
Begins	01-04-91 To 01-04-95 SSI 01-04-95 To 01-04-02	01-04-93 To 01-04-04 <u>J & K</u> 01-04-93 To 01-04-12	01-10-94 To 01-04-04	01-10-94 To 01-04-04
Additional conditions	A1 to A3	A1 to A3	A1 to A3	A1 to A3
Computation exclusive 80IA(5)	Yes	Yes	Yes	Yes
Report of Accountant 80IA(7)	Yes	Yes	Yes	Yes
Captive consumptions 80IA(8)	M V	M V	M V	M V
Exclusive deduction 80IA(9)	Yes	Yes	Yes	Yes
Close connection 80IA(10)	RP	RP	RP	RP
Powers of government 80IA(11)	Yes	Yes	Yes	Yes
Amalgamation / demerger 80IA(12)	Friendly	Friendly	Friendly	Friendly
NOTES	B11	B12	B13	B14

NOTE B11

An industrial undertaking

(i) it begins to manufacture or produce, articles or things or to operate such plant or plants as the Central Government may, by notification in the Official Gazette, specify with reference to any particular undertaking ;

(ii) where it is an industrial undertaking being a small scale industrial undertaking, it begins to manufacture or produce articles or things or to operate its cold storage plant [not specified in sub-section (4) or sub-section (5)].

NOTE B12

The amount of deduction in the case of an industrial undertaking in an industrially backward State specified in the Eighth Schedule.

No deduction shall be allowed for the assessment year beginning on the 1st day of April, 2004 or any subsequent year to any undertaking or enterprise referred to in section 80-IC.

No deduction shall be allowed to an industrial undertaking in the State of Jammu and Kashmir which is engaged in the manufacture or production of any article or thing specified in Part C of the Thirteenth Schedule.

NOTE B13 AND B14

The amount of deduction in case of an industrial undertaking located in such industrially backward districts as the Central Government may, having regard to the prescribed guidelines, by notification in the Official Gazette, specify in this behalf as industrially backward district of category "A" or an industrially backward district of category "B"

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Nature of business	Operation of Ships 80(IB)6	Hotels Paid up capital > 5 lakhs 80(IB)7	Multiplex not in specified areas 80(IB)7A	Convention Centre any areas. 80(IB)7B
Years and amount of Deduction	10-100%	Hilly areas 10 – 50% Other Areas 10 – 30%	5 – 50%	5 – 50%
Initial AY	Year of commencement.	Year of commencement.	Year of commencement.	Year of commencement.
Begins	01-04-91 To 01-04-95	Hilly areas 01-04-97 To 01-04-01 Other Areas 01-04-97 To 01-04-01	01-04-02 To 01-04-05	01-04-02 To 01-04-05
Additional conditions	A1 to A3	A1 to A3	A1 to A3	A1 to A3
Computation exclusive 80IA(5)	Yes	Yes	Yes	Yes
Report of Accountant 80IA(7)	Yes	Yes	Yes	Yes
Captive consumptions 80IA(8)	M V	M V	M V	M V
Exclusive deduction 80IA(9)	Yes	Yes	Yes	Yes
Close connection 80IA(10)	RP	RP	RP	RP
Powers of government 80IA(11)	Yes	Yes	Yes	Yes
Amalgamation / demerger 80IA(12)	Friendly	Friendly	Friendly	Friendly
NOTES	B15	B16	B17	B18

NOTE B15

In the case of the business of a ship —

(i) Is owned by an Indian company and is wholly used for the purposes of the business carried on by it ;

(ii) Was not, previous to the date of its acquisition by the Indian company, owned or used in Indian territorial waters by a person resident in India ; and

(iii) Is brought into use by the Indian company at any time during the period beginning on the 1st day of April, 1991, and ending on the 31st day of March, 1995.

NOTE B16

Hotels in Hilly areas	Other areas
Nothing shall apply to a hotel located at a place within the municipal jurisdiction (whether known as a municipality, municipal corporation, notified area committee or a cantonment board or by any other name) of Calcutta, Chennai, Delhi or Mumbai. Hotel is approved by the prescribed authority.	Nothing shall apply to a hotel located at a place within the municipal jurisdiction (whether known as a municipality, municipal corporation, notified area committee, town area committee or a cantonment board or by any other name) of Calcutta, Chennai, Delhi or Mumbai.

Eligible business conditions

(i) The business of the hotel is owned and carried on by a company registered in India with a paid-up capital of not less than five hundred thousand rupees ;

(ii) The hotel is for the time being approved by the prescribed authority :

NOTE B17

In the case of any multiplex theatre

Nothing shall apply to a multiplex theatre located at a place within the municipal jurisdiction (whether known as a municipality, municipal corporation, notified area committee or a cantonment board or by any other name) of Chennai, Delhi, Mumbai or Kolkata ;

NOTE B18

In the case of any convention centre it can be in any area.

Nature of business	Scientific Research 80(IB)8A	Refining Mineral Oil in various regions. 80(IB)9	Housing Project. Built up area 1500 or less per unit (for metros 1000). Shops < 3 % of aggregate built up area or 5000 Sq feet built up area (whichever is higher). One person maximum one unit allotment. 80(IB)10
Years and amount of Deduction	10-100%	7-100%	100% for approved projects
Initial AY	Year of commencement.	Year of commencement.	Year of commencement.
Begins	01-04-00 To 01-04-07	B20	B21
Additional conditions	A1 to A3	A1 to A3	A1 to A3
Computation exclusive 80IA(5)	Yes	Yes	Yes
Report of Accountant 80IA(7)	Yes	Yes	Yes
Captive consumptions 80IA(8)	M V	M V	M V
Exclusive deduction 80IA(9)	Yes	Yes	Yes
Close connection 80IA(10)	RP	RP	RP
Powers of government 80IA(11)	Yes	Yes	Yes
Amalgamation / demerger 80IA(12)	Friendly	Friendly	Friendly
NOTES	B19	B20	B21

NOTE B19

In the case of any company carrying on scientific research and development, if such company

(i) is registered in India ;
(ii) has its main object the scientific and industrial research and development ;
(iii) is for the time being approved by the prescribed authority
(iv) fulfils such other conditions as may be prescribed ;

NOTE B20

An undertaking shall be fulfils any of the following, namely

(i) Is located in North-Eastern Region and has begun or begins commercial production of mineral oil before the 1st day of April, 1997 ;
(ii) Is located in any part of India and has begun or begins commercial production of mineral oil on or after the 1st day of April, 1997 ;
(iii) Is engaged in refining of mineral oil and begins such refining on or after the 1st day of October, 1998 8but not later than the 31st day of March, 2012.
(iv) Is engaged in commercial production of natural gas in blocks licensed under the VIII Round of bidding for award of exploration contracts (hereafter referred to as "NELP-VIII") under the New Exploration Licencing Policy announced by the Government of India vide Resolution No. O-19018/22/95-ONG.DO.VL, dated 10th February, 1999 and begins commercial production of natural gas on or after the 1st day of April, 2009.
(v) Is engaged in commercial production of natural gas in blocks licensed under the IV Round of bidding for award of exploration contracts for Coal Bed Methane blocks and begins commercial production of natural gas on or after the 1st day of April, 2009.

All blocks licensed under a single contract, which has been awarded under the New Exploration Licencing Policy announced by the Government of India vide Resolution No. O-19018/22/95-ONG.DO.VL, dated 10th February, 1999 or has been awarded in pursuance of any law for the time being in force or has been awarded by Central or a State Government in any other manner, shall be treated as a single "undertaking".

NOTE B21

(a) An undertaking developing and building housing projects (approved)
(b) the project is on the size of a plot of land which has a minimum area of one acre Provided that nothing contained in clause (a) or clause (b) shall apply to a housing project carried out in accordance with a scheme framed by the Central Government or a State Government for reconstruction or redevelopment of existing buildings in areas declared to be slum areas under any law for the time being in force and such scheme is notified by the Board in this behalf ;
(c) the residential unit has a maximum built-up area of one thousand square feet where such residential unit is situated within the cities of Delhi or Mumbai or within twenty-five kilometres from the municipal limits of these cities and one thousand and five hundred square feet at any other place; and

(d) The built-up area of the shops and other commercial establishments included in the housing project does not exceed 3 % of the aggregate built-up area or 5000 sq feet whichever is higher.

(e) Not more than one residential unit in the housing project is allotted to any person not being an individual ; and

(f) In a case where a residential unit in the housing project is allotted to a person being an individual, no other residential unit in such housing project is allotted to any of the following persons, namely

(i) the individual or the spouse or the minor children of such individual,

(ii) the Hindu undivided family in which such individual is the karta,

(iii) any person representing such individual, the spouse or the minor children of such individual or the Hindu undivided family in which such individual is the karta;

Nothing contained in this sub-section shall apply to any undertaking which executes the housing project as a works contract awarded by any person (including the Central or State Government).

Approved by	To be completed by
in a case where a housing project has been approved by the local authority before the 1st day of April, 2004,	on or before the 31st day of March, 2008;
in a case where a housing project has been, or, is approved by the local authority on or after the 1st day of April, 2004 but not later than the 31st day of March, 2005	within four years from the end of the financial year in which the housing project is approved by the local authority;
in a case where a housing project has been approved by the local authority on or after the 1st day of April, 2005,	within five years from the end of the financial year in which the housing project is approved by the local authority.

Nature of business	Preservation, processing and Packaging of Fruits, vegetables or meat, poultry, marine or dairy products 80(IB)11A	Hospital in Rural Area. 100 beds minimum. 80(IB)11B	Hospital in any Area other then excluded area. 100 beds minimum. 80(IB)11C
Years and amount of Deduction	Company 5 – 100% 5 – 30% Any other 5 – 100% 5 – 25%	5-100%	5-100%
Initial AY	Year of commencement.	Year of commencement.	Year of commencement.
Begins	Up to 01-04-01 meat, poultry, marine or dairy products After 01-04-09	01-10-04 To 01-04-08	01-04-08 To 01-04-13
Additional conditions	A1 to A3	A1 to A3	A1 to A3
Computation exclusive 80IA(5)	Yes	Yes	Yes
Report of Accountant 80IA(7)	Yes	Yes	Yes
Captive consumptions 80IA(8)	M V	M V	M V
Exclusive deduction 80IA(9)	Yes	Yes	Yes
Close connection 80IA(10)	RP	RP	RP
Powers of government 80IA(11)	Yes	Yes	Yes
Amalgamation / demerger 80IA(12)	Friendly	Friendly	Friendly
NOTES	B22	B23	B24

NOTE B22

An undertaking deriving profit from the business of processing, preservation and packaging of fruits or vegetables or meat and meat products or poultry or marine or dairy products or from the integrated business of handling, storage and transportation of foodgrains.

This section shall not apply to an undertaking engaged in the business of processing, preservation and packaging of meat or meat products or poultry or marine or dairy products if it begins to operate such business before the 1st day of April, 2009.

NOTE B23

An undertaking deriving profits from the business of operating and maintaining a hospital in a rural area if

(i) such hospital is constructed at any time during the period beginning on the 1st day of October, 2004 and ending on the 31st day of March, 2008 ;

(ii) the hospital has at least one hundred beds for patients ;

(iii) the construction of the hospital is in accordance with the regulations, for the time being in force, of the local authority ; and

(iv) the assessee furnishes along with the return of income, the report of audit in such form and containing such particulars as may be prescribed, and duly signed and verified by an accountant, certifying that the deduction has been correctly claimed.

A hospital shall be deemed to have been constructed on the date on which a completion certificate in respect of such construction, is issued by the concerned local authority.

NOTE B24

An undertaking deriving profits from the business of operating and maintaining a hospital located anywhere in India, other than the excluded area, if—

(i) the hospital is constructed and has started or starts functioning at any time during the period beginning on the 1st day of April, 2008 and ending on the 31st day of March, 2013 ;

(ii) the hospital has at least one hundred beds for patients ;

(iii) the construction of the hospital is in accordance with the regulations or bye-laws of the local authority ; and

(iv) the assessee furnishes along with the return of income, a report of audit in such form and containing such particulars, as may be prescribed, and duly signed and verified by an accountant, certifying that the deduction has been correctly claimed.

(c) "excluded area" shall mean an area comprising—

(i) Greater Mumbai urban agglomeration ;

(ii) Delhi urban agglomeration ;

(iii) Kolkata urban agglomeration ;

(iv) Chennai urban agglomeration ;

(v) Hyderabad urban agglomeration ;

(vi) Bangalore urban agglomeration ;

(vii) Ahmedabad urban agglomeration ;
(viii) District of Faridabad ;
(ix) District of Gurgaon ;
(x) District of Gautam Budh Nagar ;
(xi) District of Ghaziabad ;
(xii) District of Gandhinagar ; and
(xiii) City of Secunderabad ;

The area comprising an urban agglomeration shall be the area included in such urban agglomeration on the basis of the 2001 census.

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Nature of business	Article or thing other then XIII schedule in specified states. 80IC	Article or thing in XIV schedule in specified state. 80IC
Years and amount of Deduction	Sikkim 10 – 100 % HP and Utt 5 – 100% 5 – 25% HP and Utt (companies) 5 – 100% 5 – 30% North Indian States 10 – 100 %	Sikkim 10 – 100 % HP and Utt 5 – 100% 5 – 25% HP and Utt (companies) 5 – 100% 5 – 30% North Indian States 10 – 100 %
Initial AY	Year of commencement.	Year of commencement.
Begins	B51	B52
Additional conditions	A1 & A2 & A4	A1 & A2 & A4
Computation exclusive 80IA(5)	Yes	Yes
Report of Accountant 80IA(7)	Yes	Yes
Captive consumptions 80IA(8)	M V	M V
Exclusive deduction 80IA(9)	Yes	Yes
Close connection 80IA(10)	RP	RP
Powers of government 80IA(11)	Yes	Yes
Amalgamation / demerger 80IA(12)	Friendly	Friendly
NOTES	B51	B52

NOTE B51 AND B52

This section applies to any undertaking or enterprise,

(a) which has begun or begins to manufacture or produce any article or thing, not being any article or thing specified in the Thirteenth Schedule, or which manufactures or produces any article or thing, not being any article or thing specified in the Thirteenth Schedule and undertakes substantial expansion during the period beginning

  (i) on the 23rd day of December, 2002 and ending before the 1st day of April, 2007, in any Export Processing Zone or Integrated Infrastructure Development Centre or Industrial Growth Centre or Industrial Estate or Industrial Park or Software Technology Park or Industrial Area or Theme Park, as notified by the Board in accordance with the scheme framed and notified by the Central Government in this regard, in the State of Sikkim ; or

  (ii) on the 7th day of January, 2003 and ending before the 1st day of April, 2012, in any Export Processing Zone or Integrated Infrastructure Development Centre or Industrial Growth Centre or Industrial Estate or Industrial Park or Software Technology Park or Industrial Area or Theme Park, as notified by the Board in accordance with the scheme framed and notified by the Central Government in this regard, in the State of Himachal Pradesh or the State of Uttaranchal ; or

  (iii) on the 24th day of December, 1997 and ending before the 1st day of April, 2007, in any Export Processing Zone or Integrated Infrastructure Development Centre or Industrial Growth Centre or Industrial Estate or Industrial Park or Software Technology Park or Industrial Area or Theme Park, as notified by the Board in accordance with the scheme framed and notified by the Central Government in this regard, in any of the North-Eastern States ;

(b) which has begun or begins to manufacture or produce any article or thing, specified in the Fourteenth Schedule or commences any operation specified in that Schedule, or which manufactures or produces any article or thing, specified in the Fourteenth Schedule or commences any operation specified in that Schedule and undertakes substantial expansion during the period beginning

  (i) on the 23rd day of December, 2002 and ending before the 1st day of April, 2007, in the State of Sikkim ; or

  (ii) on the 7th day of January, 2003 and ending before the 1st day of April, 2012, in the State of Himachal Pradesh or the State of Uttaranchal ; or

  (iii) on the 24th day of December, 1997 and ending before the 1st day of April, 2007, in any of the North-Eastern States.

Nature of business	Hotels and convention centres in specified areas. Hotels in specified district having world heritage site. 80ID	Certain undertaking in north eastern states. Eligible business with eligible products. 80IE
Years and amount of Deduction	5 – 100 %	10 – 100 %
Initial AY	Year of commencement.	Year of commencement.
Begins	01-04-07 To 01-08-10 World Heritage Site 01-04-08 To 01-04-13	01-04-07 To 01-04-17
Additional conditions	A1 & A2	A1 & A2 & A4
Computation exclusive 80IA(5)	Yes	Yes
Report of Accountant 80IA(7)	Yes	Yes
Captive consumptions 80IA(8)	M V	M V
Exclusive deduction 80IA(9)	Yes	Yes
Close connection 80IA(10)	RP	RP
Powers of government 80IA(11)	Yes	Yes
Amalgamation / demerger 80IA(12)	Friendly	Friendly
NOTES	B61	B62

NOTE 861

This section applies to any undertaking,

(i) engaged in the business of hotel located in the specified area, or

(ii) engaged in the business of building, owning and operating a convention centre, located in the specified area.

(iii) engaged in the business of hotel located in the specified district having a World Heritage Site

(iv) the assessee furnishes along with the return of income, the report of an audit in such form and containing such particulars as may be prescribed, and duly signed and verified by an accountant, certifying that the deduction has been correctly claimed.

In computing the total income of the assessee, no deduction shall be allowed under any other section contained in Chapter VI-A or section 10AA, in relation to the profits and gains of the undertaking.

"convention centre" means a building of a prescribed area comprising of convention halls to be used for the purpose of holding conferences and seminars, being of such size and number and having such other facilities and amenities, as may be prescribed;

"hotel" means a hotel of two-star, three-star or four-star category as classified by the Central Government;

"specified area" means the National Capital Territory of Delhi and the districts of Faridabad, Gurgaon, Gautam Budh Nagar and Ghaziabad.

'specified district having a World Heritage Site' means districts, specified in column (2) of the Table below, of the States, specified in the corresponding entry in column (3) of the said Table :

S. No.	Name of district	Name of State
(1)	(2)	(3)
1.	Agra	Uttar Pradesh
2.	Jalgaon	Maharashtra
3.	Aurangabad	Maharashtra
4.	Kancheepuram	Tamil Nadu
5.	Puri	Orissa
6.	Bharatpur	Rajasthan
7.	Chhatarpur	Madhya Pradesh
8.	Thanjavur	Tamil Nadu
9.	Bellary	Karnataka
10.	South 24 Parganas (excluding areas falling within the Kolkata urban agglomeration on the basis of the 2001 census)	West Bengal
11.	Chamoli	Uttarakhand
12.	Raisen	Madhya Pradesh
13.	Gaya	Bihar
14.	Bhopal	Madhya Pradesh
15.	Panchmahal	Gujarat
16.	Kamrup	Assam
17.	Goalpara	Assam
18.	Nagaon	Assam
19.	North Goa	Goa
20.	South Goa	Goa

21.	Darjeeling	West Bengal
22.	Nilgiri	Tamil Nadu.".

NOTE 862

Any undertaking which has, begun or begins, in any of the North-Eastern States, —

(i) to manufacture or produce any eligible article or thing ;

(ii) to undertake substantial expansion to manufacture or produce any eligible article or thing ;

(iii) to carry on any eligible business.

"North-Eastern States" means the States of Arunachal Pradesh, Assam, Manipur, Meghalaya. Mizoram, Nagaland, Sikkim and Tripura ;

"substantial expansion" means increase in the investment in the plant and machinery by at least twenty-five per cent. of the book value of plant and machinery (before taking depreciation in any year), as on the first day of the previous year in which the substantial expansion is undertaken ;

"eligible article or thing" means the article or thing other than the following :

(a) goods falling under Chapter 24 of the First Schedule to the Central Excise Tariff Act, 1985 (5 of 1986) which pertains to tobacco and manufactured tobacco substitutes ;

(b) pan masala as covered under Chapter 21 of the First Schedule to the Central Excise Tariff Act, 1985 (5 of 1986) ;

(c) plastic carry bags of less than 20 microns as specified by the Ministry of Environment and Forests vide notification number S.O. 705(E), dated the 2nd September, 1999 and S.O. 698(E), dated the 17th June, 2003 ; and

(d) goods falling under Chapter 27 of the First Schedule to the Central Excise Tariff Act, 1985 (5 of 1986), produced by petroleum oil or gas refineries ;

"eligible business" means the business of,

(a) hotel (not below two-star category) ;

(b) adventure and leisure sports including ropeways ;

(c) providing medical and health services in the nature of nursing home with a minimum capacity of twenty-five beds ;

(d) running an old-age home ;

(e) operating vocational training institute for hotel management, catering and food craft, entrepreneurship development, nursing and paramedical, civil aviation related training, fashion designing and industrial training ;

(f) running information technology related training centre ;

(g) manufacturing of information technology hardware ; and

(h) bio-technology.

Nature of business	Collecting and processing of bio-degradable waste 80JJA	
Years and amount of Deduction	5 – 100 %	
Initial AY	Year of commencement.	
Begins	NA	
Additional conditions	No	
Computation exclusive 80IA(5)	No	
Report of Accountant 80IA(7)	No	
Captive consumptions 80IA(8)	NA	
Exclusive deduction 80IA(9)	NA	
Close connection 80IA(10)	NA	
Powers of government 80IA(11)	NA	
Amalgamation / demerger 80IA(12)	NA	
NOTES	B71	

NOTE B71

Any profits and gains derived from the business of collecting and processing or treating of bio-degradable waste for generating power, or producing bio-fertilizers, bio-pesticides or other biological agents or for producing bio-gas or, making pellets or briquettes for fuel or organic manure.

ADDITIONAL CONDITIONS A1
(NOT FORMED BY SPLITTING UP OR RECONSTRUCTION)

This section applies to any industrial undertaking which fulfils all the following conditions, namely

a. it is not formed by splitting up, or the reconstruction, of a business already in existence : (Provided that this condition shall not apply in respect of an industrial undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such industrial undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section)

b. it is not formed by the transfer to a new business of machinery or plant previously used for any purpose ;

c. it manufactures or produces any article or thing, not being any article or thing specified in the list in the Eleventh Schedule, or operates one or more cold storage plant or plants, in any part of India :

ADDITIONAL CONDITIONS A2
(MUST USE NEW PLANT AND MACHINERY)

Any machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose, if the following conditions are fulfilled, namely

(a) such machinery or plant was not, at any time previous to the date of the installation by the assessee, used in India ;

(b) such machinery or plant is imported into India from any country outside India ; and

(c) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of this Act in computing the total income of any person for any period prior to the date of the installation of the machinery or plant by the assessee.

Where in the case of an industrial undertaking, any machinery or plant or any part thereof previously used for any purpose is transferred to a new business and the total value of the machinery or plant or part so transferred does not exceed twenty per cent. of the total value of the machinery or plant used in the business, then, for the purposes section, the condition specified therein shall be deemed to have been complied with.

ADDITIONAL CONDITIONS A3 (NUMBER OF WORKERS TO BE EMPLOYED)

Industrial undertaking manufactures or produces articles or things, the undertaking employs ten or more workers in a manufacturing process carried on with the aid of power, or employs twenty or more workers in a manufacturing process carried on without the aid of power.

ADDITIONAL CONDITIONS A4

In computing the total income of the assessee, no deduction shall be allowed under any other section contained in Chapter VIA or in section 10A or section 10B, in relation to the profits and gains of the undertaking or enterprise.

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THE EIGHTH SCHEDULE

[See section 80-IA(2)(iv)(b)]

LIST OF INDUSTRIALLY BACKWARD STATES
AND UNION TERRITORIES

(1) Arunachal Pradesh
(2) Assam
(3) Goa
(4) Himachal Pradesh
(5) Jammu and Kashmir
(6) Manipur
(7) Meghalaya
(8) Mizoram
(9) Nagaland
(10) Sikkim
(11) Tripura
(12) Andaman and Nicobar Islands
(13) Dadra and Nagar Haveli
(14) Daman and Diu
(15) Lakshadweep
(16) Pondicherry.

THE THIRTEENTH SCHEDULE

[See section 80-IC(2)]

LIST OF ARTICLES OR THINGS

PART A

FOR THE STATE OF SIKKIM

S. No.	Article or thing
1.	Tobacco and tobacco products (including cigarettes, cigars and gutka, etc.)
2.	Aerated branded beverages
3.	Pollution-causing paper and paper products

PART B

FOR THE STATE OF HIMACHAL PRADESH AND THE STATE OF UTTARANCHAL

S. No.	Activity or article or thing	Excise classification	Sub-class under National Industrial Classification (NIC), 1998
1.	Tobacco and tobacco products including cigarettes and pan masala	24.01 to 24.04 and 21.06	1600
2.	Thermal Power Plant (coal/oil based)		40102 or 40103
3.	Coal washeries/dry coal processing		
4.	Inorganic Chemicals excluding medicinal grade oxygen (2804.11), medicinal grade hydrogen peroxide (2847.11), com pressed air (2851.30)	Chapter 28	
5.	Organic chemicals excluding Provitamins/ vitamins, Hormones (29.36), Glycosides (29.39), sugars* (29.40)	Chapter 29	24117
6.	Tanning and dyeing extracts, tannins and their derivatives, dyes, colours, paints and varnishes; putty, fillers and other mastics; inks	Chapter 32	24113 or 24114
7.	Marble and mineral substances not classified elsewhere	25.04 25.05	14106 or 14107
8.	Flour mills/rice mills	11.01	15311
9.	*Foundries using coal*		
10.	Minerals fuels, mineral oils and products of their distillation; bituminous substances : mineral waxes	Chapter 27	
11.	Synthetic rubber products	40.02	24131
12.	Cement clinkers and asbestos, raw including fibre	2502.10, 2503.00	
13.	Explosive (including industrial explosives, detonators and fuses, fireworks, matches, propellant powders, etc.)	36.01 to 36.06	24292
14.	Mineral or chemical fertilizers	31.02 to 31.05	2412
15.	Insecticides, fungicides, herbicides and pesticides (basic manufacture and formulation)	3808.10	24211 or 24219
16.	Fibre glass and articles thereof	70.14	26102
17.	Manufacture of pulp - wood pulp, mechanical or chemical (including dissolving pulp)	47.01	21011

18.	Branded aerated water/soft drinks (non-fruit based)	2201.20, 2202.20	15541 or 15542
19.	Paper	4801	21011 to 21019
	Writing or printing paper, etc	4802.10	
	Paper or paperboard, etc.	4802.20	
	Maplitho paper, etc.	4802.30	
	Newsprint, in rolls or sheets	4801.00	
	Craft paper, etc.	4804.10	
	Sanitary towels, etc.	4818.10	
	Cigarette paper	48.13	
	Grease-proof paper	4806.10	
	Toilet or facial tissue, etc.	4803	
	Paper and paper board, laminated internally with bitumen, tar or asphalt	4807.10	
	Carbon or similar copying paper	4809.10	
	Products consisting of sheets of paper or paperboard, impregnated, coated or covered with plastics, etc.	4811.20	
	Paper and paperboard, coated, impregnated or covered with wax, etc.	4811.40	
20.	Plastics and articles thereof	39.09 to 39.15]	

*Serial No. 5 Reproduction by synthesis not allowed as also downstream industries for sugar.

The following Part C shall be inserted after Part B of the Thirteenth Schedule by the Finance (No. 2) Act, 2004, w.e.f. 1-4-2005 :

PART C
FOR THE STATE OF JAMMU AND KASHMIR

S.No.	Article or thing
1.	Cigarettes/cigars of tobacco, manufactured tobacco and substitutes
2.	Distilled/brewed alcoholic drinks
3.	Aerated branded beverages and their concentrates.

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The Fourteenth Schedule
[See section 80-IC(2)]
List of Articles or things or operations

Part A
For the North-Eastern States

1. Fruit and Vegetable Processing industries manufacturing or producing—
   (i) Canned or bottled products;
   (ii) Aseptic packaged products;
   (iii) Frozen products;
   (iv) De-hydrated products;
   (v) Oleoresins.
2. Meat and Poultry Product industries manufacturing or producing—
   (i) Meat Products (buffalo, sheep, goat and pork);
   (ii) Poultry production;
   (iii) Egg Powder Plant.
3. Cereal Based Product industries manufacturing or producing—
   (i) Maize Milling including starch and its derivatives;
   (ii) Bread, Biscuits, Breakfast Cereal.
4. Food and Beverage industries manufacturing or producing—
   (i) Snacks;
   (ii) Non-alcoholic beverages;
   (iii) Confectionery including chocolate;
   (iv) Pasta products;
   (v) Processed spices, etc.;
   (vi) Processed pulses;
   (vii) Tapioca products.
5. Milk and milk based product industries manufacturing or producing—
   (i) Milk powder;
   (ii) Cheese;
   (iii) Butter/ghee;
   (iv) Infant food;
   (v) Weaning food;
   (vi) Malted milk food.
6. Food packaging industry.
7. Paper products industry.
8. Jute and mesta products industry.
9. Cattle or poultry or fishery feed products industry.
10. Edible Oil processing or vanaspati industry.

11. Processing of essential oils and fragrances industry.
12. Processing and raising of plantation crops - tea, rubber, coffee, coconuts, etc.
13. Gas based Intermediate Products Industry manufacturing or producing—
    (i) Gas exploration and production;
    (ii) Gas distribution and bottling;
    (iii) Power generation;
    (iv) Plastics;
    (v) Yarn raw materials;
    (vi) Fertilizers;
    (vii) Methanol;
    (viii) Formaldehyde and FR resin melamine and MF resin;
    (ix) Methylamine, Hexamethylene tetramine, Ammonium bi-carbonate;
    (x) Nitric Acid and Ammonium Nitrate;
    (xi) Carbon black;
    (xii) Polymer chips.
14. Agro forestry based industry.
15. Horticulture industry.
16. Mineral based industry.
17. Floriculture industry.
18. Agro-based industry.

Part B
For the State of Sikkim

1. Eco-Tourism including Hotels, Resorts, Spa, Amusement Parks and Ropeways.
2. Handicrafts and handlooms.
3. Wool and silk reeling, weaving and processing, print ing, etc.
4. Floriculture
5. Precision Engineering including watch making.
6. Electronics including computronics hardware and software and Information Technology (IT) related industries.
7. Food processing including Agro-based industries. Proc essing, preservation and packaging of fruits and vegetables (excluding conventional grinding/extraction units).
8. Medicinal and aromatic Herbs - Plantation and Processing.
9. Raising and processing of plantation crops, i.e., tea, oranges and cardamom.
10. Mineral based industry.
11. Pharma Products
12. Honey
13. Biotechnology

Part C
For the State of Himachal Pradesh and the State of Uttaranchal

S. No.	Activity or article or thing or operation	4/6 digit excise classification	Sub-class under NIC classification on 1998	ITC (HS) classification 4/6 digit
1.	Floriculture	-	-	0603 or 060120 or 06029020 or 06024000
2.	Medicinal herbs and aromatic herbs, etc., processing	-	-	
3.	Honey	-	-	040900
4.	Horticulture and agro-based industries such as			
	(a) Sauces, ketchup, etc.	21.03	15135 to15137 and 15139	
	(b) Fruit juices and fruit pulp	2202.40		
	(c) Jams, jellies, vegetable juices, puree, pickles, etc.	20.01		
	(d) Preserved fruits and vegetables			
	(e) Processing of fresh fruits and vegetables including packaging			
	(f) Processing, preservation, packaging of mushrooms			
5.	Food Processing Industry excluding those included in the Thirteenth Schedule	19.01 to19.04		
6.	Sugar and its by-products	-	-	17019100
7.	Silk and silk products	50.04 50.05	17116	
8.	Wool and wool products	51.01 to 51.12	17117	
9.	Woven fabrics (Excisable garments)	-	-	6101 to 6117
10.	Sports goods and articles and equipment for general physical exercise and equipment for adventure sports/activities, tourism (to be specified, by notification, by the Central Govern ment)	9506.00		
11.	Paper and paper products excluding those in the Thir teenth Schedule (as per excise classification)			
12.	Pharma products	30.03 to 30.05		
13.	Information and Communication Technology Industry, Computer hardware, Call Centres	84.71	30006/7	
14.	Bottling of mineral water	2201		
15.	Eco-tourism including hotels, resorts, spa, entertain ment/	-	55101	

amusement parks and ropeways
16. Industrial gases (based on atmospheric fraction)
17. Handicrafts
18. Non-timber forest product-based industries.]

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PART L

CLASS WORK QUESTIONS

WEALTH TAX & CLUBBING PROVISIONS

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/-, he is growing food crop like banana and oranges on this land. For the income tax purposes income from sale of bananas and oranges amount to Rs. 85,500 and is considered as exempt u/s 10.
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 08.09.2008 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

1)	He has acquired a Farm House near Delhi out of his funds brought from Japan	12,00,000
2)	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
3)	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
4)	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
5)	Shares in Indian Companies	8,00,000
6)	Cash on Hand.	
	(Represent cash brought by him in India at time of his return to India)	1,25,000
	Conversion rate $1 = Rs. 45	$ 21,500
7)	Cash on Hand. (Rs. 1,25,000 is withdrawn from bank over draft account)	1,36,000

8)	Loan taken on mortgage of Farm House for the purpose of buying shares	1,00,000
9)	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 (Revision Class / Home work)

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 or 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 (Revision Class / Home work)

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 un-built 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. Compute his net wealth.

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 un-built 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	5,96,000		
Total	63,98,000	Total	63,98,000

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?

Question 19

R is aged 45 years. His father settled a property in trust giving whole life interest therein to R. The income from the property for the years 2003-04 to 2006-07 was Rs. 60,000, 64,000, 70,000 and 76,000 respectively. The expenses incurred each year were Rs. 2,000. Rs. 4,000, 5,000 and 6,000 respectively. Calculate the value of life interest of R in the property so settled on the valuation date 31-3-2007 with the help of the factor of 9.267.

Question 20

The net wealth of a firm consisting of three partners A, B and C, having equal share and a capital contribution of Rs. 7,00,000, Rs. 3,00,000 and Rs. 2,00,000 respectively is as under:

(a)	Value of assets located outside India	20,00,000
(b)	Value of assets located in India	50,00,000
(c)	Debts incurred in relation to assets located in India	10,00,000

Compute the value of the interest of each partner in the firm assuming C is non-resident in India.

Question 21

1. X has a hose property in Delhi, which was lying vacant for last 3 years. He constructed the property in 1990 at a cost of Rs. 40 lakh. He has let out the same at a monthly rent of Rs. 30,000 for a period of 3 years with effect from 01-January. The quarterly corporation tax is Rs. 30,000. He took a premium of Rs. 1,20,000 from the tenant and also security deposit of Rs. 1,00,000. The house was constructed on a land measuring 4,000 square feet. It has three floors each measuring 960 square feet. Compute the value of the house property for wealth tax purpose.
2. An association of persons (AOP), consisting two members Y and Z, owns an urban land valued at Rs. 60 lakh on the valuation date. Examine the tax implications under the Wealth-tax Act.

Question 22

Compute the net wealth of X Ltd. (carrying on the business of running cars in hire and also dealing in jeweler) which furnishes the following particulars of its assets and liabilities. (Rs. in crore)

Assets	Book value	valued as per Schedule III
Fixed assets:		
Plant and machinery	10	15
Factory building	25	10
Urban land (450 sq. meters)	40	100
Motor cars	5	10
Investments:		
Jewellery	15	30
Plot of land in Mumbai (480 sq. meters)	10	50
Equity shares in subsidiary companies	20	25
Current assets:		
Inventories (jewellery)	150	150
Sundry debtors	10	10
Cash and bank balances (includes cash balance of Rs. 1,00,000)	5	5
Liabilities		
Current liabilities	40	40
Loans secured on fixed assets (urban land)	30	30

Question 23 (Revision Class / Home work)

X, Y and Z are partners in a firm engaged in the business of running a manufacturing unit in the municipal town of Siliguri having a population of more than 10,000 located in State of West Bengal. Given below is balance sheet of the firm as on March 31,

Liabilities and capital	Rs. (in lakhs)	Rs. (in lakhs)	Assets	Rs. (in lakhs)
Partner's capital:			Urban land	300
			Urban land (construction not allowed)	700
X	300			
Y	400		Factory land	200
Z	300	1,000	Residential house	300
Cash credit from bank (secured by hypothecation of stock and debtors)		100	Plant (WDV)	120
Term loan taken from bank (secured by charge on gold and silver)		1,200	Factory shed	400
Creditors		1,000	Lorry (WDV)	100
Other liabilities		600	Stocks	300
			Gold and silver	800
			Sundry debtors	180
			Advance tax	200
			Cash at banks	300
Total		3,900	Total	3,900

Two urban lands are valued by independent valuer at Rs. 550 and Rs. 50 lakh respectively. The market value of gold and silver on the balance sheet Rs. 1,100 lakh. The value of residential house as per rule 3 of Schedule III is Rs. 350 lakh.

Term loan was taken for purchase of: (a) plant and machinery Rs. 300 lakh; (b) lands the plots are of equal size Rs. 700 lakh. The residential house is occupied by partner X, who looks after the production activity of the firm. Partner Y is a non-resident for Income-tax purposes. The partners share the profits in the ratio of 2:2:1.

Details of personal assets of the partners as on March 31, are as follows:

	(Rs. In Lakhs)		
	X	Y	Z
Shares of companies	40	Nil	Nil
Cash in hand (in India)	Nil	0.75	Nil
Fixed deposit and other deposits with banks	35	32	40
Loan taken for making investment in the firm	30	Nil	Nil
Residential house in Nairobi, Kenya	Nil	400	Nil

You are required to determine the assessable wealth of each partner, stating clearly the reason for inclusion and exclusion of each item.

Question 24

1. X executed a will during his life time. His uncle A was appointed as executor, under the will. X died on June 13, 2009. The executor could complete the distribution of assets after the valuation date March 31, 2010. The wealth-tax records of X reveal that (a) the return of wealth for the valuation date March 31, 2009 has not been filed, (b) wealth-tax demands for the assessment years 2007-08 and 2008-09 are payable. On these facts, A approached you to advise him on his obligations under Wealth-tax Act.
2. In respect of defaults committed under Wealth-tax Act, penalty proceedings are initiated against the deceased prior to his death. Can the Wealth-tax Officer continue the proceedings and levy penalty on the legal representative ?
3. X enters into an agreement on March 13, to sell the house property for Rs. 50 lakh purchased by him for Rs. 20 lakh and receives an advance of Rs. 10 lakh. Further amount of Rs. 15 lakh is received by him on March 22, but the sale deed is executed on April 21 of AY. Whether in the hands of X the house constitutes an asset on the valuation date March 31.

EXEMPTIONS 10A,10B ETC.

Question 1

R Ltd. furnishes the following particulars for the year.

Total sales of the above undertaking	50,00,000
Export sales	40,00,000
Domestic sales	10,00,000
Money brought to India in convertible foreign exchange upto 30-9-AY	36,00,000
Profit from the above undertaking	5,00,000

Compute the deduction available from the total income under section 10A.

Question 2

R & Co., a partnership concern, has established an undertaking for manufacture of computer software in a free trade zone. It furnishes the following particulars of its 2nd year of operations for the previous year:

	Rs.
Total sales of business	1,00,00,000
Export sales	80,00,000
Profit of business	10,00,000

Out of the total export sales, realization of a sale of Rs. 5,00,000 is difficult because of insolvency of buyer. Realisation of rest of the sales has been received in time. The plant and machinery used in the business has been depreciated @ 15% on SLM basis and depreciation of Rs. 3,00,000 is charged in profit & loss account. Compute the taxable income of R & Co.

Question 3

A company is engaged in the development and sale of computer software application. It has started a new undertaking for which approval as a 100% export oriented undertaking has been obtained from the CBDT. It furnishes the following data and requests you to compute the deduction allowable to it under section 10B.

	(Rs. In lacs)
Total profit of the company for the previous year	50
Total turnover i.e. Export, Sales and Domestic Sales for the previous year	500
Consideration received in respect of export of software received in convertible foreign exchange within 6 months of the end of the previous year	250
Sale proceeds credited to a separate account in a bank outside India with the approval of R.B.I.	50
Telecom and insurance charges attributable to export of software	10
Staff costs and travel expenses incurred in foreign exchange to provide technical assistance outside India to a client	40

AGRICULTURAL INCOME

Question 1

X Ltd. grows sugarcane to manufacture sugar. Data is as follows

	Rs.
Cost of cultivation of sugarcane	6
Market value of sugarcane when sugarcane is transferred to factory	9
Other manufacturing cost	6
Sales turnover of sugar	22
Salary of managing director who looks after agriculture as well as non-agricultural operations of the company	2

You are required to find out the agricultural income of the company.

Question 2

For the year, net agricultural income of an assessee is Rs. 86,000 and non-agricultural income is Rs. 12,65,000. The taxpayer contributes Rs. 40,000 towards public provident fund. Find out the tax if the taxpayer is:

(a) X, an individual (22 years)

(b) A Ltd. an Indian company.

CO-OPERATIVE SOCIETY

Question 1

XYZ Consumer Co-operative Society furnishes the following particular of its income in respect of year. You are required to work out the taxable income of the Co-operative Society:

	Rs.	Rs.
Income from business		2,50,000
Interest on deposits with bank		10,000
Dividend on investments:		
-Investments in share of other Co-operative societies	4,000	
-Other investments	4,000	8,000
Income from letting of godowns for storage of commodities		20,000

Give reason for your answer.

Question 2

Calcutta Suburban Co-operative Society is engaged in processing agricultural produce of its members without the aid of power, and its marketing, furnish the following particulars:

(i) Income from processing of agricultural produce Rs. 17,000
(ii) Income from marketing agricultural produce Rs. 3,000
(iii) Dividends from another co-operative society Rs. 55,000
(iv) Income from letting of godowns Rs. 10,000;
(v) Income from agency business Rs. 85,000.

Determine its total income for the year.

Question 3

The total income of a co-operative society (not being a consumers co-operative society) for financial year under various heads is as under:

	Rs.
Banking business	10,000
Income from cottage industry	15,000
Marketing of agricultural produce grown by members	15,000
Income from purchase and sale of agricultural Implements to members	12,000
Profit and gains of business	75,000
Interest and dividend from other co-operative society	12,000
Collective disposal of labour	11,000
Income from house property	50,000

Compute taxable income of the co-operative society

Question 4 (Revision Class / Home work)

PQR Co-operative Bank, a co-operative society, having its area of operation confined to Gubbi Takuk and the principal object of which is to provide for long term credit for agricultural and rural development activities, has received the following amounts during the year:

(i) Interest amounting to Rs. 1,00,000 from its members on loans advanced to them.
(ii) Interest amounting to Rs. 1,50,000 on deposits with other co-operative societies.
(iii) Rent amounting to Rs. 2,00,000 from letting out its godowns for storage of commodities.

PQR Co-operative Bank seeks your advise in the matter of taxability of the above amounts and the eligibility for deduction, if any, in respect thereof.

Question 5 (Revision Class / Home work)

Samode Food Processing co-operative Society engaged in processing without the aid of power of the agricultural produce of its members, in carrying out activities of marketing of agricultural produce, in agency business and others, furnishes the following particulars of its income for the year.

	Rs.
Income from processing of the produce of members	50,000
Income from marketing activities	30,000
Income from letting of building used as godowns	96,000
Dividend from another Co-operative Society	45,000
Collective disposal of Labour of its members	25,000
Income from agency business	75,000
Interest on deposits from another Cooperative Society	15,000

Compute the income chargeable to tax.

POLITICAL PARTY AND ELECTORAL TRUST

Question 1

The books of account maintained by a National Political Party registered with Election Commissioner for the year disclose the following receipts:

	Rs.
Rent of property let out to a departmental store at Chennai	6,00,000
Interest on deposits other than Banks	5,00,000
Contributions from 100 persons (who have secreted their names) of Rs. 21,000 each	21,00,000
Contribution @ Rs. 11 each from 1,00,000 members in cash	11,00,000
Net profit of Cafeteria run in the premises at Delhi	3,00,000

Compute the total income of the political party, with reasons for inclusion or otherwise.

Question 2

Electoral Trust invests the donations received by it in say Bank FDR, then the interest from such investment is not exempt under section 13B and shall not be taxable, is the view of trust. You are required to offer your comments for the same.

Donations received by Electoral Trust	Rs.10,00,00,000
Interest earned by Electoral Trust	Rs. 40,00,000

You are required to answer the tax consequence if the trust distributes 9,50,00,000 or 9,00,00,000 to political parties.

BUSINESS INCOME

Problem 1 (Section 33AB Tea Development account) (Business ID 02)

R Ltd. is engaged in the business of growing and manufacturing tea in India. For the previous year ending on 31-3-2010 its composite business profits before allowing deduction u/s 33AB are Rs. 60,00,000. On 1-9-2010 it deposited a sum of Rs. 11,00,000 in the Tea Development Account. During the previous year 2008-09 R Ltd. has incurred a business loss of Rs. 14,00,000 which has been carried forward. on 25-1-2011, it withdraws Rs. 10 lakh which is utilised as under:

Rs. 6,00,000 for purchase of non-depreciable asset as per the scheme specified.

Rs. 3,00,000 for purpose other than specified in the scheme.

Rs. 1,00,000 was spent for the purpose of scheme on 5-4-2011.

a) Compute the business income of R Ltd. for assessment year 2010-11.
b) What are the tax consequences of money misutilised/not utilised?
c) What will be the consequence if the asset which was purchased for Rs. 6,00,000 is sold for Rs. 8,00,000 in April, 2011.

Problem 2 (Section 35 Scientific research) (Business ID 03)

R purchased an asset for scientific research for Rs. 15,00,000 in the previous year 2004-05. During the previous year, the said asset is ceased to be used for scientific research.

The following information is also submitted to you:

	Rs.
Profit from business before depreciation	5,00,000
Written down value of block of assets 15% as on 1-4-2010	10,00,000

The scientific research asset if used for business shall be eligible for depreciation @ 15%.

Compute the total income if the scientific research asset is sold for Rs. 25,00,000 assuming:

a) It is sold without using for business;
b) It is sold after using for business.

Problem 3 (Section 35 Scientific research) (Business ID 04)

Business income of R Ltd. before allowing expenditure on scientific research for the previous year 2010-11 is Rs. 2,50,000. The company has incurred the following expenditure on scientific research during the previous year.

	Rs.
Revenue expenditure on Scientific Research	2,60,000
Capital expenditure on Scientific Research	5,00,000

Compute the deduction available on account of Scientific Research assuming the company does not have any other income.

Problem 4 (Section 35ABB Telecom Rights) (Business ID 05)

R Ltd. obtained a licence to operate telecommunication services from Department of Telecommunication on 5-6-2010 for a period of 11 years i.e. till 4-6-2021 for a sum of Rs. 13,20,000. Calculate the amount of deduction available to the company under section 35ABB for the various previous year assuming:-

a) The payment of the entire licence fee is made on the date of acquisition of the licence;
b) Rs. 4,00,000 was paid on the date of acquisition, Rs. 2,50,000 was paid on 15-10-2010 and balance Rs. 6,60,000 will be paid in two equal installments of Rs. 3,30,000 each during previous year 2011-12 and 2012-13.

Problem 5 (Section 35ABB Telecom Rights) (Business ID 06)

How would you treat the following:
Licence acquired for Rs. 24 lakhs on 1-4-2008 for 12 years
WDV as on 1-4-2010 Rs. 20 lakh
Part of licence sold for Rs. 12 lakh

Problem 6 (Section 35ABB Telecom Rights) (Business ID 07)

A licence for operating telecommunication service was acquired on 1-4-2010 by R Ltd. for 18,00,000. The licence was to remain in force for 12 years and payment of entire 18,00,000 was made in the previous year 2010-11. The assessee sold the entire licence on 17-12-2012 for:

a) Rs. 12,00,000
b) Rs. 17,80,000
c) Rs. 20,00,000

How will the above transaction of sale be treated under Income Tax ?

Problem 7 (Section 35AD Specified business) (Business ID 08)

R ltd. constructed a building and started operating a hotel of 3 star category w.e.f. 1-4-2010. The company incurred the following expenditure in this connection.

1.	Capital expenditure (including cost of land Rs. 50 lakhs) incurred during December, 2009 to March 2010 which were capitalized in the books of accounts 31-3-2010.	Rs. 1,10,00,000
2.	Capital expenditure incurred during previous year 2010-11 (it includes Rs. 20 lakhs paid for Goodwill)	Rs. 1,40,00,000

Compute the deduction available under section 35AD in the assessment year 2011-12

Question 01 (Business ID 01)

On April 1, X Ltd. commences the operation of a warehousing facility in Andhra Pradesh for storage of agricultural produce. The following information is available from the records of company –

expenses are capitalized of preceding year	
Purchase of land for warehouse	50,00,000
Construction cost of warehouse	8,00,000
Purchase of know-how for warehouse	10,00,000
Salary to staff	78,000

Expenses incurred during previous year	
Construction cost of warehouse	60,00,000
Purchase of old plant and machinery (from domestic market)	2,00,000
Purchase of old plant and machinery (from Germany)	4,00,000
Purchase of new plant and machinery	9,00,000
Purchase of goodwill	3,50,000

Profit and loss account for the year

Depreciation of building	3,40,000	Amount collected (from persons using warehouse)	78,00,000
Depreciation of machinery	3,50,000		
Cost of know-how (amount written off)	10,00,000		
Other operating expenses	7,51,000		
Donation to a political party	10,000		
Net profit	53,49,000		
	78,00,000		78,00,000

Out of other operating expenses, a payment of Rs. 40,000 is made in cash. Other operating expenses are deductible under section 37. Find out the taxable income of X Ltd. on the assumption that X Ltd. has the following income from other sources – income from the business of commission agency: Rs. 20,15,000 (computed under the provisions of the income – tax Act) and dividend from a foreign company in Australia : Rs. 50,000. (TDS in Australia Rs. 10,000)

Problem 8 (Section 35D Amortisation of Expense) (Business ID 09)

a) Compute the deduction allowable under section 35D on the basis of the following information submitted to you.

	Rs.
Preliminary expenses incurred	2,40,000
Cost of project	40,00,000

b) What will be your answer if the above preliminary expense have been incurred by R Ltd. & the capital employed is Rs. 46,00,000.

Problem 9 (Section 36 Other Deductions) (Business ID 10)

For the previous year 2010-11, the business income of R ltd. before allowing expenditure on family planning is Rs. 2,00,000. The company had incurred the following expenditure on family planning amongst its employees during the previous year 2010-11:

(i) Revenue expenses on family planning Rs. 1,10,000

(ii) Capital expenditure on family planning Rs. 6,00,000

Compute the deduction available for expenditure on family planning to the company assuming the company has income from other sources amounting to Rs. 20,000.

Problem 10 (Section 36 Other Deductions) (Business ID 11)

XY Ltd., a public financial institution, is eligible for claiming deduction under section 36(1)(viia). Its business income (before claiming this deduction) for the previous year is Rs. 160 lakh. Provision for bad and doubtful debts account has an opening balance of Rs. 1 lakh. XY Ltd. wants to write off Rs. 14 lakh during year on account of bad debts. Compute the amount of deduction under section 36(1)(vii) / (viia). What are the formalities the taxpayer is required to complete ?

Problem 11 (Section 36 Other Deductions) (Business ID 12)

X Ltd. is a financial corporation for the purpose of section 36(1)(viii). Income of the taxpayer for the previous year from different sources is as follows-

		In lakh
a.	From providing long-term finance for industrial/agricultural development or	1120
b.	Business income from other sources	105

Compute the amount of deduction under section 36(1)(viii) for the assessment year taking into consideration the following data

1. Paid-up capital and general reserve on March 31,: Rs. 610 lakh.
2. Opening Balance standing to the credit of special reserve account: Rs. 1,050, lakh (and the same was allowed as deduction in the earlier years).
3. Amount transferred to special reserve account is Rs. 220 lakh.

Will your answer be different if, X Ltd. withdraws the following amount from the special reserve account

a. Rs. 55 lakh on May 10, AY; and
b. Rs. 20 lakh on June 10, AY

CAPITAL GAINS

Question 2 (specific computations, Part Performance) (Capital Gains ID 02)
R owns a plot of land acquired on 1-6-1994 for a consideration of Rs. 2 lakhs. He enters into an agreement to sell the property on 15-3-PY for a consideration of Rs. 5 lakhs. In part performance of the contract, he handed over the possession of land on 21-3-PY on which date he received the full consideration. As on 31-3-PY, the sale was not registered. Discuss the liability to capital gain. Computation need not be made.

Question 3 (specific computations, Insurance monies) (Capital Gains ID 03)
A manufacturing company was transporting two of its machines from unit 'A' to unit 'B' (which is at a distance of 100 miles) on 1-9-PY by a truck. On account of a civil disturbance, both the machines were damaged. The insurance company paid Rs. 5 lakhs for the damaged machineries. On these facts, for submitting the return of income for the previous year, your advice is sought as to:

(i) Whether the damage of machines result in any transfer ?
(ii) How the amount received from the insurance company are to be treated for taxability ?
(iii) Would there be any impact on the written down value of the block of plant and machinery ?

Discuss these points in your answer and give your valuable opinion.

Question 4 (specific computations, partnership firms) (Capital Gains ID 04)
A firm consisting of four partners was dissolved consequent to the death of one of the partners. The remaining partners reconstituted the firm immediately, without discontinuance of the business, and carried on the business as before. The inventory of stocks on the date of dissolution was valued at cost, which was lower than the market value and all other assets were valued at book value, for the purpose of transfer to the reconstituted firm. The Assessing Officer, while arriving at the total income of the firm as constituted prior to dissolution, valued the stocks as well as the other assets at market value. You are required to comment on the correctness of the Assessing Officer's action.

Question 5 (specific computations, partnership firms) (Capital Gains ID 05)
A firm RGS had an immovable property purchased out of the firm's funds for Rs. 6,00,000. On 31-3-2001, the property was divided among the partners equally by making entries in the capital accounts of the partners. The property was subsequently sold on 1-7-PY for Rs. 9,00,000. The Assessing Officer assessed the resultant capital gain in the hands of the firm. Discuss the validity of the order of the Assessing Officer.

Question 6 (specific computations, DE-mat of shares) (Capital Gains ID 06)
Discuss the following: R furnishes the following information:

No. of shares	Month and year of purchase	Shares dematted month and year
1,000	March 1992	July, 1999
500	March 1995	-
1,000	December 1996	October 1998

He sold 1,500 shares in January out of the dematted shares. He seeks your advice as to the taxability towards capital gains.

Question 7 (specific computations, compulsory acquisition) (Capital Gains ID 07)
R Ltd., a public limited company, engaged in the generation and distribution of power had its business acquired by the Government in June, 2003. Certain items of plant and machinery used by the company in its business were taken over by the Government at a price which resulted in the company realizing a surplus of Rs. 26,60,000 over its written down value. The compensation was received by the company in April, which was accepted by it under protest. The company proceeded to initiate arbitration proceedings under law and was granted an additional compensation Rs. 16 lakhs. This was decided by the arbitrators in December and received by the company in March.
The company claims that the assessment of the company to tax should not be made since the business was completely taken over by the Government in June, 2003 and at the time of final determination of compensation in March, the company did not exist. Do you agree to the company's claim ? Discuss with reference to the assessment year(s) to which the claim to tax, if any, can be related.

Question 8 (specific computations, compulsory acquisition) (Capital Gains ID 08)
A plot of land purchased 5 years back by Ram Janki trust was acquired by Government of India for construction of an over-bridge in Mumbai. The compensation awarded by Revenue Authorities was at Rs. 5,00,000. The trust preferred an appeal against the order for increase in the compensation awarded to it. The appellate authority increased the compensation by further Rs. 4 lakhs in August, 2009 but the amount was actually received in April, 2010. You are required to compute the capital gains, if any, arising to the trust in respect of additional compensation by it and state the year of its taxability.

Question 9 (specific computations) (Capital Gains ID 09)
R acquires 10,000 equity shares of R Ltd., listed in stock exchanges in India and abroad and a constituent of BSE 500 on 15-3-2003 @ Rs. 2.250 per share. He transfers the shares at Rs. 5,000 per share on 31-12-PY. The brokerage and securities transactions tax deducted were at 0.5% and 0.1% respectively. Examine the liability of R to income tax. Will your answer be different, if instead of selling the shares in the market R privately transferred the shares to his son at the same price ?

Question 10 (specific computations) (Capital Gains ID 10)
Discuss the following:

1. R entered into an agreement with G for the purchase of a property of Rs. 10 lakhs and paid Rs. 10,000 as earnest money. On G failing to execute a conveyance in respect of the property, a suit for specific performance was filed by R. the suit was comprised and R agreed to receive

Rs. 50,000 by way of damages and gave up his right to specific performance. What will be the position of this amount under the Income-tax Act.

2. An assessee acquired 1,000 shares of R Ltd. at Rs. 100 per share on 1-4-1975. The company issued bonus shares in the ratio of 1:1 in April 1984 and a further issue in the ratio of 1:2 in April 1988. The assessee sold in June-PY the bonus shares allotted to him in April 1988 at Rs. 175 per share. The market value of the shares as on 1-4-1981 is Rs. 250 per share. What is the capital gain assessable in the hands of the assessee?

Question 11 (specific computations) (Capital Gains ID 11)

R was allotted 3,000 equity shares of a widely held company on 1-3-2009 of the value of Rs. 10 each. R gifted 2,000 shares to his son G on 30-11-PY on which day the share is quoted at Rs. 50. G disposed of 1,000 shares at Rs. 80 per share on 15-3-PY. What are the consequences of the transaction in the hands of G ? Discuss.

Question 12 (specific computations, company in liquidation) (Capital Gains ID 12)

R Private Ltd. went into liquidation on 1-6-PY. The company was seized and possessed of the following funds prior to the distribution of assets to the shareholders:

	Rs.
Share capital	5,00,000
Reserves prior to 1-6-2009	3,00,000
Excess realization in the course of liquidation	5,00,000
Total	13,00,000

There are 5 shareholders, each of whom received Rs. 2,60,000 from the liquidation in full settlement. The shareholders desire to invest the resultant element of capital gains in long-term specified assets as defined in section 54EC. You are required to examine the various issues and advice the shareholders about their liability to income-tax.

Question 13 (specific computations, company in liquidation) (Capital Gains ID 13)

R had purchased 5,000 equity shares in M/s. Kamat & Co. Ltd. at the rate of Rs. 2 per share (on 16-4-1985). M/s. Kamat & Co. Ltd. goes into liquidation on 30-6-PY. The Balance Sheet of the company as on the date of liquidation stood as under:

	Rs.		Rs.
50,000 equity shares	5,00,000	10,000 debentures in Patel & Co. Ltd. (Cost Rs. 10,00,000)	30,00,000
Accumulated profits	30,00,000	Cash in hand	5,00,000
	35,00,000		35,00,000

On liquidation tax, the assets are distributed to the shareholders. In the process, on 30-6-PY, R gets 1,000 debentures (market value Rs. 3,00,000) and Rs. 50,000 in cash. He transfers the entire debentures on 10-3-PY for Rs. 3,20,000. Indicate the tax consequences of these transactions.

Question 14 (specific computations, advance money) (Capital Gains ID 14)
R entered into an agreement with G for the sale of his property and received earnest money of Rs. 1,00,000 on 1-4-PY. The balance of Rs. 4,00,000 was to be paid within 3 months, failing to which R was entitled to a compensation of Rs. 50,000. The earnest money was also liable to be forfeited. G defaulted in the payment of the business within the time specified and, therefore, the earnest money was forfeited. A suit was also filed for breach of contract and Rs. 50,000 was awarded, which was received on 24-3-PY. Discuss the nature of the two receipts from the point of view of liability to tax.

Question 15 (specific computations, advance money) (Capital Gains ID 15)
R received a house in may, 1996 by way of Gift from Mr. G who had purchased the same in April, 1979 for Rs. 12,00,000. The cost of improvements incurred by G were Rs. 2,55,000 in March, 1980 and Rs. 3,40,000 in November, 1988. The fair market value of the house as on 1-4-1981 was Rs. 9,14,000. Before this house was gifted to R, G had received an advance of Rs. 3,00,000 in March, 1996 towards sale of this house from S but the sale did not materialize and the advance was forfeited by G. the house was sold by R in March-PY for Rs. 48,00,000. Ascertain the capital gains chargeable to tax.

Question 16 (Not regarded as transfer) (Capital Gains ID 16)
An individual was the sole proprietor of a business. His net investment in the business, on 31-3-PY, was Rs. 20 lakhs represented by:

	Rs.	Rs.
Fixed assets		18,00,000
Current assets		10,00,000
		28,00,000
Current liabilities	5,00,000	
Loans	3,00,000	8,00,000
		20,00,000

Finding himself unable to carry on business by himself and also to attract additional capital, he formed a private limited company in April-PY with an authorized capital of Rs. 1 crore. At the time of formation of the company, A and his wife had subscribed to 100 equity shares each-fully paid in cash on 10-6-PY. A transfers his individual business in entirely, as going concern, to the private limited company for Rs. 40 lakhs for issue of shares in the following manner:

Preference Shares:	
Wholly to Mrs. A and her sister Mrs. G (in joint names)	1,50,000 Shares
Equity Shares:	
Mr. A	1,30,000 Shares
Mr. C, major son of A	20,000 Shares
Mr. D, friend of A	30,000 Shares
Mrs. E, a married sister of A	20,000 Shares
Mr. F, husband of Mrs. E	50,000 Shares

The shares of the face value of Rs. 10 each are to be issued fully paid up. No other purchase consideration for the transfer of the business to the company was due.

Required:

(i) Ascertain whether in A's hands any tax liability will be due; if so, also indicate the assessment year relevant for this.

(ii) If, on 10-5-AY, A sold 10,000 equity shares allotted to him, at Rs. 50 per share, to a friend, what will be the consequences ?

Question 17 (Not regarded as transfer) (Capital Gains ID 17)

R held 2,000 shares in G Ltd. This company amalgamated with another company during the previous year. Under the scheme of amalgamation, R was allotted 1,000 shares in the new company. The market value of shares so allotted is higher by Rs. 50,000 than the value of holding in G Ltd. The Assessing Officer proposes to treat the transaction as an exchange and to tax Rs. 50,000 as capital gain. Is he justified ? Discuss.

Question (stamp duty) (Capital Gains ID 01)

X owns a piece of land situated in Noida (date of acquisition: March 1, 1983, cost of acquisition: Rs. 19,291, value adopted by Stamp duty authority at the time of purchase: Rs. 45,000). On March 30, the piece of land is transferred for Rs. 4 lakh.

1. The value adopted by Stamp duty authority is Rs. 5.5 lakh. X does not dispute it.
2. The value adopted by the Stamp duty authority is Rs. 5.75 lakh. X files an appeal under the Stamp Act and Stamp duty valuation has been reduced to Rs. 4.90 lakh by the Allahabad High Court.
3. The value adopted by the Stamp duty authority is Rs. 5.60 lakh. X does not challenge it under the Stamp Act However, he claims before the Assessing officer that Rs. 5.60 lakh is more than the fair market value of the land. The Assessing Officer referred it to the Valuation Officer who determines Rs. 5.25 lakh as fair market value.
4. In situation (3), suppose the value adopted by the Valuation Officer is rs. 6.10 lakh.

Question 18 (stamp duty) (Capital Gains ID 18)

A piece of land owned by Mr. Mishra located on Jaipur-Delhi highway was acquired by NHAI in the F.Y. 2006-07, but the award ordered in F.Y. 2007-08 was paid in the previous year. This land was purchased by him on 2-4-1977 for Rs. 1,000. The fair market value of the land on 1-4-1981 was Rs. 900. Compensation paid was Rs. 5,00,000.

The other piece of land located in Chennai purchased in April 2005 for Rs. 25,00,000 was also sold by him in February-PY for Rs. 35,00,000, but sale deed therefore could not be executed by 31-3-PY. The value for the purpose of stamp duty applied by the stamp valuation authority was Rs. 38,00,000.

Compute the income chargeable to tax arising as a result of these transactions.

Question 19 (stamp duty) (Capital Gains ID 19)

'X', purchased on 18-6-1982, house property for Rs. 2,25,000 which was sold to A on 18-10-PY for Rs. 8,75,000. The sub-registrar, at the time of registration of sale deed, charged stamp duty on Rs. 13,50,000 which was paid by the buyer. The Assessing Officer while assessing for capital gain referred the matter to the valuation officer who determined the value of property at Rs. 15,00,000 on the date of transfer. X seeks your advice on the following:

(i) Is the Assessing Officer correct to charge capital gain on the value of Rs. 15,00,000 as determined by valuation officer?

(ii) The amount of capital gain on which 'X' is required to pay capital gains tax.

Question 20 (slump sale) (Capital Gains ID 20)

Your client, A Ltd. has two industrial undertakings-one engaged in production of audio music CDs and cassettes and the other engaged in production of video CDs. As a restructuring drive, the company has decided to sell its undertaking producing video CDs as a going concern by way of slump sale for Rs. 450 lakhs to new company called T Ltd., in which it holds 75% equity shares. The balance sheet of A ltd. as on 31-3-PY reads as follows: (Rs. In lakhs)

	Audio Unit	Video Unit
Fixed assets	150	225
Debtors	150	112.5
Inventories	75	37.5
Liabilities	42	75
Paid up share capital	Rs. 378 lakhs	
General Reserve	Rs. 222 lakhs	
Share premium	Rs. 33 lakhs	
Revaluation Reserve	Rs. 140 lakhs	

The company set up the video unit on 1-4-2005. The written down value of the block of assets for tax purposes as on 31-3-PY is Rs. 200 lakhs of which Rs. 85 lakhs are attributable to video unit.

(i) Determine the capital gains which would arise to A Ltd. from slump sale;

(ii) Suggest modification of the restructuring plan of A Ltd. without changing the amount of consideration so as to make it more tax efficient.

Question 21 (slump sale) (Capital Gains ID 21) (Revision Class / Home work)

Axel Ltd. has two industrial undertakings. Unit-I is engaged in the production of television sets and Unit-II is engaged in the production of refrigerators. The company has, as part of its restructuring program, decided to sell Unit-II as a going concern by way of slump sale for Rs. 260 lacs to a new company called Gamma Ltd., in which it holds 85% equity shares. The following is the extract of the balance sheet of Axel Ltd. as on 31-3-PY:

		Rs. In lacs
	Unit-1	Unit-II
Fixed Assets	112	158
Debtors	88	67
Inventories	60	23
Liabilities	33	45
Paid-up share capital Rs. 231 lacs		
General Reserve Rs. 160 lacs		
Share Premium Rs. 39 lacs		
Revaluation Reserve Rs. 105 lacs		

The company set up Unit-II on 1-4-2006. The written down value of the block of assets for tax purpose as on 31-3-PY is Rs. 150 lacs of which Rs. 60 lacs are attributable of Unit-II. Determine what would be the capital gains of Axel. Ltd. on account of Slump sale.

Question 22 (exemptions) (Capital Gains ID 22)

V, an individual, owned three residential houses which were let out. Besides, he and his four brothers co-owned a residential house in equal shares. He sold one residential house owned by him during the previous year. Within a month from the date of such sale, the four brothers executed a release deed in respect to their shares in the co-owned residential house in favour of V for a monetary consideration. V utilized the entire long-term capital gain arising out of the sale of the residential house for payment of the said consideration to his four brothers. V is not using the house, in respect of which his brothers executed a release deed, for his own residential purposes, but has let it out to another person, who is using it for his residential purposes. Is V eligible for exemption under section 54 of the Income-tax Act, 1961 in respect of the long-term capital gain arising from the sale of his residential house, which he utilized for acquiring the shares of his brothers in the co-owned residential house ? Will the ownership of two more houses by him or the date of sale of the residential house and non-use of the new house for his own residential purposes disentitle him to exemption ?

Question 23 (exemptions) (Capital Gains ID 23)

R owns a residential house which is self-occupied and also a house plot. He sells the house on 31-1-PY and the house plot on 15-2-PY for Rs. 12,00,000 and Rs. 7,00,000 respectively. The house was purchased on 15-1-1995 for Rs. 4,00,000 and the plot on 30-5-1995 for Rs. 2,00,000. R has purchased a new residential house on 25-4-PY for Rs. 10,00,000. Compute the income chargeable under the head 'Capital gains'.

Question 24 (exemptions) (Capital Gains ID 24)

X Ltd. located within the corporation limits decided in December-PY to shift its industrial undertaking to non-urban area. The company sold some of the assets and acquired new assets in the process of shifting. The relevant details are as follows:

					(Rs. In lakhs)
	Particulars	Land	Bldg.	P/M	Fur.
(i)	Sale proceeds (Sale effected in March,-PY)	8	18	16	3
(ii)	Indexed cost acquisition	4	10	12	2
(iii)	Cost of acquisition in terms of section 50	1	4	5	2
(iv)	Cost of new assets purchased in July-PY for the purpose of business in the new place	4	7	17	2

Compute the capital gains of R Ltd.

Question 25 (exemptions) (Capital Gains ID 25)

R is a member of a Hindu undivided family which owned a house for the purpose of residence. There was a partial partition of the family and instead of selling property to an outsider, the property was allotted to R for a consideration of Rs. 5 lakhs. Release deeds were accordingly executed in favour of R by the other members of the family. R had also his individual property which he sold during the

same previous year, thereby making a capital gain of Rs. 5 lakhs, which he wants to set off against the consideration fixed for the family property. Discuss the impact of these arrangements on the assessments of the family and R.

Question 26 (exemptions) (Capital Gains ID 26)
R was the owner of two residential houses. On 2-4-PY he disposed one of the house and utilized the entire sale proceeds to construct first floor on his second house which he completed by 15-3-PY. He seeks your advice as to the taxability of transaction to capital gains under the provisions of Income-tax Act, 1961. Discuss.

Question 27 (exemptions) (Capital Gains ID 27)
X has acquired a residential house property in Delhi on April 1, 2000 for Rs. 10,00,000 and decided to sell the same on May 3, 2003 to Ms. P and an advance of Rs. 25,000 was taken from her. The balance money was not paid by Ms. P and X has forfeited the entire advance sum. On June 3, 2010, he has sold this house to Y for Rs. 35,00,000. In the meantime on April 4, 2010, he had purchased a residential house in Delhi for Rs. 8,00,000, where he was staying with his family on rent for the last 5 years and paid the full amount as per the purchase agreement. However, X does not possess any legal title till March 31, 2011, as such transfer was not registered with the registration authority.
X has purchased another old house in Chennai on October 14, 2010, from Z, an Indian resident by paying Rs. 5,00,000 and purchase was registered with the appropriate authority.
Determine the taxable capital gain arising from above transactions in the hands of X for the assessment year 2011-12.

Question 28 (exemptions) (Capital Gains ID 28)
Mrs. X, resident woman, transfers a house property on January 16, 2011. On the said transaction she earns a long-term capital gain of Rs. 1,01,50,000. She invests a sum of Rs. 50,00,000 in capital gains bonds specified in section 54EC on March 5, 2011. She further invests a sum of Rs. 50,00,000 in the same bonds on May 5, 2011. Her other income for the financial year 2010-11 is Rs. 46,000. Compute the tax payable by her for the assessment year 2011-12

Question 29 (exemptions) (Capital Gains ID 29)
XY & CO., a partnership firm, transfers a piece of land situated in Thane district on August 17, 2010 for Rs. 50 lakh. The land purchased on March 6, 1980 for Rs. 1 lakh got registered on April 3, 1983 on payment of stamp duty of Rs. 20,000. Expenses on land development and construction of boundary wall incurred in August 1983 were of Rs. 1,50,000. The charges for the transfer of land paid to the broker were 2.5% of the sale consideration. Fair market value of the land as on April 1, 1981 was Rs. 1,50,000. The firm invested Rs. 20 lakh on December 1, 2010 in the bonds issued by National Highways Authority of India redeemable after a period of 48 months. Compute the amount of capital gain chargeable to tax for the assessment year 2011-12. Also give in brief the reasons and the provisions of the Act for each of the items dealt with.

Question 30 (Legal Updates) (Capital Gains ID 30)
X had taken a loan under registered mortgage deed dated July 16, 2008 against the house which was purchased by him on March 26, 2982 for Rs. 5 lakh. The said property is inherited by his son A during July 2010 under Will who for obtaining a clear title thereof has paid the outstanding amount of loan on February 12, 2011 of Rs. 15 lakh. The said house property is sold by A on March 16, 2011

for Rs. 50 lakh. State with reasons the amount chargeable to capital gains for the assessment year 2011-12.

DIVIDEND TAX

Question (ID 01)

A Domestic Company's Total Income was determined at a loss of Rs.20 Lakhs for the year. It has distributed the following dividends to its shareholders in respect of the previous year. The Paid-up Capital of the Company on the date was Rs.50 Lakhs

(a) Interim Dividend at 10% on 31.10.PY
(b) Bonus Shares in the ratio 1:10 on 30.6.PY
(c) Final Dividend at 10% on 31.8.PY

What are the tax consequences of such distribution in the hands of the Company ?

Question (ID 02)

Suman Ltd is a Company incorporated in India. The Balance Sheet of the Company discloses the following position -

Liabilities	Rs.	Assets	Rs.
Preference Capital	2,00,000	Fixed Assets	5,00,000
Equity Share Capital		Investment in Shares	2,00,000
-Issued for Cash 4,00,000		Market Value (7,00,000)	
-Bonus Issued in 1995 - 2,00,000	6,00,000	Other Assets	7,00,000
General Reserve	2,00,000		
Profit and Loss A/c			
-Opening balance 1,40,000			
-Profit for year 60,000	2,00,000		
Provision for Taxation	1,30,000		
Current Liabilities	70,000		
Total	14,00,000	Total	14,00,000

The Company distributes the entire investment in share in species to its shareholders pro rata. Is 'X' a holder of 10% of the Equity Share Capital liable to tax on his receipt ? If so, what is the amount liable to tax ?

Question (ID 03)

X Ltd. gives the following information for the year:

1. Net profit as per Profit and Loss Account for the financial year 2008 to 2010 Rs. 33,00,000 was included in General Reserve.
2. On 1.8.PY, the company issues its redeemable bonus shares to its preference shareholder for Rs. 9,09,000.
3. A shareholder holding 10% equity shares of the company borrowed Rs. 3,00,000 from the company @ 18% p.a. on 31.8.AY.
4. The company declared dividend of Rs. 14,00,000 at its annual general meeting held on 30.9.PY. But the dividend remained unpaid up to 31.3.PY.

Compute the tax liability of the company under section 115-O (tax on distributed profits).

MAT / BUSINESS INCOME

Question 01 (ID 01) (Revision Class / Home work)

The profits as per P&L A/c of M/s. PQR Ltd. are Rs. 50 crores. You are requested to compute the tax liability of the company under section 115-JB after taking into consideration the following information:

(1) Provision for Income Tax: Current Tax Rs. 10 crores and Deferred Tax Rs. 5 crores;
(2) Fringe Benefit Tax: Paid Rs. 1.5 crores; Provision Rs. 0.5 crores;
(3) The company had acquired shares of a listed company for Rs. 6 crores on 1st of January three years back, which it had sold for Rs. 10 crores on 31st of January. The Securities Transaction Tax on purchase and sale of shares was 0.075 % and 0.1 % respectively. The gains arising from such sale were credited directly to Investment Reserve A/c.
(4) The following extract of Balance Sheet is furnished (Rs. crores):

Fixed Assets as on 1-4	100
Add: Increase on account of Revaluation	200
Total	300
Less: Depreciation @ 10%	30
Fixed Assets as on 31-3	270

The company has credited Rs. 15 crores out of Revaluation Reserve to the Profit & Loss A/c.

Question (ID 05)

Fun India Limited has a carried forward credit of Rs. 2 lakh under section 115 JAA(3A) of the Income-tax Act from one year back. In the previous year, the company's total income and "book profit" under section 115JB are Rs.5 lakh and Rs. 8 lakh respectively. Compute the tax payable by the company and the amount to be carried forward under section 115JAA.

Question 02 (ID 02) (Revision Class / Home work)

A domestic company, ABC Ltd., has an undertaking newly established for export of computer software in a free trade zone, the profits of which have been merged in the net profit of the company as per Profit and Loss Account prepared in accordance with the provisions of Parts II and HI of Schedule VI to the Companies Act. It furnishes the following particulars in respect of Assessment and seeks your opinion on the application of section 115JB. You are also required to compute the total income and tax payable by the company:

	lakhs
(1) Net profit as per P & L A/c as per Schedule VI	200
(2) Profit and Loss A/c includes:	
(a) Credits: Dividend income	20
Excess realised on sale of land held as Investment	30
Net profit for export of Computer software	100
(b) Debits: Depreciation on straight line method basis	100
Provision for losses of subsidiary company	60
(3) Depreciation allowable as per I.T. Act and Rules	150
(4) Capital Gains as computed under I.T. Ac	40
(5) Losses brought forward as per books of account:	
Business loss	50
Unabsorbed depreciation	60

The company has represented to you that the excess realised on sale of land cannot form part of the book profit for purposes of sec. 115JB. You will have to deal with this issue.

Question 03 (ID 03) (Revision Class / Home work)

The net profit for the year of India biotech Ltd. Engaged in the business of bio – technology works out at Rs. 45 lacs after debit / credit of the following items :

i) Profit of Rs. 2,50,000 from a hedging contract entered into for meeting out the loss in foreign currency payments towards an imported machinery of Rs. 80 lacs installed on 1.2.

ii) Incidental charges of Rs. 20 lacs paid to a financial institution for taking short – term loan of Rs. 25 crores repayable in 18 months.

iii) Commission of Rs. 25,000 paid to a recovery agent for getting realization of an old outstanding.

iv) Registration fees of Rs. 20,000 and listing fees of Rs. .30,000 paid to the Registrar of Companies and the Stock Exchange respectively on the issue of bonus shares.

v) Amount of Rs. 1,00,000 towards carry forward losses for Asst. Year 2003-04 of X Ltd., which got merged with the company during the financial year 2007-2008.

vi) Interest received from banks of Rs. 90,000 net of TDS of Rs. 10,000.

vii) Amount of Rs. 1,50,000 incurred towards reconditioning of generator.

viii) Employees share to the EPF for the month of March, of Rs. 40,000. The amount was deposited with the PF Commissioner on 22-04-AY.

Compute the total income of the company and given brief reasons for the treatment given to each of the items.

Question 04 (ID 04)

Netherlands oil Corporation is a Foreign Company engaged in the exploration of Oil and Gas in all countries including India. In respect of its Indian Business, the company has prepared the Profit and Loss Account in accordance with Part II and III of Schedule VI to the Companies Act, 1956 and such Profit and Loss Account for the previous year shows a Net Profit of Rs. 65 lakhs. The Net profit from activities in all other countries stands at Rs. 550 lakhs. The company informs that while arriving at the Net Profit as indicated above in respect of Indian business, the following debits / credits have been made in its Profit and loss Account.

	Credits to the Profit and Loss Account	Rs. In Lakhs
(i)	Net agricultural income in India	16
(ii)	Share of Profits from a firm engaged in business in India	15
(iii)	Amount withdrawn from Reserve created during 2003-2004 (book Profit was not increased by the amount transferred to such reserve in the year 2003-2004)	3
(iv)	Profits from an Industrial Undertaking covered and qualified for deduction under section 10B of Income – tax Act, 1961	30
(v)	Profits from an Industrial undertaking covered and qualified under section 80-1C (in the state of Sikkim) of Income – tax Act, 1961	6

	Debits to the Profit and Loss Account	Rs.(in lakhs)
(i)	Expenditure relating to 10 B undertaking	12
(ii)	Depreciation for current year under Companies Act, 1956	24
(iii)	Interest to Financial Institutions not paid up to the date of filing the return	6
(iv)	Penalty for infraction of law	1
(v)	Proposed Dividend	3
(vi)	Provision for taxation 1 (Income-tax) + RBD 1	2
(vii)	Transfer to General Reserve	5
(vii)	Provision for Unascertained liabilities	2
(ix)	Expenditure relating to 80-IC undertaking (in the state of Sikkim)	5

The following additional information is also provided:

Particulars	Rs. (lakhs)
Brought forward Book Loss	12
Depreciation allowable under Income-tax rules	30
Brought forward Business Loss and unabsorbed depreciation as per Income-tax law (Loss Rs. 7 lakhs and Depreciation Rs. 10 lakhs)	17

You are requested to compute the total tax liability of the company.

Question (ID 06)

R Ltd., a closely held Indian company, is engaged in the business of manufacture of paints in India. A profit or loss account for the year is given below: [Rs. (in lakhs)]

Salary and wages	7.50	Sales	48.00
Postage and Telegrams	0.40	General Reserve	3.00
Travelling and Conveyance	0.50		
Depreciation	5.00		
Income-tax	4.00		
Wealth-tax	0.10		
Excise duty due	1.00		
Provisions for future losses	0.60		
Proposed dividend	0.80		
Loss of subsidiary company	0.50		
Audit fee	0.25		
Director remuneration	8.00		
Deferred tax liability	1.35		
Net profit	21.00		
Total	51.00	Total	51.00

Additional information

1. The excise duty due on 31-3-PY was paid on 2-12-AY
2. Custom duty of Rs. 1,20,000 which was due 3 years back was paid during the financial year.
3. Depreciation as per income tax is Rs. 11.43 lakhs.
4. The company wants of set off the following losses/allowances:

	For tax purposes	For accounting purposes
Brought forward loss of 2 years back	12,00,000	10,00,000
Unabsorbed depreciation 5 years back	3,00,000	3,00,000

Compute the total income of the assessee and the tax liability.

Question (ID 07)

The accounts of a public company have been prepared in accordance with provisions of Parts II and III of Schedule VI to the Companies Act and its Profit and Loss Account laid before the Annual General Meeting for the previous year shows a net profit of Rs. 15 lakhs. The following information relevant for the purpose of computing its assessable income has been extracted from a scrutiny of the Profit and Loss Account:

	Credits in Profit and Loss Account	
(1)	Profit from a new industrial undertaking qualifying for deduction under section 80-IA (Net)	17,00,000
(2)	Profits from a new industrial undertaking qualifying for deduction under section 10A (Gross)	10,00,000
(3)	Long-term capital gains	3,00,000

	Debits in Profit and Loss Account	
(1)	Expenditure relating to industrial undertaking qualifying for deduction under section 10A	7,00,000
(2)	Depreciation relating to 2008-09 brought forward	10,00,000
(3)	Business loss relating to 2008-09 brought forward	12,00,000
(4)	Current year's depreciation	10,00,000
(5)	Penalty for infraction of law	1,00,000
(6)	Provision of Sales-tax	3,00,000
(7)	Dividend proposed	2,00,000

Depreciation admissible under the Income-tax Act and Rules for the previous year is Rs. 19,50,000. The capital gain has been invested in specified assets under section 54EC. Sales tax provided in the accounts has been remitted before the due date. There is no loss or unabsorbed depreciation to be carried forward and adjusted as per income-tax assessment.

You are required to compute the total tax liability of the company.

Question (ID 08) (Revision Class / Home work)

R Ltd. is a closely held company engaged in manufacture of insecticides and fertilizers. The value of plant and machinery owned by the company is Rs. 55 lakhs. Its profits and loss account for the year is as under :

Domestic sales	22,23,900	
Export sales	5,76,100	
Other receipts	2,00,000	30,00,000
Less: Expenses		
Depreciation	4,16,000	
Salary and wages	1,34,500	
Entertainment expenses	10,000	
Travelling expenses	36,000	
Miscellaneous expenses	5,000	
Income-tax	3,50,000	
Wealth-tax	8,000	
Outstanding customs duty	17,500	
Provision for unascertained liabilities	70,000	
Proposed dividends	60,000	
Loss of subsidiary company	30,000	
Consultation fees paid to a tax consultant	21,000	
Salary and perquisites of managing director	1,80,000	
Excise duty of 2007-08	75,500	14,13,500
Net profit		15,86,500

The assessee claims the following as deductions:

(a) Deduction under section 80-IB (30% of Rs. 15,86,500).

(b) Excise duty pertaining to three years back paid during the year Rs. 75,500.

(c) Depreciation under section 32 is Rs. 5,36,000.

The following further particulars are furnished.

	For tax purposes	For accounting purposes
Brought forward loss of 3 years back	11,80,000	9,10,000
Unabsorbed depreciation	Nil	2,45,000

Question (ID 09)

Kalpesh Sanghavi was a director in a private company floated by, his brother. He resigned from directorship of the company with effect from 31-3-PY. For the year, tax and interest were found due against the company. As the departmental authorities could not recover the outstanding dues from the company, proceedings were initiated against Kalpesh Sanghavi under section 179(1). His salary from his employer, Punjab Roadways was attached in month of August. Subsequently, the company filed a revision petition for the stay against recovery proceedings. Can the recovery proceedings against Kalpesh Sanghavi be stayed ?

OR

In respect of the taxes due from a private limited company, which could not be recovered from it, the Tax Recovery Officer attached the properties of an erstwhile director for recovery thereof. It was contended by the director that notice under section 156 had not been served on him and, therefore, the proceedings for recovery were not valid. What is the correct legal position?

OR

'A' was a director of a Private Company floated by his brother. He resigned on 31st March. Tax and interest was due from the Company. Proceedings were initiated against 'A'. His salary was attached. Company filed a revision petition for stay of recovery against the company. Can recovery against 'A' be stayed?

Question (ID 10)

X,Y and Z carried on a business of running hotels in partnership firm from April 1, 2000 to March 31, 2007. In order to increase its scale of operation and meet its fund requirement, the firm decided to carry on its business through corporate route. For that purpose, a company under the name and style XYZ Hospitality (P.) Ltd. Was formed on April 1, 2008 and the business of the partnership firm as a whole was succeeded by the company with effect from June1, 2008. The company's profit and loss account for the year shows a net profit of Rs. 450 lakh after debit/credit of the following items-

1. Interest of Rs. 3 lakh paid to Allahabad Bank on a term loan taken for the purpose of acquiring a land a Bhubaneswar for a new hotel to be set up.
2. Depreciation charged: Rs. 40 lakh.
3. Rs. 2 lakh credited on account of waiver of dues obtained from a supplier of the erstwhile firm against supply of certain materials.
4. Rs. 1.18 lakh being the aggregate of amounts paid in cash to D, a transport contractor, as follows-

Date of payment	Rs. In lakh
June 5,	0.15
July 20,	0.21
September 20,	0.22
November 3,	0.26
November 5,	0.36

Tax was not deducted at source as D submitted a certificate under section 197(1), which he had obtained from TDS circle of the Income-tax Department.

5. Rs. 50,000 being proportionate part of the cost of animals (purchased and kept for entertainment of the guests of hotel), is debited in the profit and loss account as amortization of expenditure as per the accounting policy of the company.
6. Rs. 10,000 is credited on account of sale proceeds of carcass of animal which died during the year.
7. Provision for bad and doubtful debts: Rs. 12 lakh
8. Payment of Rs. 25 lakh to some employees as compensation for voluntary retirement, as per scheme.
9. Foreign exchange fluctuation loss (net) amounting to Rs. 30 lakh arising from restatement of the year end liabilities to foreign suppliers of provisions and beverages as per the requirement of AS-11 of ICAI.

Other information-

1. Depreciation as per the Income-tax Act: Rs. 65 lakh.
2. Cost of animal died as referred to in (6) above was Rs. 2 lakh.
3. Debt of Rs. 4 lakh due from one corporate customer for three months has been written off during the year after giving few reminders by debiting provision for bad and doubtful debts account.
4. The erstwhile firm was allowed exemption of Rs. 50 lakh under section 47(xiii) in respect of long-term capital assets transferred to the company.
5. The company's voting rights till 01-04-PY were held as follows:

X	40 percent
Y	30 percent
Z	15 percent
Others	15 percent

During the year, shares constituting 36 percent voting rights are transferred by X to his son-in-law, E.

6. Unabsorbed business loss and unabsorbed depreciation of Rs. 10 lakh each have been carried forward from 9 years back.
7. The company has subsidiary company, PQR Ltd. (a closely held company). During the year the company obtains a temporary loan of Rs. 12 lakh from its subsidiary company. Accumulated profit of the subsidiary company is Rs. 30 lakh at the time of payment of the loan. The loan is repaid by the company before the end of the year.

Compute total income of XYZ (P.) Ltd. indicating reason for treatment of each of the items. Ignore the provisions relating to the minimum alternate tax.

Question (ID 11)

Explain in brief, the treatment as to their taxability and or allowability, in the following cases-

1. A Ltd., an investment company receives dividend income of Rs. 1,00,000 on its investment in shares. It incurs interest expenditure of Rs. 2,00,000 on the borrowed capital utilized in the investment of shares.

2. B Ltd. is a company engaged in the business of financing and investment in shares. It suffers loss in an amount of Rs. 3,00,000 on account of futures and options, a transaction in the form of derivatives in which the underlying asset was shares.
3. C Ltd., which does not have any active business carried on by it, incurs capital expenditure on scientific research amounting to Rs. 5,00,000 that relates to its subsidiary companies.

Question (ID 12)

The trading and profit and loss account of X (P.) Ltd. having business of agricultural produce, consumer items and other products for the year is as under:

Trading Account			
Opening stock	3,75,000	Sales	1,55,50,000
Purchases	1,25,75,000	Closing stock	4,50,000
Freight and cartage	1,26,000		
Gross profit	29,24,000		
	1,60,00,000		1,60,00,000

Profit & Loss Account			
Bonus to staff	47,500	Gross profit	29,24,000
Rent of premises	53,500	Income-tax refund	20,000
Advertisement	5,000	Warehousing charges	15,00,000
Bad Debts	75,000		
Interest on Loans	1,63,500		
Depreciation	75,500		
Sales-tax demand paid	1,08,350		
Misc. expenses	5,25,650		
Net profit	33,90,000		
	44,44,000		44,44,000

On scrutiny of records the following further information and details were extracted/gathered-

1. There was a survey under section 133A on the business premises on March 31, in which it was revealed that the value of opening stock was Rs. 8,75,000 and sales of Rs. 75,000 made on March 31, was not recorded in the books. The value of closing stock after considering these facts and on the basis of inventory prepared in the department, worked out at Rs. 12,50,000, which was accepted to be correct and not disputed.
2. Income-tax refund includes a sum of Rs. 4,570 of interest allowed thereon.

3. Bonus to staff includes a sum of Rs. 7,500 paid in the month of December, which was provided in the books 2 years back.
4. Rent of premises includes an amount of Rs. 5,500 incurred on repairs. The assessee was under no obligation to incur such expenses as per rent agreement.
5. Advertisement expenses include an amount of Rs. 2,500 paid for advertisement published in the souvenir issued by a political party.
6. Miscellaneous expenses include:
   a. Rs. 15,000 paid towards penalty for non-fulfillment of delivery conditions of a contract of sale for the reason beyond control.
   b. Rs. 1,00,000 spent on a notified scheme meant for the uplift of residents of Mid Himalayan Region,
   c. Rs. 1,00,000 paid to the wife of a director, who is working as junior lawyer for taking an opinion on a disputed matter. The senior advocate of Supreme Court had charged only Rs. 25,000 for the same opinion.
   d. Rs. 1,00,000 paid to an Electoral Trust.
7. Sales-tax demand paid includes an amount of Rs. 5,300 charged as penalty for delayed filing of returns and Rs. 12,750 towards interest for delays in deposit of tax.
8. The company had made an investment of Rs. 25 lakh on the construction of a warehouse in rural area for the purpose of storage of agricultural produce. This was made available for use from September 15, and the income from this activity is credited in the profit and loss account under the head of warehousing charges.
9. Depreciation under the Income-tax Act works out Rs. 65,000.
10. Interest on loans includes an amount of Rs. 20,000 on which tax at source was not deducted.

Compute the income chargeable to tax of X (P.) Ltd. Support your answer with working notes.

PARTNERSHIP FIRMS

Question (ID 026 001)

X and Y are equal partners in a firm carrying on some business. The firm failed to comply with the provisions of section 184. Compute the total income of the firm. The profit and the loss account of the firm is as follows:

Selling and administrative expenses (Rs. 30,000 paid in cash)		1,05,000	Gross profit		3,00,000
Interest to partners :			Miscellaneous receipts		10,000
Y		20,000			
Remuneration to partners :					
X	70,000				
Y	70,000	1,40,000			
Net profit					
X	22,500				
Y	22,500	45,000			
TOTAL		3,10,000	TOTAL		3,10,000

Question (ID 026 006)

Section 40(b) a firm comprising of four Partners A,B,C and D carrying on business in partnership, sharing profits and losses equally shows a profit of Rs.1,00,000 in its books after deduction of the following amounts for the year —

a. Remuneration to partner A, who is not actively engaged in business	48,000
b. Remuneration to partner B and C actively engaged in business	
Partner B	60,000
Partner C	72,000
c. Interest on partner D on loan of Rs. 2,25,000	36,000

The deed of partnership provides for the payment of above remuneration and interest to partners. You are required to work out the taxable income of the firm as well as partners.

Question (ID 01)

A partnership firm, consisting of three partners A,Band C was engaged in the business of Civil Construction and received the following amounts by way of contract receipts:

Contract work for supply of labour	30,00,000
Value of materials supplies by Government	8,00,000
Total value of contract	38,00,000

Each partner of the firm was entitled to draw rs. 2,500 by way of salary as authorized by the terms of the partnership deed. Interest of Rs. 1,00,000 was also paid to partner C on the capital of Rs. 5,00,000 contributed by him. The profit as per books of accounts, before deduction of salary to partners and interest C amounted to Rs. 2,50,000. Compute the total income of the firm, applying the provisions of section 44AD.

Question (ID 04)

Patel & Co., is a partnership firm consisting of three partners, Mr. Patel, Mr. Malhotra and Mr. Anand, sharing profit and losses in ratio of 3:2:3. The firm was doing business in manufacture of electrical appliances. The Profit loss account of the firm was under:

Particulars		Rs.	Particulars	Rs.
Purchases		7,50,000	Sales	16,70,000
salary to staff		3,00,000	Long-term capital gains	4,90,000
Interest to Partners:			Debenture Interest	40,000
- Patel	30,000		Miscellaneous business receipts	4,000
- Malhotra	2,20,000		Interest on drawings recovered from Mr. Patel	16,000
- Anand	70,000	3,20,000		
Depreciation		1,80,000		
Remuneration to partners				
- Patel	1,02,000			
- Malhotra	60,000			
- Anand	72,000	2,34,000		
Miscellaneous expenses		1,80,000		
Net profit				
- Patel	96,000			
- Malhotra	64,000			
- Anand	96,000	2,56,000		
		22,20,000		22,20,000

The following further details are furnished:

(1) The firm has completed all the formalities to be considered as a partnership assessed as such.
(2) The firm satisfies all the conditions of Sec. 80-IA but is not found to be eligible for deduction.
(3) The partnership deed was amended on 1st April, 2007 providing remuneration and interest to partners as under:

	Remuneration	Interest on capital
Mr . Patel (Working partner)	Rs. 8,500 p.m.	20% simple interest
Mr. Malhotra (Sleeping partner)	Rs. 5,000 p.m.	24% simple interest
Mr. Anand (Working partner)	Rs. 6,000 p.m.	20% simple interest

(4) Depreciation eligible under the Income-tax Act works to Rs. 96,000.
(5) Under Miscellaneous expense Rs. 82,000 are inadmissible expenses, out of which Rs. 60,000 were donations given to an approved charitable trust.
(6) For the assessment years 2006-2007 and 2007-2008, the firm was assessed on a business loss of Rs. 40,000 and long term capital loss of Rs. 10,000.
(7) Partnership deed contains clause for the allowance of partners remuneration and interest as per the provisions of income tax act.

Compute the total income of the firm and the tax payable by it.

Question (ID 07)

M/s HIG, a firm, consisting of three partners namely H , I and G, carried on the business of purchase and sale of television sets in wholesale and manufacture and sale of pens under a deed of partnership executed on 1-4-2004. H, I and G were partners in their individual capacity. The deed of partnership provided for payment of salary amounting to Rs 2,00,000 each to H and G who were the working partners. A new deed of partnership was executed on 1-10-PY which, apart from providing for payment of simple interest @ 12% p.a on the balance standing to the credit of the capital accounts of partners from 1-4-PY. The firm was dissolved on 31-3-PY and the capital asset of the firm were distributed among the partners on 20-4-AY. The net profit of the firm for the year after payments of salary to the working partners and debit /credit of the following items to the profit and loss account was 1,50,000.

(i)	Interest amounting to Rs 1,00,000 paid to the partners on the balances standing to the credit of their capital accounts from 1-4-PY to 31-3-PY
(ii)	Interest amounting to Rs 50,000 paid to the partners on the balance standing to the credit of their accounts from 1-4-PY to 31-3-PY
(iii)	Interest amounting to Rs 20,000 paid to the Hindu undivided family of partner H @18% p.a.
(iv)	Payment of Rs 25,000 towards purchase of television sets made by crossed cheque on 1-11-PY.
(v)	Rs. 30,000 being the value of gold jewelry received as gift from a manufacturer for achieving sales target.

(vi)	Depreciation amounting to Rs 15,000 on motor car bought and used exclusively for business purpose, but not registered in the name of the firm.
(vii)	Depreciation under section 32(1) (ii) amounting to Rs 37,500 of new machinery bought and installed for manufacture of pens on 1-11-PY at a cost of Rs 5,00,000. There was no increase in the installed capacity as a result of the installation of the new machinery.
(viii)	Interest amounting to Rs 25,000 received from bank on fixed deposits made out of surplus funds.

The firm furnishes the following information relating to it:

(a)	Closing stock –in-trade was valued at Rs 60,000 as per the method of lower of cost or market rate consistently followed by it. The market value of the closing stock-in-trade was Rs 65,000.
(b)	Brought forward business loss of 3 years back Rs 50,000.
(c)	The fair market value of the capital assets as on 31-3-PY was Rs 20,00,000 and the cost of their acquisition was Rs 15,00,000.

Compute the total income of M/s HIG. You are required to furnish explanations for treatment of the various items given above.

Question (ID 08) (Revision Class / Home work)

X, Y and HUF of Z (represented by Z) are partners with equal shares in profits and losses of a firm, ABC, which is engaged in the production of TV serials and tele-films. Two years back, one partner A retired, but his dues have been settled in the previous year.

The earlier partnership deed did not authorize payment of remuneration or interest to partners. The partnership deed was revised by the partners on June 1, to authorize payment of remuneration of Rs. 1 lakh per month to each working partner and simple interest at 15 percent per annum to X and Y on their capital. X, Y and Z are actively associated with the affairs of the firm. The profit and loss account of the firm for the year ending March 31, shows a net profit of Rs. 10 lakh after debiting/crediting the following:

1. Interest amounting to Rs. 15 lakh paid to X and Y on the balances standing to their capital accounts from April 1, to March 31,
2. Remuneration to the partners including partner in representative capacity Rs. 30 lakh.
3. Interest amounting to Rs. 2 lakh paid to Z on loan provided by him in his individual capacity at the rate of 16 percent per annum.
4. Royalty of Rs. 5 lakh paid to partner X, who is a professional scriptwriter, for use of his scripts as per an agreement between the firm and X.
5. Two separate payments of Rs. 18,000 and Rs. 15,000 made in cash on February 7, to P, a hair dresser against his bill for services rendered in January, and two payments of Rs. 19,000 and Rs. 10,000 made in cash on February 7, and February 8, respectively to Q, assistant cameraman against her bill for services provided in January.
6. Amount of Rs. 5 lakh provided in the books on March 31, as liability for remuneration to S, a film artist and a non-resident. Tax deducted at source under section 195 from the amount so credited was paid on June 3 AY.

7. Amount of Rs. 6 lakh provided as gratuity for the year on the basis of actuarial valuation. Gratuity paid to retired employees in Rs. 1.50 lakh.
8. Interest of Rs. 1.20 lakh received on income tax refund under section 244(1A) in respect of two years back.

The firm has also provided the following additional information:

The amount due to A, the former partner was Rs. 15 lakh. The dues were settled on September 30, by transferring a plot of land purchased two years back having a book value of Rs. 10 lakh. The difference of Rs. 5 lakh was credited to the partners' capital accounts in their profit sharing ratio. The fair market value of the plot on the date of transfer was Rs. 16 lakh.

Compute total income of the firm stating the reasons for treatment of each item.

A O P

Question (ID 05)

Two individuals A & B and one foreign company X Ltd. who are sharing profits and losses in the ratio of 2:2:1 are members of an AOP. The total income of AOP has been determined at Rs. 2,00,000. The separate income of members of AOP was s under.

A	90,000
B	1,10,000
X Ltd. (a foreign company)	Nil

1. Compute the tax leviable on the income of AOP.
2. What will be your answer if instead of X Ltd., C (an individual) had been the member of AOP

Question (ID 03)

(a) Prakash , a member in two AOPs, namely, "AOP & Co." and "Prakash & Akash", provides the following details of his income:
   (a) "AOP & Co", assessed at normal rates of tax, had credited in his account, amount of Rs. 96,000 as salary and Rs. 20,000 as share of profit and 96,000 as interest.
   (b) A house property located at Jaipur was purchased on 1.7.2001 with the borrowed capital in "Prakash & Akash" jointly shared equally and occupied by both of them for self residential purposes. Total interest paid for the year on the borrowed capital was Rs. 1,00,000.

Compute the income and the tax liability thereon and support your answer with brief reasons and the provisions of the Act.

Question (ID 026 019)

X, Y, and Z are three members of B & Co. (an AOP). Profit and loss account of the firm for the year ending is as follows:

Cost of goods sold	1,34,000	Sales	4,00,000
Interest to the members :		Short term capital gain	2,10,000
X	9,000	Interest on drawings recovered from members	
Y	27,000	X	2,000
Z	35,000	Y	1,000
Salary to members		Z	3,000
Y	65,000		
Z	70,000		

Other expenses	60,000		
Net profit	2,16,000		
Total	6,16,000	Total	6,16,000

Other information:

1. The AOP gives a donation of Rs.46,000 to a public charitable trust (not debited to P & L Account) which is eligible for section 80G deduction.

2. Out of other expenses, Rs.26,000 is not deductible by virtue of section 43B.

Find out the tax liability of the AOP and members under the following situations:

Situation 1- The profit sharing ratio of X, Y and Z is 2 : 3 : 5. Other incomes of members are given below:

	Amount	Nature of income	Investment sections 80C and 80U	PPF contribution
X	130,000	Bank interest	Rs. 6,000 mediclaim	14,000
Y	106,000	Interest on Government securities	------	16,000
Z	25,000	Interest on company deposit	Rs.3,000 mediclaim	28,000

Situation 2: The profit sharing ratio of X, Y and Z is 3 : 1: 6. Other incomes of members are given below:

	Amount of income	Donation	PPF deposit
X	1,30,000	6,000	2,000
Y	1,06,000	26,000	36,000
Z	2,25,000	15,000	6,000

Situation 3: One of the members X is a closely – held foreign company and the profit- sharing ratio of X. Ltd. Y and Z is 2 : 3 : 5. Other income of the members is as follows:

X. Ltd. (foreign company)	Nil
Y	32,000
Z	40,000

Situation 4- From the available information, it is not possible to find out the profit-sharing ratio. Other income of members is:

	Amount	Nature of income
X	40,000	Bank interest
Y	60,000	Rent (taxable)

Z	8,65,000	Interest on company deposit
Z	15,000	Being 60% share from D & Co.(an AOP which has not paid tax because its taxable income is lower than Rs.50,000)

Situation 5: It is not possible to determine the profit-sharing ratio of members. One of the members, X is closely held foreign company. Other income of members is as follows:

X Ltd.	1,17,000
Y	3,60,000
Z	9,30,000

Question (ID 06)

The profit and loss account of the AOP viz. M/s R and S, sharing profit and losses in the ratio of 2:1 for the previous year is as follows:

Cost of goods sold	42,45,000	Sales	51,00,000
Remuneration of member R	1,80,000	Dividends	25,000
Remuneration of member S	1,20,000	Long-term capital gain	4,40,000
Remuneration to employees	2,70,000		
Interest to R	48,000		
Interest to S	36,000		
Other expenses	1,60,000		
Sales tax outstanding	30,000		
Net Profit	4,76,000		
	55,65,000		55,65,000

Additional information is given below:

(1)	Other expenses include the following:
(i)	Entertainment expenses Rs. 40,000
(ii)	Watches costing of Rs. 2,500 each given to 12 dealers who exceed the sales target fixed under sales promotion scheme.
(iii)	Employer's contribution to provident fund included in other expenses, amounting to Rs. 6,000 was paid by cheque on 15-11-AY.
(iv)	Rs. 30,000 paid in cash to an advertising agency.
(2)	Outstanding sales tax was paid on 3-9-PY
(3)	Other incomes of R and S 9,64,000 and 1,56,000

You are required to compute.

(i) Total income of the AOP
(ii) Tax liability of the AOP
(iii) Tax liability of the members

NON RESIDENTS

Question (ID 08)

Mar. Ravi citizen of India and a non-resident purchased the Savings Certificate issued by the Central Government from out of Dollars remitted from USA on 11.07 on which the interest for the year was Rs. 3 lakhs.

Question (ID 09) (Deemed to accrue or arise in India)

Thomo, a South Korean company, a non-resident under the Income-tax Act, 1961, had the following receipts of royalty during the previous year. Indicate whether these will be taxable in India. Give reasons for your answer :

a) Rs. 1,50,000 from the Government of India under an agreement approved by the governments of South Korea and India.
b) Rs. 70,000 from an Indian company for import of technical know-how for use in business in India.
c) Rs. 86,000 from an Indian organization for import of drawings for use in its business in Singapore and Malaysia.
d) Rs. 50,000 from X, a non-resident under the Indian income-tax law, for use of a formula for a business at NOIDA (UP).
e) Rs. 92,000 from X, an Indian non-resident, for use of drawings and technical know-how, for a business in U.K.

Question (ID 10) (Deemed to accrue or arise in India)

Joel Ltd., a foreign company, owns a property in Mumbai. It is given on rent (rent being 5,000 US dollar per month) to Peter Ltd., another foreign company. The two companies are non-residents in India. The agreement is made outside India. Rent is payable in foreign currency outside India. As per agreement, rent is accrued outside India. Discuss whether the rental income of Joel Ltd. is chargeable to tax in India under the Income-tax Act, 1961.

Question (ID 11) (Representative assessee)

A Firm of solicitors in Delhi engaged a barrister of London for arguing a case before the Supreme Court in India. A payment of $ 50,000 was made to the barrister in London, according to the terms of the professional engagement. It is claimed that since the payment is made outside India, no tax is payable on the fee paid. How should the Assessing Officer proceed in this matter?

Question (ID 12) (Representative assessee)

A Non-Resident Company purchases goods in India for the purpose of export and thereby earns profit. Examine the tax consequence of the above transaction.

XY Pvt Ltd a Company having registered head office in Singapore for the first time had carried out operations during year of purchase of goods in India on four occasions. Immediately after the purchase the Company exported the same to China. The total value of such exports was Rs.100

Lakhs on which it earned profits of Rs. 20 Lakhs before the expenses of Rs. 12 Lakhs, which were directly paid by HO. Company seeks your advice to its liability to tax in India.

Question (ID 13) (Deemed to accrue or arise in India)

A foreign Company having no Indian citizen / resident of India as shareholder, has shot a TV film entirely on India locations. The film is to be telecast exclusively in the foreign countries. But it has also agreed with the Government of India to give the right of telecast in India, free of charge. Discuss, giving reasons whether the above transaction will give rise to income which will be deemed to accrue or arise in India.

Question: (ID 14) (Representative assessee)

X Co. Ltd is the Indian subsidiary of an American Company manufacturing and selling copier machines. The Indian Company among other things purchases and sells these copier machines also. Does any part of the profits on the sales of American Company to the Indian Company accrue or arise in India? Discuss.

Question: (ID 15) (Deemed to accrue or arise in India)

R, a non resident and not an Indian citizen, holds 5000 equity shares in X Ltd., an Indian Company. The share certificates are lying with R, in UK where he normally resides. R sold these shares to G by handing over to G in UK, the duly executed share transfer form and the relevant share certificates. The purchase consideration is received in UK in sterling currency.

Discuss giving reasons whether the above transaction will give rise to income which will be deemed to accrue or arise in India.

Question: (ID 16) (Deemed to accrue or arise in India)

X, a non-resident lent Rs.5 Lakhs to Y, a resident in India. Y used the money borrowed by him for purposes of business in India. Y paid an interest of Rs. 75,000 during the year ended 31st March to X in the United Kingdom. Discuss the tax liability of such interest in the hands of X in India.

Question: (ID 17)

A Foreign Company has entered into an agreement with an Indian Company on 1.6.PY under which industrial equipment belonging to the firm has been leased to the latter on lump sum payment of $50,000. How will the lease rent be taxed in the hands of the Foreign Company ?

Question: (ID 18)

Bharat Mines Ltd., an Indian Company, entered into an agreement with British Mines Ltd., a Company registered in the United Kingdom for rendering technical services in India for exploration and extraction of ores. The consideration fixed was $5,00,000 and was arrived at as follows-

Drawings, designs prepared in U.K	$1,00,000
Engineering Services rendered in India	$2,00,000
Salary and allowances paid to staff deputed for work in India	$2,00,000

Discuss the taxability of above payments in the hands of British Mines Ltd. (the Company registered in U.K.).

Question: (ID 19)

M/s Kangaru Australia, a Non-Resident Foreign Company had entered into a collaboration agreement on 21.2.2008 with an Indian Company and was in receipt of the following payments during the Previous Year. How do you deal with them for computation, in the case of M/s Kangaroo Australia?

(a) Interest on 8% Debentures for Rs. 50 Lakhs issued by Indian Company on 1.7 in consideration of providing of technical know-how, manufacturing process and designs.

(b) Service Charges at 2.5% of the value of Plant and Machinery for Rs.500 Lakhs leased out to Indian Company payable each year before 31st March.

Question: (ID 20) (Representative assessee)

C, a British barrister, was appointed by an English company to represent it in a patent case before the Delhi High Court. The High Court rules provided that an advocate who is not a member of the Delhi Bar can address the court only through a member advocate. B, a member of Delhi Bar, was appointed to be the advocate on record. B briefed C regarding Indian precedents relating to the case. The English company paid him a fee of Rs. 10,000 while C received in England a fee of $ 25,000. The Assessing Officer treated B as the agent of C under section 163 and taxed him in respect of $ 25,000. Comment on the actions of the Assessing Officer.

Question: (ID 21) (Representative assessee)

During the previous year X exported tobacco to Japan and France where it was sold through non-resident assesses – A a Japanese company and B, a French concern. A and B were operating as X' s agents and were to be paid commission on sales effected through them. X received the entire sale proceeds in India. X made credit entries in his books of account in respect of commission payable to A and B and remitted the same to them subsequently. State whether A and B are chargeable to tax in respect of commission on the basis of receipt of income (actual or constructive in India and whether it can be said that they have received or are deemed to have received commission when their accounts were credited.

Question (ID 023) (Representative assessee)

An Indian company made 2 agreements with a foreign company for purchase of machines at a consolidated consideration. Foreign Company deputed 2 technicians for supervising installation free of cost. Assessing officer held that Indian Company was agent u/s 163 for the foreign Co. & there was a business connection between the 2 companies. Do you agree ?

Question (ID 024) (Representative assessee)

'K' was a non-resident Indian. He purchased certain agricultural land in a village in India. The entire income from such land was spent by K's father 'S' for household expenses. So no part of the income was paid to 'K'. How can the assessment be made by the assessing officer in respect of income from such land?

Question (ID 01)

A non- resident Indian has the following sources of income in India. You are required to compute his total income and determine his tax liability. Details of your workings, with reasons, should form part of your answer.

(1)	Dividend from Indian company		50,000
(2)	Interest on debentures of an Indian company invested out of remittances in convertible foreign exchange	75,000	
	Less : Interest paid on money borrowed in India for investment in the debentures	25,000	
			50,000
(3)	Long – term capital gains on sale of shares subscribed in convertible foreign exchange:		
	Cost in 2000-2001	2,00,000	
	Sale	3,00,000	
		1,00,000	
	Less : Brokerage	10,000	90,000
	Inflation index (base year)	406	
	Inflation index of previous year	632	
(4)	Property income in Indian (Net)		2,00,000
(5)	T.D.S.		30,000

The property was acquired partly out of a loan from HDFC. The repayment of loan made during the year amounted to Rs. 20,000. The assessee also claims deduction of Rs. 10,000 by way of donation to the Prime Minister's Relief Fund and of Rs. 50,000 towards repayment of loan taken for higher education in India in 1998 before his migration.

Question (ID 02)

Massy incorporated, a foreign company furnishes the following data for the previous year.

1.	Royalty from Indian concern under an agreement made on 15-9-1995 approved by Central Government	3,00,000
2.	Expenditures as per section 28 to 44C for earning such income	2,00,000
3.	Interest from an Indian company on money lent in foreign currency	11,00,000
4.	Expenditure on collection of above interest	50,000
5.	Income from units purchased in foreign currency	5,00,000
6.	Collection charges for collecting above income	40,000
7.	Gross sale of business in India	30,00,000
8.	Expenditure as per sections 28 to 44C for above business	28,00,000
9.	Donations to P.M.N.R.F.	6,00,000

Determine the total income of the foreign company and the tax payable by it. What would be the total income and the tax payable, if the donation was Rs. 4,00,000 instead of Rs. 6,00,000

Question (ID 03) (Revision Class / Home work)

From the following information submitted by R, a non-resident, compute the total income and tax payable by R

Name of company	Holding Period in months	Nature of share	Cost Rs.	Date of Sale	Sales Rs.
A Ltd	55	GDR'S (purchased in US $)	7,00,000	15-6	9,00,000
B Ltd	58	-do-	6,00,000	5-7	7,50,000
C Ltd	11	-do-	4,50,000	5-6	5,06,000
D Ltd	65	Listed equity shares purchased in US $	3,28,000	15-6	4,23,000
E Ltd	74	-do-	3,00,000	17-10	5,00,000
F Ltd	7	-do-	2,25,000	17-10	2,58,500
G Ltd	51	Listed equity shares purchased from NRO account	4,00,000	17-10	5,20,000

The exchange rates are as under:

Cost of acquisition	TTBR US $	TTSR US $	Transfer of GDR / Shares	TTBR US $	TTSR US $
A Ltd	35	37			
B Ltd	35	37	05-06	45	47
C Ltd	44	46	05-07	45	47
D Ltd	42	43	15-06	46	48
E Ltd	44	46	17-10	46	48
F Ltd	44	46			

The exchange rates are as under:

1. GDR of A Ltd were sold to a non-resident outside India.
2. Shares of companies D,E,F and G were sold through a recognized stock exchange in India.

Question (ID 04)

The total income of a non-resident Indian includes:

Investment income (gross)	62,500
Long-term capital gains	25,000
Other income	1,25,000

What will be the tax payable by him on the above income under Chapter XII or Chapter XII-A of the Income-tax Act ?

Question (ID 05)

Brian Lara, a well know cricketer, as a member of the West Indian touring team, received a sum of Rs. 5 lakhs for participation in matches in India. He also received a sum of Rs. 1 lakh for an advertisement of a product on TV. He contributed articles in a newspaper for which he received Rs. 10,000. During the tour of India, he attended horse racing in Bombay and won a prize of Rs. 10,000. What will be his tax liability?

Question (ID 06)

Ritesh, a Non-Resident Indian remitted USD 75,000 to India in 31.1.1992, part of which is utilized for acquiring 5,000 Shares of Akash Ltd. and Indian Company at Rs. 210 on 15.2.1992. These shares are sold for Rs. 1,760 per share on 28.3.PY. Ritesh deposited Rs. 50 Lakhs with an Indian Public Company on 1.8.AY (one day after due date of filing return of income). Compute Capital Gains chargeable to tax on the basis of the following TT Rates (as per State Bank of India) –

Date	TT Buying Rate (Rs. / $)	TT Selling Rate (Rs. / $)
31.1.1992	20.00	21.00
15.2.1992	20.50	21.50
28.3.PY	43.00	45.00

If the above shares were sold through a Recognized Stock Exchange, what will be tax incidence ?

Question (ID 026) (Revision Class / Home work)

The assessee, which was a part of the Department of Space in the Government of India, had the objective of developing satellite technology and application of space technology for socio-economic development and space research. It entered into a contract with Inmarsat Global of the U. K. for leasing of the Inmarsat navigation transponder capacity for its GAGAN TDS project, under which it had taken on lease the space segment capacity of L1 and L5 transponder centered on an Inmarsat 4th generation satellite, making an orbit at 36,000 km altitude above the earth's atmosphere. The capacity was utilized through data commands sent from a ground station set up by the applicant to that transponder out of many which was for navigation purposes which dispatched signals in space on two specified frequencies. The corrected or augmented data sent from the satellite and transmitted by the transponder were used for better navigational accuracies. The applicant paid a fixed annual charge regardless of the actual use of transponder capacity. On these you are required to answer (i)

whether the payment to Inmarsat Global of the U. K. for leasing of transponder was not royalty; and (ii) whether the applicant had to deduct tax at source under section 195 of the Income-tax Act, 1961, in respect of the lease amount.

Question (ID 027) (Revision Class / Home work)

The assessee, a non-resident Australian company, was engaged in the business of providing professional services to the energy and resource industries. It was awarded a contract for providing (i) engineering and procurement services, (ii) project management services, and (iii) construction advisory and commissioning advisory services, to Reliance, an Indian company, for laying cross-country pipelines for transportation of hydro-carbons from Jamnagar to Bhopal and from Goa to Hyderabad, in India. The assessee was provided with office space in the office of the local engineering contractor of Reliance in Mumbai. Under an engineering and procurement services agreement, the applicant received substantial amounts : Australian dollars 2,229,794 for the Jamnagar to Bhopal project and Australian dollars 1,232,994 for the Goa to Hyderabad project. According to the applicant, 80 per cent. of the activities concerning basic engineering services were primarily carried out in Perth in Australia, the procurement functions were essentially performed in India and some work relating to project management services was also carried out in India. The applicant's employees were present in India for 127 days during the financial year and 241 days during the next year. On these facts your advise is sought on the following questions :

1. whether the applicant formed a permanent establishment in India due to its activities and services rendered in India;
2. whether the services were in the nature of "royalty" and
3. whether the the receipts of the applicant were not taxable in India.

Question (ID 028) (Revision Class / Home work)

A private company registered in India, was a part of the Dell group of companies. It was mainly engaged in the business of providing call centre, data processing and information technology support services to the Dell group companies. The applicant's parent company had entered into an agreement with BT, a non-resident company formed and registered in the USA, under which BT, the non-resident company, provided the company with two way transmission of voice and data through telecom bandwidth. While BT was to provide the international half-circuit from the USA/Ireland, the Indian half-circuit was provided by VSNL, an Indian telecom company. Apart from installation charges payable initially, fixed monthly recurring charges for the circuit between the USA and Ireland and for the circuit between Ireland and India were payable by the applicant to BT, and this was net of Indian taxes. BT raised its invoice directly on the applicant and the applicant made the payment directly to BT. The company was paying tax in India in relation to the recurring charges in accordance with section 195 of the Income-tax Act, 1961. There was no equipment of BT in the applicant's premises and the applicant had no right over any equipment held by BT for providing the bandwidth. Fibre link cables and other equipment were used for all customers including the company. The bandwidth was provided through a huge network of optical fibre cables laid under seas across several countries of which BT used only a small fraction. There was no dedicated machinery or equipment identified or allowed to be used in the hands of the company; a common infrastructure was being utilised by various operators to provide service to various service recipients and the company was one among them receiving the service. The landing site was at Mumbai, and the Indian leg thereof to Bangalore, including the last mile connectivity to the premises of the company, was catered to by Bharti Telecom. On these facts the company sought your advise on

questions relating to the tax liability of BT and the companies duty to deduct tax at source. You are required to offer your comments.

Question (ID 029) (Revision Class / Home work)

Company incorporated in Canada, was a contract research organization providing clinical and bio-analytical services to assist pharmaceutical companies around the world in the development of new drugs or generic copies of drugs already being marketed. It evaluated on behalf of its clients the bio-equivalence and/or comparative bio-availability of the new generic drug vis-a-vis the reference drug which was already available in the market, by devising various methods/protocols in conformity with international regulations. The reports produced by the company were acceptable to the regulatory authorities. Neither the methods/protocols developed, which were product specific, nor the specimens, were given to the clients. Only the final reports/conclusions of the evaluation were given to the clients. The client seeking approval of regulatory authorities for marketing of a new generic drug would enclose the test report provided by the applicant along with its application. The applicant entered into agreements with Indian pharmaceutical companies, viz., Sandoz and Ranbaxy, for rendering such services. The clients paid a fee to the applicant for these services. You are required to give your comments on taxability of above transaction.

Question (ID 030) (Revision Class / Home work)

A private company an assessee engaged in the business of prospecting and mining for diamonds and other minerals, had been granted licences by the State Governments of Karnataka, Andhra Pradesh and Chattisgarh for mineral reconnaissance activities. Reconnaisance is the early stage of exploration. During the early stage various techniques are employed like collection of steam samples, geophysical survey like airborne multispectral scanner survey, electro-magnetic survey. Exploration has various stages like the early stage, initially for a period of 3 to 5 years, the advanced stage for a period of 5 to10 years and the feasibility stage of 5 to10 years. On an average the time taken from a discovery to production is eight years. For the purposes of carrying out geophysical survey, the assessee-company entered into an agreement with F of the Netherlands which had a team of experts who specialised in performing airborne geophysical services for clients, process the data acquired during the survey and provide necessary reports. The services of F were engaged to conduct the airborne survey for providing high quality, high resolution, geophysical data suitable for selecting probable kimberlite targets. F conducted the airborne survey using its specialised equipment, but the helicopter for the survey was hired by the assessee. All the logistics of the survey, such as flight schedule, re-flights survey lines, control lines, positioning, etc. were set by F and F deputed technical personnel for conducting the survey. The data collected from the survey was provided to the assessee in a particular format called the acquisition and processing report. The Assessing Officer treated the consideration paid to F under the agreement as falling within the definition of "fees for technical services" You are required to give your comments on taxability of above transaction.

Question (SLID 007) (Non Resident Shipping / air crafts 172, 44B, 44BBA)

M/s Global Airlines incorporated as a Company in USA operated its flights to India and vice versa during the year and collected charges of Rs.125 Lakhs for carriage of passengers and cargo out of which Rs.65 Lakhs were received in US dollars for the Passenger Fare booked from New York to Mumbai. The total expenses for the year on operation of such flights were Rs. 195 Lakhs. Income chargeable to tax of the foreign airlines may please be computed.

Question (ID 022) (Non Resident Shipping / air crafts 172, 44B, 44BBA)

The assessee was non-resident shippers. During the relevant years, assessments were made under section 172(4) in respect of the fright earnings. On regular assessment under section 172(2) as claimed by the assessee the Assessing Officer, found that the total income assessed was far less than the earlier assessed under section 172(4). So he held that assessees were entitled to refunds of the excess amount paid by them. After refunds the assessees claimed interest on excess amount which was turned down by the revenue on the ground that assessment under section 172(4) could not be said to be payment of advance income-tax. What is your opinion?

Question (ID 031) (Non Resident Shipping / air crafts 172, 44B, 44BBA)

X (45 years), a non resident, is engaged in the business of shipping. During the previous year, one of the ships owned by X collects freight as follows:

a) On August 6, a sum of Rs. 40 lakh for shipping goods from Cochin Port (it includes demurrage of Rs. 10,000 and handling charges of Rs. 60,000); and
b) On January 10, a sum of Rs. 25 lakh for shipping goods from Bombay (it is paid to X in New York).

Besides, X collects Rs. 22,70,000 in India on March 31, for shipping goods from Karachi to California. Barring the cases noted above, X does not have any other income in India. X incurs an expenditure of Rs. 2,40,000 in India (out of which Rs. 65,000 is paid in cash). X has brought forward loss of Rs. 5,000 from a trading business in India which has discontinued 3 years back. Compute the tax liability of X.

Question (ID 032) (Non Resident Shipping / air crafts 172, 44B, 44BBA)

Discuss the following

X, a non-resident, operates an aircraft between Singapore and Chennai. He received the following amounts in the course of the business of operation of aircraft during the year.

a) Rs. 2 crore in India on account of carriage of passengers from Chennai.
b) Rs. 1 crore in India on account of carriage of goods from Chennai.
c) Rs. 3 crore in India on account of carriage of passengers from Singapore.
d) Rs. 1 crore in Singapore on account of carriage of passengers from Chennai.

The total expenditure incurred by X for the purposes of the business was Rs. 675 crore.

Compute the income of X chargeable to tax in India under the head "Profits and gains of business or profession" for the assessment.

Question (ID 033) (Oil Exploration 44BB)

ONGC has agreements (approved by the Government) with the following three foreign companies which provide services and facilities to ONGC in connection with prospecting for (or extraction/production of) mineral oils in India-

	A Inc.	B Inc.	C Inc.
Due of agreement	June 10, 1982	June 10, 1992	June 10, 2002
Amount paid by ONGC during 2010-11 on account services provided by foreign companies (in Rs.)	90 crore	90 crore	90 crore
Tax liability borne by ONGC (in Rs.)	Nil	3.8007 lakh	3.96828 lakh

Find out the taxable income and tax liability of the foreign companies. Discuss whether tax liability borne by ONGC would be perquisite arising to B Inc. and C Inc. under section 28(iv) and would be taxable separately in addition to income computed under section 44BB.

DOUBLE TAXATION -- D T A A

Question 01

A is a musician deriving income from concerts performed outside India of Rs. 50,000. Tax of Rs. 10,000 was deducted at source in the country where the concerts were given. India does not have any agreement with that country for avoidance of double taxation. Assuming that the Indian income of A is Rs . 1,75,000, what is the relief due to him u/s 91.

Question 02

Arif, a resident both in India and Malaysia in previous year, owns immovable properties (including residential house) at Malaysia and India. He has earned income of Rs. 50 lakhs from rubber estates in Malaysia during the financial year. He also sold some property in Malaysia resulting in short-term capital gain of Rs. 10 lakhs during the year. Arif has no permanent establishment of business in India. However, he has derived rental income of Rs. 6 lakhs from property let out in India and he has a house in Lucknow where he stays during his visit to India. The Article 4 of the double taxation avoidance agreement between India and Malaysia provides that where an individual is a resident of both the Contracting States, then he shall be deemed to be resident of the Contracting State in which he has permanent home available to him. If he has permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests).

You are required to state with reasons whether the business income of Arif arising in Malaysia and the capital gains in respect of sale of the property situated in Malaysia can be taxed in India.

Question 03

A foreign company, ST, has entered into an agreement with an Indian Company KN for supply of know – how and the agreement is within the industrial policy conditions laid down by the Central Government. In the year, Rs. 50 lakh is paid, under the agreement, to ST by KN. ST claims to have spent Rs. 14 lakh as expenses in India to be recognized as a deduction.

In the following situations, what will be your decision on the tax liability of the parties:

i) The agreement having been entered into before June 1, 2001 and approved by the Government, KN pays to the Indian Income-tax Authorities the tax payable by ST;

ii) There is no agreement as to KN bearing the tax liability. The royalty payable is decided to be Rs. 59 lakh net of taxes.

TRANSFER PRICING

Question (ID 05)

I Ltd., an Indian company, supplies billets to its holding United Kingdom company, U Ltd. during the previous year. I Ltd. also supplies the some product to another UK based company. V Ltd., an unrelated entity. The transactions with U Ltd. are Euro 500 per MT (FOB), whereas the transactions with V Ltd. are priced at Euro 700 per MT (CIF). Insurance and freight amounts to Euro 200 per MT. Compute the arm's length price for the transaction with U Ltd.

Question (ID 06)

X Ltd., an Indian company is engaged in manufacturing electronic components. 74 percent of shares in X Ltd. are held by Y Inc., incorporated in USA. X Ltd. has borrowed funds from Y Inc. at London Inter-Bank Offer Rate (LIBOR) plus 150 points. The LIBOR prevalent at the time of borrowing is 4 percent of US$. The borrowings allowed under the External Commercial Borrowings (ECB) guidelines issued under Foreign Exchange Management Act (FEMA) are LIBOR plus 200 points. Discuss whether the borrowings made by X Ltd. is at arm's length.

Question: (ID 11)

Doc Solutions Inc. a US Company, sells Laser Printer Cartridge Drums to its Indian Subsidiary Quality Printing Ltd at $ 10 per drum. Doc Solutions Inc. has other takers in India for its Cartridge Drums, for whom the price is $ 15 per drum. During the year, Doc Solutions had supplied 10,000 Cartridge Drums to Quality Printing Ltd.

Determine the Arm's Length Price and taxable income of Quality Printing Ltd if its income after considering the above is Rs. 35,00,000. Compliance with TDS provisions may be assumed and Rate per USD is Rs. 45. Also determine income of Doc Solutions Inc.

Question: (ID 12)

Quipro Ltd is an Indian Company engaged in the business of developing and manufacturing industry components. Its Canadian Subsidiary Techpro Inc. supplies technical information and offers technical support to Quipro for manufacturing goods, for a consideration of Euro 80,000 per year.

Income of Quipro Ltd is Rs. 70 Lakhs. Determine the Taxable Income of Quipro Ltd if Techpro charges Euro 1,00,000 per year to other entities in India. What will be the answer if Techpro charges Euro 50,000 per year to other entities. (Rate per Euro may be taken at Rs. 50.)

Question: (ID 13)

US Ltd, a US Company has a subsidiary, IND Ltd in India. US Ltd sells computer monitors to IND Ltd. for resale in India. US Ltd also sells computer monitors to CMI Ltd, another computer reseller. it sells 50,000 computer monitors to IND Ltd at Rs. 11,000 p.u. The price fixed for CMI Ltd Rs. 10,000 per unit. The warranty in case of sale of monitors by IND Ltd is handled by IND Ltd However, for sale of monitors by CMI Ltd is US Ltd is responsible for the warranty for 3 months. Both US Ltd and IND Ltd offer extended warranty at a standard rate of Rs. 1,000 per annum. On these facts, how the assessment of IND Ltd is going to be affected ?

Question: (ID 07)

Kio Japan and AB Ltd, an Indian Company are associated enterprises. AB Ltd manufactures Cellule Phones and sells them to Kio Japan and Geel, a Company based at Beijing, During the year AB Ltd supplied 2,50,000 Cellular Phones to Kio Japan at a price of Rs. 3,000 per unit and 35,000 units Geel at a price of Rs. 4,800 per unit. The transactions of AB Ltd with Kio and Geel are comparable subject to the following considerations –

(a) Sales to Kio is on FOB basis, sales to Geel are CIF basis. The freight and insurance paid by Kio for each unit is Rs. 700.

(b) Sales to Geel are under a free warranty for Two Years whereas sales to Kio are without any warranty. The estimated cost of executing such warranty is Rs. 500.

(c) Since Kio's order was huge in volume, quantity discount of Rs. 200 per unit was offered to it.

Compute the Arm's Length Price and the amount of increase in the Total income of AB Ltd, if are due to such Arm's Length Price.

Question: (ID 08)

Mobeaux LLP of Poland and Vamsi Ltd of India are associated enterprises. Vamsi imports 1000 compressors for Air Conditioners from Mobeaux at Rs. 7,500 per unit and these are sold to Winland cooing Solutions Ltd at a price of Rs. 11,000 per unit. Vamsi had also imported similar products from De-Heat Ltd and sold outside at a Gross Profit of 20% on Sales.

Mobeaux offered a quantity discount of Rs. 1,500 per unit. De-Heat could offer only Rs. 500 per unit as quantity Discount. The freight and customs duty paid for imports from Poland had cost Vamsi Rs. 1,200 a piece. In respect of purchase from De-Heat, Vamsi had to pay Rs. 200 only as freight charges.

Determine the Arm's Length Price and the amount of increase in Total income of Vamsi Ltd.

Question (ID 04)

A Ltd., an Indian company, sells computer monitor to its 100 per cent subsidiary X Ltd. in United States @ $ 50 per piece. A Ltd. also sells its computer monitor to another company Y Ltd. in United States @ $ 80 per piece. Total income of A Ltd. for the assessment year is Rs. 12,00,000 which includes sales made for 100 computer monitors @ 50 to X Ltd.

Compute the arm's length price and taxable income of A Ltd. The rate of one dollar may be assumed to be equivalent to Rs. 49 for the sake of simplicity.

Question (ID 01)

Anush Motors Ltd., an Indian company declared income of Rs. 300 crores computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the year:

(i) 10,000 cars sold to Rida Ltd. Which holds 30% shares in Anush Motors Ltd. At a price which is less by $ 200 each car than the price charged from Shingto Ltd.

(ii) Royalty of $ 1,20,00,000 was paid to Kyoto Ltd. For use of technical know-how in the manufacturing of car. However, Kyoto Ltd. Had provided the same know-how to another Indian company for $ 90,00,000.

(iii) Loan of Euro 1000 crores carrying interest @ 10% p.a. advanced by Dorf ltd., a German company, was outstanding on 31.3. the total book value of assets of Anush Motors Ltd. On the date was Rs.90,000 crores. The said German company had also

advanced a loan of similar amount to another Indian company @ 9% p.a. Total interest paid for the year was EURO 100 crores.

Explain in brief the provisions of the Act affecting all these transaction and compute the income of the company to tax keeping in mind that the value of 1$ and of 1 EURO was Rs. 50 and Rs. 55, respectively, throughout the year.

Question (ID 02)

Hotmail, a U.S.A. company holds 30% shares in Staffing Solution Ltd. (India). Staffing Solution Ltd. develops software for various customers including Hotmail. Staffing Solution Ltd during the year billed Hotmail U.S.A. for 2,000 man-hours at the rate of Rs. 400 per man-hour. The total cost (direct and indirect) for executing this work amounted to Rs. 6, 50,000.

Staffing Solution Ltd. billed R Ltd. India at the rate of Rs. 800 per man-hour although the persons who were working for development of the software of R Ltd. were of the same caliber and level that of persons who developed the software for Hotmail U.S.A. Staffing Solution Ltd. earned a Gross Profit of 40% on its sales to R Ltd.

The transactions of Staffing Solution Ltd. with Hotmail U.S.A. and R Ltd are comparable subject to the following differences:

i) While Hotmail U.S.A. have given technical know-how to Staffing Solution, there is no such know-how provided by R Ltd. The value of technical know-how received from Hotmail U.S.A. can be taken at 10% of normal gross profit.

ii) A quantity discount was given by Staffing Solution Ltd. to Hotmail Co. which can be valued at 5% of normal gross profits.

iii) Staffing Solution Ltd. offered 60 days credit to Hotmail. The cost of providing such credit may be valued at 2.5% of gross profit. No such trade discount was given to R Ltd.

Compute the arm's length price and the amount of increase in the total income of Staffing Solution Ltd, if any, due to such arm's length price.

Question (ID 03)

X Ltd. UK received an order from Y Ltd Germany for developing a software product for a sum of US $ 1,00,000. In order to execute the same, X Ltd., Z Ltd. (a company in which X Ltd. holds 50% shares) and S Ltd India (where Z Ltd holds 40% shares) together develop the above software.

X Ltd. UK pays to Z Ltd and S Ltd. India a sum of US $ 24,000 and $ 27,000 resectively and keeps the balance for itself. In the entire transaction, a profit of $16,000 is earned. S Ltd. India incurred a total cost of $24,000 in the execution of its work relating to the above project. Assume the relative contribution of X Ltd, Z Ltd and S Ltd. is 40%, 25% 35% respectively. Compute the arm's length price and the amount of increase in the total income of S Ltd., if any due to such arm's length price.

Question: (ID 09) (Revision Class / Home work)

Boulevard Inc., a French Company, holds 40% of Equity in the Indian Company Vista Technologies Ltd (VTL). VTL is engaged in development of software and maintenance of the same for customers of the same for customers across the globe. Its clientele includes Boulevard Inc.

During the year, VTL had spent 2,000 Man Hours for developing and maintaining software for Boulevard inc, with each hour being billed at Rs. 1,250. Cost incurred by VTL for executing work for Boulevard Inc. amount to Rs. 18,00,000.

VTL had also undertaken developing software for Bal Industries Ltd for which VTL had billed at Rs. 2,700 per man Hour. The persons working for Bal industries Ltd and Boulevard were part of the same team and were of matching credentials and caliber. VTL had made a Gross Profit of 50% on the Bal industries work.

VTL's transactions with Boulevard inc. is comparable to the transactions with Bal industries, subject to the following differences –

(a) Boulevard gives technical know how support to VTL which can be valued at 8% of the Normal Gross Profit. Bal industries does not provide any such support.
(b) Since the work for Boulevard involved huge number of man hours, a quantity discount of 14% of Normal Gross Profits was given.
(c) VTL had offered 90 Days credit to Boulevard the cost of which is measured at 2% of the Normal Billing Gross profit Rate. No such discount was offered to Bal industries Ltd.

Compute ALP and the amount of increase in Total Income of Vista Technologies Ltd.

Question: (ID 10) (Revision Class / Home work)

ABR Medical Equipments Inc. (ABR) of Canada has received an order from a leading UK bast Hospital for development of a hi-tech medical equipment which will integrate the best of software and latest medical examination tool to meet varied requirements. The order was for 2,50,000 Euros

To execute the order, ABR joined hands with its subsidiary Precision Components inc. (PCI) of us and Bioinformatics India Ltd (BIL), an India Company. PCI holds 40% of BIL. In the entire transaction, a profit of Euro 50,000 is earned. Bioinformatics India Ltd incurred a Total Cost of Euro 75,000 in execution of its work in the above contract. The relative contribution of ABR, PCI and BIL may be taken at 35%, 25% and 40% respectively.

Compute the Arm's Length Price and the incremental Total Income of Bioinformatics India Ltd, and due to adopting Arms Length Price determined here under.

PRIVATE AND PUBLIC TRUST

Question (ID 051) (Private Trust)

Assessee trust was a 20% beneficiary of the main trust & its only source of income was 5% share in the income of main trust. Trust claims that its share should be taxed at normal rate as none of the beneficiaries was a beneficiary in any other trust & none of them had income exceeding maximum limit not liable to tax. But A.O.'s view is that assessee was a chain trust created for avoiding tax, so income should be charged at maximum marginal rate (MMR). What is your opinion?

Question (ID 052) (Private Trust)

The settler of the trust amended certain clauses to rectify certain mistakes in order to make the trust wholly for charitable & religious purposes. Can the trust acquire such status and claim the exemption u/s. 11?

Question (ID 053) (Private Trust)

A trust was created with a sole beneficiary, it was provided in the deed that all the assets of the trust were to be regarded as one single fund. Can it be said that vesting of income in the beneficiary is not a precondition to claim that sec.164 should not apply. The trustees had the discretion of the time at which to extend the benefit to the beneficiary. Do you think section 164 is applicable?

Question (ID 054) (Private Trust)

A trust deed named granddaughter of the author of the trust as the beneficiary on attaining majority. During the P.Y., she had not attained majority. The payment of income to the beneficiary was left to the absolute discretion of the trustees. The trustees claim that beneficiary is only one who is known. Hence, income of the trust should not be charged at MMR. Do you agree with this view?

Question (ID 055) (Private Trust)

An assessee was a trustee of a trust created by Will. She was a wife of the executor (T). She was the sole trustee of the trust as well as beneficiary. She had a life interest in the trust and after her death the children were to become beneficiaries in the shares determined in the deed and immovable property used by her as residence which was sold and new house was purchased. She claimed u/s.54. A.O. disallowed it. Do you think it is proper?

Question (ID 056) (Private Trust)

Can the character of discretionary trust be changed by a resolution passed by trustees to give income to only one beneficiary out of the many?

Question (ID 032 001) (Private Trust)

Welfare trust is a private discretionary trust, which derived income from the following sources.

Income from property (Net)	25000
Capital gains-Long term	30000
Total income	55000

What will be the tax liability of the trust?

Question (ID 032 021) (Private Trust) (Revision Class / Home work)

XY trust derives a total income of Rs. 6,40,000. Out of Rs 6,40,000, Rs. 1,40,800 is meant for public charitable purposes and the balance Rs. 4,99,200 is for the benefits of X (29 years) and Y (31 years) whose individual shares are not known. The trust has actually applied Rs. 40,000 toward public charitable purposes during the previous year. Determine the tax liability of the trust for the assessment year under the following situations:

a) X and Y neither beneficiaries under any other trust nor their taxable income exceeds Rs. 1,00,000.
b) X is member of another trust (no income is derived for the trust), though taxable income of X and Y does not exceed Rs. 1,00,000.
c) Taxable income of X and / or Y is Rs. 8,00,010 though they are not beneficiaries under any other trust

Question (ID 039) (Charitable Trust)

The assessee, a Charitable Trust received donations exceeds Rs.8 lacs through the executor of a will. The executor gave a letter stating that the donation was made towards the corpus of the trust. In the will, executor was given the direction to donate the said sum but was not mentioned that it was donated towards the corpus. Assessing officer was of the opinion that the executor cannot assume for himself any role other than the one envisaged in the will. Hence, the A.O. held the donations to be general donations. Do you agree?

Question (ID 040) (Charitable Trust)

The Assessee Company was incorporated and registered under Companies Act as a guarantee Company and the status was accepted by the revenue. It was not a company u/s.25 of Companies Act. Can it automatically make the Assessee and AOP? The main object was of public utility and not of earning profit. So, subsidiary objects to be regarded as mere power for achieving the means.

Question (ID 041) (Charitable Trust)

A Charitable Trust applied for registration u/s 12A Commissioner made a number of suggestions for amendment of by-laws because he considered that if those clauses remain in the deed, trust will not be able to claim exemption u/s. 11. The trust wants to file a writ petition on the argument that the Commissioner is exceeding his powers. Do you find any merits in his claim?

Question (ID 031) (Trust with business income)

A trust had main objects of educational, medical & relief to poor. It was authorized to establish, maintain & run such institutions to carry out the objectives, for the benefit of general public. One clause of the trust deed empowered the trustees to invest funds & carry on business. The trustees cached out the business of purchasing & selling cotton yam. The trust claims exemption for this income contending it to be income from property held for charitable purpose. A.O. denied it. Do you agree?

Question (ID 032) (Trust with business income)

Primary purpose of a company was provided specialized information in respect of circulation of newspapers & periodicals through the process of independent audit. Can it be said that it is engaged in activity of general public utility? Can it claim exemption u/s. 11? A.O. disallows the exemption for income from subscription, application fees & entrance fees. Is it correct?

Question (ID 033) (Trust with business income)

The Assessee, a charitable trust, received certain amount from an industry to be spent for agricultural development and specially for organizing Kisan rally. According to A.O., the income is not for charitable purpose and it should be considered as taxable. According to assessing Officer (A.O.) the receipt from the donor was not towards the corpus. Do you agree?

Question (ID 032 011)

A public charitable trust registered under section 12A, for the previous year derived gross income of Rs.16 lakh , which consist of the following : (Rs. In lakhs)

Income from properties held by trust (net)	5
Income (net) from business (incidental to main objects)	4
Voluntary contributions from public	7

The trust applied a sum of Rs.11.60 lakh towards charitable purposes during the year, which includes repayment of loan taken for construction of orphan home Rs.3.60 lakh. Determine the taxable income of the trust.

Question (ID 032 009) (Charitable Trust)

"Charities Unlimited" a charitable trust is running a hospital and medical institution has made its services available to trustees of the trust. The value of medical service and hospital service made available to trustees of trust is Rs. 30,000. Other details of the income and expense of the trust is given below.

Gross collection from the counter of the hospital	300,000
Voluntary donations received (Rs. 100,000 is with specific direction to form part of the corpus)	450,000
Expenditure incurred for maintaining hospital	250,000
Actual expenditure incurred for making its services available to trustees of trust a specified person u/s 13	20,000

Amount applied toward the charitable objects	200,000
Amount invested in Units of Unit trust of India	250,000

You are required to compute the total income of the trust.

Question (ID 032 010) (Charitable Trust)

X Public Charitable Trusts runs a hospital, which is derived income of Rs.250 lakh, from its operational activities. Expenses incurred to earn such income are Rs.55 lakh. Depreciation on various assets used in the hospital is Rs.15 lakh. Out of the income of Rs.250 lakh. the amount accrued but non received during the year is Rs.20 lakh. The institution earmarked and set apart Rs.30 lakh to give as advance for a building intended to be taken on lease for expansion of the hospital, but the amount was paid on April 7, of assessment year, as the lease agreement could not be signed during the previous year. The trust has got an ERP package developed and installed by an IT company during the year. The total coat to the trust on account of the ERP package was Rs.85 lakh. Advice the trust on its total income, if the trust has incurred Rs.12 lakh for purchase of a number of desktop and laptop computers for use in the hospital.

Question (ID 032 020) (Charitable Trust)

Varinder Charitable Trust, a charitable Trust registered u/s 12A of the Income Tax Act, 1961 has sold the plot acquired two years back. The purchase price was Rs. 2,00,000. The sale consideration was Rs. 3,60,000. A sum of Rs. 10,000 was incurred in connection with the sale. The Trust acquired English mortgage [worth Rs. 3,10,000] of an Immovable property utilizing the sale proceeds. Is the Trust entitled to exemption u/s 11(1A)?

Question (ID 22) (Charitable Trust)

AB Memorial Trust which runs hospitals is registered under section 12A. Following particulars relevant for the previous year are furnished to compute tax liability of the trust.

1. Income from running of hospitals: Rs. 14.25 lakh.
2. Donation received (including anonymous donation Rs. 3 lakh): Rs. 5.75 lakh.
3. Amount applied for the purposes of hospital: Rs. 13 lakh.
4. The trust had accumulated Rs. 15 lakh under section 11(2) in the financial year 5 years back for a period of five years for extension of one of its hospitals. The trust has spent Rs. 13.50 lakh for the said purpose till 01.04.PY.

Compute the taxable income of the trust and tax payable by AB Memorial Trust.

Question (ID 034) (Violations)

Assessee trust purchased a refrigerator & kept it at the residence of managing trustee before moving it into orphanage. Can it be said that trust property was used for the benefit of prohibited person u/s. 13(3) & accordingly can the exemption be denied? Assessee says, the words "Land, building & other property" refer to only immovable property. So refrigerator is not covered by it. What are your views?

Question (ID 035) (Violations)

Object of the assessee trust was to provide general & vocational education. Its funds were invested in 2 firms where dose relatives of trustees were not only partners but also had a substantial interest. Can the trust claim exemption U/s. 11?

Question (ID 036) (Violations)

The assessee society registered u/s 12 gave money to an institution for utilisation whose objects were similar as per the bye-laws, were similar to those of this society. Assessing officer held that the amount of investment or deposit was in infrigement of Sec. 13(1)(d) r.w. Sec. 11 (5). He denied the exemption u/s. 11. Is it justified?

Question (ID 037) (Violations)

Author of the Trust is Mr. X His son has substantial interest in ABC Ltd. That company has donated shares to this trust The Assessing officer wants to deny exemption u/s 11 by invoking the provisions of sec 13(2). Do you agree ?

Question (ID 038) (Violations)

A trust was set up with the objects which included inter-alia to impact knowledge and education primarily in Gujarati Language, established and maintain institutions, reading rooms etc. and also promote social, moral and religious standards of the members. AO denied the exemption u/s 11 by invoking the provisions of sec 13(i)(b) of the ground that Trust was established mainly for Gujarati speaking persons. Is it justified?

TONNAGE TAX SCHEME

Question 01

Go India Private Limited is an Indian company in business of operating ships. The necessary procedure to avail the benefit of tax tonnage scheme is already done. It owns two ships ("The star" and "The Moon") having net tonnage of 630 and 760 tonns respectively. Both the ships are sea going vessels however "The Moon" also sometimes being used as fishing vessel. During the previous year "The Moon" and "The star" is used as fishing vessel for 45 days and 15 days respectively. It is also in the business of manufacturing Iron Rods. Some of the expenditures are common between the shipping and manufacturing business. The necessary details are given below. You are required to compute the total income of the Go India Private Limited and calculate the amount to be transferred to special reserve for the purpose of TTS. Give the adequate reasons for the same.

Particulars.	Rs. In '000
WDV of block of SHIPS	200
WDV of block of PLANT AND MACHINERY (Used for Mfg.)	400
WDV of block of FURNITURE AND FIXTURES (Partly used for Tonnage Tax Business)	100
WDV of block of COMPUTERS (Partly used for Tonnage Tax Business)	600
Book value of SHIPS (The Moon)	200
Book value of SHIPS (The Star)	300
Book value of PLANT AND MACHINERY	300
Book value of FURNITURE AND FIXTURES	150
Book value of COMPUTERS	600
Gross Collection from Business of Manufacturing and other sundry Income.	200
Gross Collection from operation of "The Moon"	250
Gross Collection from operation of "The Star"	300
Direct Expense in Business of Manufacturing	150
Direct Expense for operation of "The Star"	20
Direct Expense for operation of "The Moon"	100
Common expense for the purpose of business.	300

SET OFF AND CARRY FORWARD

Question (SLID 007)

Mr. Madhukant was carrying on proprietary business of speculation in shares, cotton and other commodities. He died leaving behind his widow, a son and a daughter. Three heirs of Madhukant entered into a partnership and executed a partnership deed wherein they agreed to carry on the said business of speculation. In the said speculation business carried on in the name of the M/s MM a partnership firm, profits were earned and the assessee sought to carry forward and set off the losses incurred by the deceased in his proprietary business against the income from the speculation business of the partnership firm. Assessee M/s MM was of the opinion that there was succession by inheritance and, therefore, the assessee is entitled to carry forward and set off the deceased Shri Madhukant's loss in business against the income.

Question (SLID 010)

X (P.) Ltd. has share capital in the form of equity share capital. The shares were held up to March 31, 2003 by four members A, B, C, & D equally. The company made losses/ profits for the past three assessment years as follows:

Assessment year	Business loss Rs.	Unabsorbed depreciation Rs.	Total Rs.
2001-02	Nil	15,00,000	15,00,000
2002-03	Nil	12,00,000	12,00,000
2003-04	9,00,000	9,00,000	18,00,000
Total	9,00,000	36,00,000	45,00,000

The above figures have been accepted by the tax department.

During the previous year ending March 31,2004, A sold his shares to y and during the previous year March 31, 2005, B sold his shares to Z. The profits for past two previous year are as follows:

For the year ending March 31, 2004: Rs.18,00,000 (before charging depreciation Rs.9,00,000)

For the year ending March 31, 2005: Rs.45,00,000 (before charging depreciation Rs.7,50,000)

Compute the taxable income for assessment year 2005-06. Workings must form part of your answer.

Question (SLID 011)

R, S and G are equal partners of a firm. The firms c/f loss was determined as Rs. 78,000. S retired from the firm and P joined on 1-4 of previous year as an equal partner. The firm made a profit of Rs. 84,000 for the previous year but it wants to set off the carried forward loss of Rs. 78,000 of the previous year against this profit. Examine the validity of the firms claim and allocate the shares of R, Sand G.

Question (SLID 013)

X provides the following information:

Sales (retail trade in garments) (no books of accounts maintained)	32,00,000
Rent from house property at Chennai (computed)	120,000
Vacant site lease rent	12,000

X purchases 20,000 shares of A.Co. Ltd., declares 1 : 1 bonus on January 1, 2003.

X sells 1,000 bonus shares in September of previous year for Rs.1,20,000.

X gets Rs.50,000 on February 12, being amount due from Y relating to electronic goods supplied by X's father, which was written off as bad debt by his father 4 years back and allowed as deduction. X's father died 2 years back.

X has brought business loss relating to discontinued automobile business of 3 years back : Rs.2,00,000; brought forward depreciation relating to the same business : Rs.1,50,000.

Compute gross total income of X.

Question (SLID 017)

From the following data, you are required to work out the total income chargeable to tax and ascertain the tax thereon of X Ltd., a domestic company.:

Business loss	50,00,000
Property income	45,00,000
Income from other sources	1,00,000
Capital gains:	
Short-term	3,00,000
Long-term	10,00,000

Question (SLID 018)

W purchase 1,000 Units of UTI Rs. 12,500 on 1.4. UTI declares dividend on 31.5 (record date) at Rs. 3 per unit. W sells the entire 1,000 units on 30.9 for Rs. 9,000. You are required to compute the capital loss.

Question (SLID 019)

R, an individual resident in India bought 1,000 equity shares of Rs. 10 each of A Ltd at Rs. 50 per share on 30.05. He sold 700 equity shares at Rs. 35 per share on 30.9 and the remaining 300 shares at Rs. 25 per share on 20.12. A Ltd declared a dividend of 50% the record date being 10.08. R sold on 01.02 a house from which he derived a long term capital gain of Rs. 75,000. Compute the capital gain.

ADVANCE TAX AND INTEREST

Question 01 (Slide ID - 06)

The accounts of a firm are subject to tax audit under Sec. 44AB. A working partner of the firm is entitled to receive a fixed remuneration of Rs 5,000 per month. He files his return of income on 30 September AY. The Assessing Officer charges interest under Sec. 234A for the delay in the filing of the return.

Question 02 (Slide ID - 01)

Give Estimated advance tax liability for the financial year in case of different assessees is given below:

Name of the assessee	*Amount of advance tax payable*
(i) NELCO Ltd.	1,50,000
(ii) X, Y and Z – partnership firm	4,000
(iii) Mr. Ramachandran	60,000
(iv) K, T and S, an association of persons	3,000
(v) R, P & Co., an HUF	10,000
(vi) Miss Sunita	4,200
(vii) J.R. Bros., a body of individuals	9,999

How is it to be paid ? Explain.

Question 03 (Slide ID - 08)

Z. Ltd. has deposited the following amounts as advance tax on the total income of Rs 3 lakh or so (tax liability 100980).

Date of deposit	*Advance tax deposited*
14-6-PY	12,000
12-9-PY	25,000
15-12-PY	20,000
12-3-PY	23,150
31-3-PY	17,000

Compute the interest payable by the company under Sec. 234C for deferment of advance tax.

Question 04 (Slide ID - 07)

A firm made the following payments of advance tax during the financial year:

15 September - 6 lakhs

15 December - 14 lakhs

15 March - 5 lakhs

The income returned by the firm is Rs 80 lakh or so (tax liability 26,92,800) under the head business and Rs 10 lakh or so (tax liability 2,24,400) by way of long-term capital gains on sale of a property effected on 1 March . What is the interest payable by the assessee under Sec. 234B and Sec. 234C ? Assume that the return of income was filed on 31 October of assessment year and tax was fully paid on self-assessment. (assume due date of filing return as 31 October.)

Question 05 (Slide ID - 02)

As the Company Secretary of Alpha Ltd., an Indian company, ascertain from the following particulars the minimum amount of advance tax payable by way of different installments to ensure that interest liability under Sec. 234C is not attracted:

- Business income 2,00,000 or so (assume tax payable 67320)
- Long-term capital gain on sale of government securities on 10 October 20,000 or so (assume tax payable 4488)
- Winning from lottery on 31 December 100,000 or so (out of which tax deducted at source is Rs 31,370 and tax payable is 33660.)

Question 06 (Slide ID - 04)

An assessee estimates his tax liability would be Rs. 88,000. (Tax liability assessed by officer 102,000 for individual and HUF, 168,300 for company.). Double taxation relief under Sec. 91, advance tax paid, tax deducted at source and tax credit under Sec. 115JAA during the previous year amount to Rs 10,000, Rs 20,000, Rs 14,920 and Rs 3,380, respectively. Tax of Rs 20,000 and interest of Rs 2,500 are projected to be paid under Sec. 140A.

It is assumed that assessment is completed on 1 July of year next of assessment. Determine the interest payable under Sec. 234A in the following cases:

(a) Assessee is an individual R. Due date of return is 31 July but it is filed late on 1 January.

(b) Assessee is an HUF, RB Bros. Due date of return is 31 October but it is not filed.

(c) Assessee is a companv, R Ltd. Due date of return is 31 October but is filed on 31 March.

Question 07 (Slide ID - 05)

Mr Kalpesh Sanghavi furnishes return of his total income on 1 August of assessment year (due date under Sec. 139(1) is 31 July). He is assessed on 15 December of assessment year. He furnishes the following particulars of his income-tax liability.

Particulars	Rs
(i) Income tax as per return	36,210
(ii) Income tax as per assessment	48,450
(iii) Tax deductible at source (while original estimates was done)	1,210
(iv) Tax deduced at source (actual)	1,450
(v) Installments of advance tax:	
15.9.PY	8,500
15.12.PY	8,500
15.3.PY	8,000
31.3.PY	5,000
(vi) Payment of self-assessment tax on 01.08.AY	10,000

Determine his tax liability including interest, if any.

Question 08 (Slide ID - 03) (Revision Class / Home work)

P Co. Ltd. is required to submit its Income Tax Return by 30th September. According to the draft return prepared by it, the gross amount of tax payable works out at Rs 10 lakh, while it had paid Rs 6 lakh by way of advance tax on 14th march and Rs 80,000 by way of deduction of tax at source. It wants to delay the submission of the return by 5 months. It expects to earn income @ 30% per annum on the money employed in the business, by taking overdraft from the bank at 15 % per annum and interest on overdraft account is fully allowed in the income tax assessment. Advise P Co. Ltd. whether it is worthwhile to delay the submission of the Return.

TRO PROCEDURE / COLLECTION AND RECOVERY

Question 01 (TRO procedure)

The assessing officer served a notice of demand on the assessee for the tax payable Rs. 2,000. The notice was served on 1st July, giving him time up to 31st July. The assessee paid it on 30th September. What are the consequences? Can the assessee have any relief?

Question 02 (TRO procedure)

If an assessee has filed an Appeal U/s. 246, can the A.O. treat the assessee as assessee In default for non-payment of tax as communicated by notice of demand? Can it be equaled with power of appellate authority to grant stay of recovery?

Question 03 (TRO procedure)

A recovery certificate U/s. 222 is to be issued. But the assessee has died. Advice the A.O. regarding to course of action.

Question 04 (TRO procedure)

A recovery certificate U/s. 222 is prepared by an A.O. The assessee is having property a part of which is not within the jurisdiction of this A.O. What is the remedy available to this A.O.? Can he correct any clerical or arithmetical error in such certificate which is discovered subsequently?

OR

Mr. Sukesh Is an assessee deemed to be in default U/s. 220. The recovery is to be made from him, but he is not having any property in India. However, it is understood that he has a lot of property in foreign countries. What is the course to action available to the revenue in such a case?

Question 05 (TRO procedure)

When can the T.R.O. stay the proceedings for recovery of tax? What is the ultimate result of such stay?

Question 06 (TRO procedure)

What is meant by 'Garnishee Proceedings'? When can TRO Initiate such proceedings?

Question 07 (TRO procedure)

A notice of demand has been served on the assessee and he failed to pay the dues. Can the government file a suit for recovery instead of using the modes of recovery under chapter XVII of Income Tax Act, 1961?

281 / 281B

Question 01 (Certain transfer to be void and provisional attachment) (ID 01)
Recovery proceedings were initiated against the assessee and her husband. Since the arrears could not be realised the assessee's property was attached u/s 281 / 281B in February, 2010. The assessee filed an objection petition stating that the properties were gifted to her by her ex-husband and she had been separated by the pronouncement of "Talaq" (divorce) and was in no way responsible for the personal liability of her ex-husband. You are required to give your valuable opinion whether attachment u/s 281 / 281B was justified.

Question 02 (Certain transfer to be void and provisional attachment) (ID 02)
One M/s. Simplex Enterprises had booked and was allotted shop No. 4 admeasuring 2403 sq. ft. (with 1437 sq. ft. of Mezzanine floor) in Virwani Plaza at Pune in June, 1988. The Mr. Kalpesh Sanghavi (defaulter) paid the earnest money for procuring the said allotment. On January 23, 1997, an ITCP-1 was served for recovery of the outstanding demand. In June, 1997, the Mr. Kalpesh Sanghavi paid the balance money to the builder and obtained the possession of the said shop. In July, 1998, the Mr. Jayanti purchased rights, title and interest of the Mr. Kalpesh Sanghavi in the said shop. Sale deed was executed between the builders and the Mr. Jayantis for sale of the said shop in November, 1998, with the Mr. Kalpesh Sanghavi as a confirming party. The Tax Recovery Officer at Pune under the certificate from Tax Recovery Officer, attached the said shop on January 10, 2001 and declare the sale as void. You are required to give your opinion whether the attachment is justified.

Question 03 (Certain transfer to be void and provisional attachment) (ID 03)
N was liable to pay certain sums on account of income tax, penalty, interest and fine. He was also liable to pay certain sums under the Wealth-tax Act. N was the owner of certain premises to the extent of 35 / 96th shares and 1/6 of 61 / 96th shares. The Tax Recovery Officer issued an order restraining N from transferring or charging the said premises and prohibited all persons from taking any benefit under such transfer or charge. Notices under section 226(3), were issued and served upon the tenants asking the tenants to pay the rent to the Income-tax Department. The writ petitioners, namely, the son of N and N's wife filed a writ petition challenging the notices. It was claimed in the writ petition that N had executed a deed of trust, concerning his shares in the premises in question and appointed the petitioners the trustees thereof. The Revenue filed an affidavit-in-opposition and declare the transaction as void under section 281 contending that the deed of trust was created fraudulently and to defraud the creditors including the Revenue to whom large sums of money were due. You are required to offer your comments for the same.

269 SS / T

Question 01 (Reasonable Cause)

The assessee a subsidiary company of another purchase certain goods from the holding company. It could not repay the price. The amount payable was converted into a loan of rupees 25.000 & the remaining odd amount was paid by cheque. The A.O. wants to create this as contravention of the provisions of section 269SS & accordingly the joint commissioner wants to levy a penalty u/s 271 D. Is he justified?

Question 02 (Reasonable Cause)

A dentist took loan from friends & relatives in cash for repayment of installments of his flat & for purchasing instruments for his Clinic A penalty was levied u/s 271 D. Is it justified?

Question 03 (Reasonable Cause)

The assessee firm repaid deposits in cash Rs. 25,000. The assessee explained that it had three sister concerns & their partners were closely related to each other. Funds were often transferred among them according to the requirement so, they were not deposits. Hence, the penalty u/s. 271 E is not justified. Do you agree?

Question 04 (Reasonable Cause)

A person has repaid the deposit in cash Rs. 30,000. He did not have any business activity or profession so there were no books of accounts. A penalty has been imposed u/s 271 E. The person repaying the deposit argues that the deposits when accepted were treated as genuine. for Income Tax assessment. Hence, at the time of repayment also they should be considered as genuine and no penalty should be levied. Is the argument acceptable?

PENALTIES IMPOSABLE

Question 1 (Scope of Penalty) (ID - 03)

Mr. X submitted following details, you are required to discuss penalty provisions for the same.

Return of loss submitted.		(-) 2,00,000
Additions made by Assessing Officer.		
(1) on account of question of law	1,20,000	
(2) on account of question of facts	1,80,000	
(3) intangible additions	60,000	3,60,000
Assessed income		1,60,000

Compute the tax payable and penalty imposable under section 27(1)(c)

Question 2 (Scope of Penalty) (ID - 04)

Anurag Traders, a partnership firm, for the year, filed its return of income on an income of Rs. 40,000. The assessment was completed on an income of Rs. 1,20,000 in the month of June, 1999. The additions included (a) profit on suppressed sales of Rs. 40,000, (b) disallowances in expenses Rs. 40,000. The assessment became final as no appeal was preferred. Penalty proceedings were initiated on the charge of concealment of income of suppressed profits. After considering the explanation to the notice to the penalty, penalty was levied on the charge that inaccurate particulars were furnished. M/s.Anurag Traders contents that the Order of penalty is bad in law. Is the contention justified.

Question 3 (Scope of Penalty) (ID - 08)

A notice to levy penalty under section 271**(**1)(c) was issued on 11-6-2009. The assessee in response thereto filed on 13-7-2009 a written submission requesting to decide the matter. The Assessing Officer before whom this reply was filed retired on 31-7-2009 and the officer, who succeeded him passed the penalty order without providing any further opportunity, but by taking into cognizance the reply filed by the assessee. Whether the order by the Assessing Officer is valid ?

Question 4 (Scope of Penalty) (ID - 10)

A trust, set up wholly for charitable purposes, furnishes its return of income in respect of assessment year on 15-10-2010; declaring an income of Rs. 1,40,000. The Assessing Officer on scrutiny of the return finds that the income of the trust is exempt from tax. Are there any penal consequences for the trust's failure of furnish the return of income within the prescribed time ?

Question 5 (Penalty explanations to 271) (ID - 01)

Mr. X submitted following details, you are required to discuss penalty provisions for the same.

Return of loss furnished	(-) 7,00,000
Concealed income under section 143(3)	3,00,000
Assessed loss	(-) 4,00,000

Question 6 (Penalty explanations to 271) (ID - 02)

X. Ltd. submitted following details, you are required to discuss penalty provisions for the same.

Return of loss submitted by X Ltd.	(-) 1,50,000
Additions made on account of concealment by Assessing Officer u/s 143(3)	2,50,000
Total income assessed	1,00,000

Question 7 (Penalty explanations to 271) (ID - 11)

For the previous year, the Assessing Officer makes the following observations:

The assessee has purchased on June 3, gold of Rs. 2 lakh for which he is unable to offer any explanation. On his daughter's marriage, the assessee spends Rs. 12 lakh on May 15, and the assessee fails to explain the source of expenditure.

1. Can the Assessing Officer levy penalty under section 271(1)(c) ?

2. Is it possible for the assessee to argue in the penalty proceedings that the aforesaid investment/expenditure have been made out of following additions made by the Department in earlier years.

Assessment years	Additions made	Whether penalty was levied under section 271(1)(c)
2004-05	20,00,000	Yes only on Rs. 1,20,000
2005-06	3,00,000	Yes only on Rs. 80,000
2006-07	Nil	-
2007-08	7,00,000	No
2008-09	50,000	No

Question 8 (Penalty explanations to 271) (ID - 05)

KP Madhusudan & Co., a partnership firm, had taken certain bank drafts for payments to suppliers of rice and it had made entries in the accounts a few days later, but not on the dates on which the bank drafts were obtained. The explanation of the assessee was that since sufficient cash balance was not available on those dates, it had obtained hand loans from friends and, as it had expected to repay such loans within a short time, no entries were made in its books of account in respect thereof. Due to inability to furnish evidence for such loans, the assessee offered the amount of Rs.93,000 as additional income towards unexplained investment. Penalty proceedings were initiated by Assessing Officer under Section 271(1)(c) read with Explanation 1 of Income-tax Act and levied a penalty of Rs.37,000. Is the levy of penalty justifiable ?

Question 9 (Flat Penalty) (ID - 06)
GK Ltd. filed its return of income for the assessment year 2011-12 on 1.6.2012. The assessing officer levied a penalty of Rs. 5,000 under Section 271F. The assessee makes a submission to the CIT (Appeals) that he has furnished the return of Income within the due date specified in Section 139(4) and hence no penalty should be levied under 271F. Discuss.

Question 10 (Penalty explanations to 271) (ID - 07)
Can penalty under section 271(1)(c) of the Income-tax Act for concealment of income or particulars thereof be imposed on "intangible" additions to income made by the Assessing Officer. Can these additions be utilised by the assessees to explain investments made in the subsequent years ? Is there any time limit for initiation of penalty proceedings in such cases ? Discuss.

Question 11 (Powers of CIT) (ID - 09)
State the conditions, if any, to be satisfied by an assessee in order to get relief under section 273A(4) of the Income-tax Act, 1961 regarding the waiver of penalty. Can the Commissioner of Income-tax refuse to grant relief when the conditions laid down in the section are complied with by the assessee ?

LIABILITY IN SPECIAL CASES

Question 01 (person leaving India)

An assessee has applied for tax clearance certificate. Can the AO. make an assessment U/s. 174?

Question 02 (legal heirs and executors)

A notice of demand has been sent to the deceased assessee during his lifetime. The assessing officer wants to recover the dues. Is there any necessity of sending further notice?

Question 03 (legal heirs and executors)

The assessee died leaving behind more than one legal representative. The assessing officer served notice U/s 148 on one of them. How far the proceedings are valid?

Question 04 (legal heirs and executors)

While making an assessment on executor, as AOP U/s 168(1) (b) the assessing officer noticed that there were some brought forward losses. Can these be allowed to be set off ?

Question 05 (legal heirs and executors)

One Mr. B having extensive business interests did not file returns. He died leaving behind ten legal representatives. J, who was one of legal representatives, filed returns for the three assessment years disclosing the income received by B. The returns were signed by J alone and not by the other legal representatives. The Assessing Officer issued notices under sections 142(1) and 143(2) to him to appear and produce documents, accounts and other material. He complied with the same without raising any objection that in the said assessment proceedings notice must be given to the other legal representatives also. However, assessment orders were made mentioning the names of all ten legal representatives against the column' Name of the assessee'. On appeal, J contended for the first time that inasmuch as all the legal representatives of B were not given notice of the assessment proceedings, the assessments made were illegal and void. The CIT rejected the contention and held that completing the assessment without serving notices upon all the legal representatives was only an irregularity in completing the assessment. Accordingly, he set aside the assessment orders and remitted the matter to the Assessing Officer for making fresh assessments after notice to all the legal representatives. The Tribunal affirmed the view of the CIT. On reference, the High Court held that in the absence of service of notice on all the legal - representatives, the assessment made upon them was a nullity and not a mere irregularity. It accordingly, set aside the direction of the CIT as affirmed by the Tribunal. The revenue wants to challenge it Do you think it would be successful?

Question 06 (legal heirs and executors)

On the death of a person who had not left any Will, the properties were managed by his mother. The widow of the deceased did not receive any share from the estate. Her mother-in- law filed a consolidated return and the ITO made assessment on the widow for her 1/6th share. Is the action justified?

Question 07 (Succession of Business)

In the following cases, mention whether there is a 'succession' for the purpose of section 170 of Income Tax Act.

a) B and Co. owned rolling mills and other manufacturing units. It transferred the rolling milts to a newly formed company.

b) A HUF carried on a money lending business. It was partitioned and the erstwhile co-parceners carried on the same business in partnership.

c) A five member HUF carried on a money lending business. The HUF was partitioned. One of the members was assigned a one fifth share of the assets of the business and separated. The other four carried on the business at old premises in the manner in which it was carried on before partition.

Question 08 (Discontinuation of business)

A business was discontinued during the previous year. Assessing officer wants to make cumulative assessment i.e. assessment of the earlier previous year in which business existed for the whole year and the part of the next previous year during which business was discontinued is such cumulative assessment valid?

Question 09 (Discontinuation of business)

An HUF was carrying on a business. It was partitioned & the business was split Two of the erstwhile members continued the business activities as their own, taking over the premises of the business. Is there a discontinuation within the meaning of sec. 176?

Question 10 (Companies in liquidation)

Imperial Chit Funds (P) Ltd. was under liquidation. On completion of assessment the official liquidator informed the I.T.O. that tax dues determined constituted debt provable in the winding up proceedings. I.T.O. however, issued a certificate to the T.R.O. and demanded the tax dues immediately and issued a demand notice. Can the income tax department be treated as a secured creditor' and the amount set aside by official liquidator U/s 178(3)(b) fall outside the area of winding up proceedings? Can the A.O. be entitled to payment of tax demand otherwise than as U/s 530 of Companies Act?

DIVERSION OF INCOME / ACCRUAL OF INCOME

Question: 01 (ID 01)
Under a decree of court, X has to make an annual payment of Rs. 60,000 for maintenance of his wife and three sons. The annual payment is not charged on any of his property. X claims that Rs. 60,000 is deductible while computing his taxable income, since it is diversion of income by overriding charge. Is he legally justified ?

Question: 02 (ID 02)
X is appointed as managing director of a company on commission of 5 per cent of total sales made by the company. If in any year the net profits of company are not sufficient to declare 8 per cent dividend, X is bound to give up such portion of commission (not being more than one-third of usual commission) as may be necessary to make up the deficiency. The agreement also provides that the commission is payable after March 31 and after account are passed by the general meeting of shareholders. On March 13, the board of directors of the company passes a resolution to the effect that X, the managing director, has agreed to charge a lower rate of commission for the accounting year ending March 31. Discuss whether the difference between commission receivable under the original contract and the commission under the modified contract is taxable in the hands of X.

Question: 03 (ID 03)
X, a leading advocate, who has been originally reluctant, agrees to defend certain accused persons in a criminal suit, on the conditions that he will be provided with Rs. 85,000 for a public charitable trust which he will create. X creates a public charitable trust on receipt of Rs. 85,000. Discuss whether the sum of Rs. 85,000 will form part of assessee's taxable income.

Question 04 (ID 04)
X is a dealer in garments and maintains his books of account on the basis of mercantile system. During the previous year ending March 31, X withdraws some garments for his personal use by crediting goods accounts by the cost price of the goods. The Assessing Officer, applying the principle laid down by the House of Lords in Sharkey v. Wernher [1956] 29 ITR 962, wants to include the difference between the market price and cost price of the goods withdrawn in the income of X. Is the Assessing Officer justified ?

Question: 05 (ID 05)
The members of the X co-operative society are teachers. The assessee is getting text-books from the Government at concessional rates and selling them to any person who wants to purchase as also to its members at a discount. For the relevant assessment years, the assessee is of the view that since it has been formed for promoting the common interest of the members the profits earned from them has an element of mutuality and, therefore, its entire earning must be dissected and those earned from members must be excluded and those earned from non-members may be taxed. Advise.

MUTUAL ORGANISATION

Question: 01 (ID 01)

XY Club Ltd., a social and sports club, conducts horse races with amateur riders and charges fees for admission into the enclosure of the club at the time of races. A resolution is passed at a general meeting of the club for charging a surcharge, apart from regular admission fee, the proceeds of which are to go for local charities. Every entrant is issued two tickets – one, an admission ticket, for admission to the enclosure of the club and the other, a separate ticket in respect of surcharge for local charities. Discuss whether receipts on account of surcharge is to be treated as assessee's income.

Question: 02 (ID 02)

XYZ Ltd., a public limited company, runs a club for its members. Its objects are to promote social intercourse among the members of the club, their families and friends, provide them will a club house and accommodation. No income or property can be paid or transferred by way of dividend, bonus or otherwise by way of profit to the members. No remuneration or other monetary benefit can be given to any member excepting payment of out-of-pocket expenses, reasonable interest on money lent to the assessee-company and proper rent on premises let to the club. During the accounting year ending March 31, the assessee provided temporary accommodation to the members in its Madras property and realised a rent of Rs. 34,000. Treating this sum as income from house property, the Assessing Officer wants to tax it. The Assessing Officer thinks that the principle of mutuality does not apply to the income received from renting from renting out of premises to members. Discuss.

Question: 03 (ID 03)

XYZ, a co-operative society, registered under the Bombay Co-operative Societies Act, 1925, owns certain land. After the land is fully developed by laying roads and making provisions for civil amenities, the society allots plots of land to its members on lease basis and collects certain amounts an execution of lease deed. The society further permits, in appropriate cases, disposition or devolution of the lease of any plot, including any building thereon, from an existing member to another prospective member, but the transferor is to pay the society half of the premium amount, if any, received by him from the purchaser.

For the assessment year, the assessee files a return showing certain amounts received on allotment of plots by lease to members and also those being half share of abovementioned premium amount, and contends that it is a mutual association and hence its income cannot be taxed. The revenue, on the other hand, insists that since the impugned amounts, received by the society from its members, remain with the society and can be disposed of as it likes, the assessee-society cannot be treated as a mutual association. Decide.

SURVEY, SEARCH AND SEIZURE

Question 1 (SLID 01) (survey)

During the course of survey operations under Section 133A, carried on 5th March, The Income-tax authority, impounded the books of account and other documents inspected by him, relating to the assessee and retained the same in his custody. Is the action of the officer justified under law ?

Question 2 (SLID 02) (survey)

An Income-tax authority in the course of exercising powers of survey under section 133A serves a summon on the assessee and impounds the books of account and other documents found in the premises visited. Discuss the legality of its action.

Question 3 (SLID 03) (search)

On 1.9, Prem & Sons have been searched. During the search, papers belonging to his close friend Mr. Shyam indicating concealed income have been found. How should the Assessing Officer proceed in such a situation under the Act ?

Question 4 (SLID 04) (search)

(a) In the course of search on 25.03, assets were seized. State the procedure laid down to deal with such seized assets under the Act.

(b) The Director of Income Tax received information that Mr. X has unaccounted cash exceeding Rs.50 lakhs. Can the Director pass orders for seizure of the cash invoking his powers under section 131(1A)? Does the Director have any other course open to him for the seizure of cash?

Question 5 (SLID 05) (search)

In the course of search operations under section 132, a tax payer makes a declaration under section 132(4) on the earning of income not disclosed. Can that State save the tax payer from a levy of penalty under section 271(1)(c) ?

Question 6 (SLID 06) (search)

State whether the information regarding possession of unexplained assets and income received from the Central Bureau of Investigation, a Government agency, can constitute "information" for action under section 132 of the Act. Discuss

Question 7 (SLID 07) (search)

The business premises of Ram Bharose Ltd. and the residence of two of its directors at Delhi were searched under section 132 of the Act by the DDI, Delhi. The search was concluded on 9-8-PY and following were also seized besides other papers and records:

I. Papers found in drawer of an accountant relating to Shri Krishna Ltd., Mumbai indicating details of various business transactions. However, Ram Bharose Ltd. is not having any direct or indirect connection of any nature with these transactions and Shri Krishna Ltd., Mumbai and its directors.

II. Jewellery worth Rs. 5,00,000 from the bedroom of one of the director, which was claimed by him to be of his married daughter.

III. Papers recording certain transactions of income and expenses having direct nexus with the business of the company for the period from 16-4-2007 to date of search. It was admitted by the director that the transactions recorded in such papers have not been incorporated in the books.

You are required to answer on the basis of the aforesaid and the provisions of Act, following questions:

a) What action the DDI shall be taking in respect of the seized papers relating to Shri Krishna Ltd., Mumbai?

b) Whether the contention raised by the director as to jewellery found from his bedroom will be acceptable?

c) What presumption shall be drawn in respect of the papers which indicate transactions not recorded in the books?

d) Proceedings for how many years shall now be taken up and within which time limit the assessment thereof be completed by the Assessing Officer?

e) Can the company move an application for settlement of case as per chapter XIX-A of the Act?

SETTLEMENT OF CASES

Question (SLID 01)

Write short notes on the Constitution of Settlement Commission.

Question (SLID 02)

Benches of Settlement Commission [Section 245BA].

Question: (SLID 03)

State briefly the proceedings for assessment in respect of which application can be made before Settlement Commission on or after 1.6.2007. Explain the provisions relating to admission of application before Settlement Commission made on or after 1.6.2007.

Question: (SLID 04)

An Assessee's case is pending in appeal before the income Tax Appellate Tribunal for Assessment Year 2005-06. Since the appeal is pending, the Assessee wishes to file an application to the Settlement Commission for disclosing additional income, the income tax on which is Rs. 15 Lakhs. Is it possible to make such application? Will your answer be different if the Tribunal sets aside the case and restores the matter to CIT (Appeals) ?

Question: (SLID 05)

Briefly describe the manner of computation of Additional Income Tax Payable.

Question: (SLID 06)

The orders of the Settlement Commission are conclusive. Discuss.

Question: (SLID 07)

Explain the consequences in case of rejection of the application by Settlement Commission [Section 245HA] is CIT (Appeals) empowered to consider an appeal filled by an assessee challenging the order of assessment in respect of which the proceedings before the Settlement Commission abates.

Question: (SLID 08)

When can a subsequent application to the Settlement Commission be barred ?

Question: (SLID 09)

Discuss the powers of the Settlement Commission. [Section 245H]

Power of the Settlement Commission to grant immunity from prosecution and penalty is limitless. Discuss.

Question: (SLID 10)

The Settlement Commission does not have the power u/s 245D to reduce or waive the interest payable by an assessee under the provisions of Section 234A, 234B or 234C. discuss.

Question: (SLID 11)

There are parallel provisions which empower the Settlement Commission as well as the income – tax authorities to reduce or waive penalties and grant immunity from prosecution. In what respects do they overlap and in what respects do they differ?

ADVANCE RULING

Question (ID 03)

Designated Authority can determine any issue under the Income-tax Act, 1961 by giving `Advance Ruling'. Elaborate the meaning assigned to `Advance Ruling' under the aforesaid Act.

Question (ID 04)

Can a person resident in India seek advance ruling from the Authority for Advance Ruling?

Question (ID 01)

Mr. Sushil Kumar is a non-resident. The appeal pertaining to the assessment year is pending before the Appellate Tribunal, the issue involved being computation of capital gains. The same issue persists for the subsequent assessment year also. Mr. Sushil Kumar's friend Mr. Sachin Gupta has obtained an advance ruling under chapter XIX-B of the Income-tax Act, 1961 from the Authority for Advance Rulings on an identical Point. Mr. Sushil Kumar proposed to use the said ruling for his assessment. Can he do so?

OR

R is a non-resident. The appeal pertaining to the assessment year is pending before the Appellate Tribunal, the issue involved being computation of income from house property. The same issue persists for the subsequent assessment year also. R's friend has obtained an advance ruling under Chapter XIX-B from the Authority for Advance Rulings on an identical point. R proposes to use the said ruling for his assessment. Advise R suitably?

OR

Saba Karim is a non-resident. The appeal pertaining to the Assessment Year is pending before the Appellate Tribunal, the issue involved being computation of income form house property. The same issue persists for the subsequent Assessment Year also. Saba Karim's friend Sheikh Ali has obtained an advance ruling under Chapter XIX-B of the Income Tax Act, 1961 from the Authority for Advance Rulings on an identical Point. Saba Karim proposes to use the said ruling for his assessment. Advise Saba Karim suitably?

OR

Who are the persons in respect of whom Advance Ruling given u/s 245R shall be binding?

Question (ID 05)

A Foreign Company entered into contracts with several Indian companies for installation of mobile telephone system and made an application to the AAR for advance ruling on the rate of withholding tax on receipts from Indian Companies. One of the Indian Companies made an application to its Assessing Officer for determination of the rate of tax at which tax is deductible on payment to the said Foreign Company.

The AAR rejected the application of the Foreign Company on the ground that the question raised is already pending before an income tax authority. Is the rejection of the application of the Foreign Company justified in law?

Question (ID 02)

List a few instances of issues on which rulings can be asked for from AAR.

Question (ID 06)

ABC Inc. a Non-resident investor Company is a beneficiary of a contributory trust established in India. The application for advance ruling u/s 245Q by ABC Inc. on a question affecting the trust involving, inter alia, provisions of Sections 161 to 164 is resisted by the Department on two grounds –

(a) This is a question which really affects the contributory trust in India, and that the applicant though a non-resident cannot avail the benefits of Chapter XIX-B for getting clarifications about a resident assessee's liability to income-tax merely because they have some mutual connections;
(b) Since the ruling given would bind only the applicant and the Department, any action at the time of assessment of the Indian trust cannot be questioned on the basis of the ruling and hence the ruling would be infructuous.

Discuss the pros and cons of the objections of the Department.

TAX DEDUCTION OR COLLECTION

Question: 01

X, while making payment to a non-resident for providing technical services on a World Bank aided project "net of tax" had deducted tax as per rates prescribed but says that the payee is not entitled for the TDS certificate since the tax was not to be borne by the payee as per agreement. Examine.

Question: 02

M Ltd, has taken a 3,000 sq.ft. flat on rent from Y Ltd. To set up its branch office. The rent payable to Y Ltd. For the flat is Rs. 60,000 per month plus applicable service tax, M Ltd. Wishes to know whether tax is required to be deducted at source under section 194-I from gross amount of rent including service tax, give your advice.

Question: 03

East Bengal Club, a renowned football club has engaged A, a resident in India as its coach at a remuneration of Rs. 6 lakh annually. The club wants to know from you whether it is liable to deduct tax at source from such remuneration.

Question: 04

Discuss the following:

1. X Ltd. Is engaged in manufacture of a product. It paid a lump-sum deposit and obtained 50 mobile phone services so that the employees of the assessee can be contracted immediately. The company paid Rs. 45,000 every month towards the service and call charges to the mobile phone franchise. On these facts
   i) Whether X Ltd., has to deduct tax at source on the payment?
   ii) If so under which provisions of the Act?
2. Y Ltd., paid Rs. 5 lakh as sales commission to X (non-resident) who acted as its agent for booking orders from various customers who are outside India. The assessee has not deducted tax at source on the commission payment for the year. On these facts:
   i) Decide whether the commission is chargeable to tax in the hands of X in India?
   ii) Decide about the deductibility of the commission payment in the assessment of X Ltd.

Question: 05

X Ltd. took on sub-lease a building from J an individual, with effect from September 1, on a rent of Rs. 20,000 per month. It also took on hire machinery from J with effect from October 1, on hire charges of Rs. 9,000 per month. X Ltd. entered into two separate agreements with J for sub-lease of building and hiring of machinery. The rent of building and hire charges of machinery for the year amounting to Rs. 70,000 and Rs. 54,000 respectively were credited by X Ltd. to the account of J in its books of account on March 31,. Examine the obligation of X Ltd. to deduct tax at source in respect of the rent and hire charges.

Question: 06

X, an individual, has let out his building on a monthly rent of Rs. 12,000. The tenant deducted tax under section 194-I from the rent paid to X, but did not remit such tax to the credit of the Central Government, X filed his return of income for the year including therein the rental income from the said building and paid the balance tax on his total income after taking credit for tax deducted at source by the tenant. The Assessing Officer has called upon X to pay the tax to the extent of tax deducted at source. Is the Assessing Officer justified in doing so?

Question: 07

Examine the obligation of the person responsible for paying income to deduct tax at source and indicate the due date for payment of such tax wherever applicable in respect of the following items:

1. X Ltd., the employer credited salary due for the year amounting to Rs. 2,40,000 to the account of Q, the employee, in its books of account on March 31,. Q has not furnished andy information about his income / loss from any other head or proof of investments / payments qualifying for deduction under section 80C.
2. Y, an individual whose total sales in business during the year ending March 31, was Rs. 1.20 crore, paid Rs. 9 lakh by cheque on January 1, to a contractor for construction of his business premises in full and final settlement. No amount was credited earlier to the account of the contractor in the book of Y.
3. X Ltd., credited Rs. 18,000 towards fees for professional services and Rs. 19,000 towards fees for technical services to the account of HG in its books of account on October 6,. The total sum was paid by cheque to HG on December 18,.

Question: 08

X Ltd. has made payments on various dates in year to Y Ltd. towards work done under different contracts as follows:

Contract Number	Date of payment	Amount (Rs.)
1.	May 5,	13,000
2.	June 6,	16,000
3.	August 8,	20,000
4.	September 10,	2,000
5.	October 10,	25,000

X Ltd. claims that it is not liable to deduction of tax at source under section 194C. Examine the correctness of the claim made by the company.

Question: 09

Discuss the liability for tax deduction at source in the following cases:

1. X has been running a sole proprietary business whose accounts are audited under section 44AB. he pays a monthly rent of Rs. 15,000 for the office premises to R, the owner of building and an individual, Besides, he also pays service charges of Rs. 10,000 per month to R towards the use of furniture, fixtures and vacant land appurtenant thereto.
2. By virtue of an agreement with a nationalised bank, a catering organisation (a sole proprietary concern) receives a sum of Rs. 50,000 per month towards supply of food, water, snacks during office hours to the employee of the bank.
3. An Indian company pays gross salary including allowance and perquisite to its General Manager on which the tax liability works out to Rs. 86,520 for the accounting year. Besides, the company provides non-monetary perquisites to him for the same period whose value is estimated at Rs. 1,20,000 and total salary is estimated at Rs. 6,00,000.
4. A foreign company which has made prescribed arrangements for the declaration and payment of dividends within India, pays a sum of Rs. 10,000 towards dividends on equity shares to a shareholder and Rs. 2,200 towards dividends on preference shares held by another share holder.

Question: 10

X is an agent selling lottery tickets, of Nagaland State. His business is in the sale of these tickets and under the terms of his agency, he is for bidden to participate in any of the draws or claim any prize. An amount of Rs. 10 lakh was collected by him from Nagaland State as the amount accruing on unsold and inclaimed tickets in his possession. The Assessing Officer has issued a notice, asking X to deposit tax at 30 per cent, being the tax deductible at source under section 194B on the sum of Rs. 10 lakh. How will you deal with this matter as an advisor to X ?

Question: 11

The following issues arise in connection with the deduction of tax at source under Chapter XVII-B. Discuss the liability for tax deduction in these cases:

1. X, an employee of the Central Government receives arrears of salary for the earlier three years. He enquires whether he is liable for deduction of tax on the entire amount during the current year.
2. A TV channel pays Rs. 11 lakh on July 1, as prize money to the winner of a quiz programme “Who will be a Millionaire”?
3. State Bank of India pays Rs. 50,000 per month as rent to the Central Government for a building in which one of its branches is situated.
4. A television company pays Rs. 50,000 to a cameraman for shooting of a documentary film.
5. A State Government pays Rs. 20,000 as commission to one of its agent on sale of lottery tickets.
6. A turl club awards a jackpot of Rs. 5 lakhs to the winner of one of its races.

Question: 12

Discuss the following:

1. A foreign company, who has a branch operating in India pays salary to its employees "net of tax". It declines to issue certificate under section 203 to its employees of the tax deducted at source on the ground that it had not deducted any tax at source.
2. A foreign company pays fees for professional and technical services rendered to it by an Indian law and accountancy firm. The foreign company does not have any branch, agent or establishment in India. Advise the foreign company as to, how it comply with provisions of section 194J.

Question: 13

Discuss the following:

1. X won the first prize in a lottery ticket on December 15, and the prize money was a Maruti car worth Rs. 2 lakh. According to section 194B, tax has to be deducted as source from the winnings of lottery at the time of payment of the prize money. What is the procedure to be adopted before handing over the Maruti car to X?
2. A private trust has two individuals and one HUF as beneficiaries and their shares are equal. The trust borrowed certain amounts on which interest payable to single lender is Rs. 38,000. Is the trust obliged to deduct tax at source at the time of payment / credit of such interest to the lender?

TYPES OF RETURNS AND SIGN

Question (ID 01)

Discuss whether the following persons are required to submit return of income

Assessee	Net income	deduction under section 10A, 10B, 10BA, 80C to 80U	Sources of Income	Turnover/gross receipt
X Ltd.	51,000	Nil	Business	80,80,000
Y (70 years)	1,45,000	1,95,010	Salary and property	-
Mrs. Z	1,90,000	2,17,000	Rent	-
A Ltd.	(-)30,000	Nil	Business	90,00,000
B	(-)20,000	Nil	Profession	85,00,000
C	(-)32,000	Nil	Capital gain	-
D	23,000	2,40,000	Pension	-
E	2,60,000	10,000	Business	38,00,000
F	75,000	25,000	Business	85,00,000
G (64 years)	75,000	1,86,000	Business	39,00,000
H (30 years)	90,000	1,71,000	Salary	-
I (Firm)	4,00,000	4,000	Business	91,00,000
J (Firm)	60,000	Nil	Business	34,00,000
K*	1,62,000	Nil	Share of profit from firm	-
L**	2,40,000	1,30,000	Business	25,00,000

*K is a working partner of I (Firm) but does not have his own business.

**L is a working partner of J (Firm) but also has his own business.

Question (ID 02)

Find out the due date for submission of return of income in the following case.

Name of the tax payer: A Ltd.

Taxable income: (-) Rs. 320,000

Turnover: Rs. 90,00,000

Number of cars owned by A Ltd.: 11

Question (ID 03)

A firm carrying on business filed a return of income disclosing an income of Rs. 3,25,000 in November, of AY. It discovered an omission therein and therefore filed a revised return under section 139(5) in January of AY showing a revised income of Rs. 2,00,000. The Assessing Officer, however, ignored the revised return and proceeded to process under section 143(1) on the original return. Please offer your comments.

Question (ID 04)

(i) For the year the company submitted the return of income 28-9-AY declaring income of Rs. 5,62,500. Subsequently, it is found that the depreciation provided in the accounts as per the Companies Act, 1956 was Rs. 3,67,500. This was claimed as deduction under section 32 of the Income-tax Act, 1961. However, as per section 32, amount of depreciation is Rs. 4,12,500. What remedy is available to the company ?

(ii) An order under section 143(3) of the Income-tax Act, 1961 for the assessment year is received. On perusal of the order, the following two points are noticed.

(a) Credit of Rs. 12,500 for T.D.S. was not given even though duplicate copy of Form 16A was submitted with the return of income.

(b) Unpaid sales tax liability of Rs. 23,600 on 31-3-2006 was actually paid on 28-9-AY before submitting the return of income. This amount is disallowed.

Question (ID 05)

A return of income was filed within the statutory time provided under the Act, without making the payment of self assessment tax due as per return. The same was paid before completion of assessment. The Assessing Officer wants to declare the return as invalid. Is the Assessing Officer justified ?

Question (ID 06)

M/s Shiv Traders, a partnership firm sustained business loss of Rs.2 lakhs, inclusive of admissible depreciation of Rs.1.15 lakhs (u/s 32 of I.T. Act) for the year. The firm did not file its return for that year. The Assessing Officer issued a notice u/s 142(1) on 1st March AY, in compliance to which the firm filed its return for the said year declaring the loss of Rs.2 lakhs, and sought carry forward for next year. Is the firm's claim justified ?

INTIMATION AND ORDERS

Question (ID 01)

Can an assessee claim a particular deduction, which he has failed to claim in his original return of income, otherwise than by filing a revised return ? Discuss.

Question (ID 02)

"Proceedings cannot be initiated under the Act, unless a proper notice to the effect has been served upon." In this context answer:

(i) What are the prescribed modes of service of such notice?

(ii) On whom should be notice be addressed and served upon in the cases where the assessee is a company, a dissolved firm, a deceases person and a partitioned HUF.

Question (ID 03)

An assessee receives an intimation under section 143(1)(a) from the Assessing Officer, determining his income at a figure higher than the income returned by him. What is the remedy available to him, if he finds that the adjustments made by the Assessing Officer are not justified ?

Also comment on the action of the Assessing Officer in the following cases, relating to the assessment:

1. He makes adjustments to the total income returned by an assessee on the basis of the past records.
2. After sending an intimation to the assessee under section 143(1)(a), he takes up the case for scrutiny by issuing of a notice under section 143(2), and finds that the assessment would result in a refund. He declines to grant refund.
3. An assessee claims a sum of Rs. 1 lakh paid towards sales tax after the close of the accounting year but before filing the return, in the statement filed along with the return. The Assessing Officer refuses to allow the claim on the ground that no proof was attached in regard to the payment.
4. A return of the income for year is filed beyond the time limit prescribed under section 139 for the category of the assessee. An amount of Rs. 2 lakhs is the depreciation carried forward from assessment year 1994-95 which the Assessing Officer has refused to adjust in the assessment made under section 143(1) in the current year.

Question (ID 04) (Revision Class / Home work)

what is the time limit in the cases given below:

(1) Completion of assessment under section 143(3) for the assessment year 2007-08.

(2) Suppose in (1) supra the Assessing Officer directs the assessee to get his accounts audited on November 11, 2009. The assessee is required to furnish audit report by December 8, 2009.

(3) Completion of reassessment for the assessment year 2005-06 under section 147, notice

under section 148 is issued on March 17, 2008 and served on the assessee on April 2, 2008.

(4) Suppose in (3) supra reassessment proceedings have been stayed by the Rajasthan High Court from June 6, 2008 to November 10, 2009.

(5) Suppose in (3) supra reassessment proceedings had been stayed by the Delhi High Court on November 20, 2009. The stay was, however, vacated by the Supreme Court on November 23, 2009.

(6) Completion of fresh assessment for the assessment year 2006-07 (original order was passed under section 144 on March 22, 2008; the order was cancelled by the Commissioner under section 264 on March 20, 2009, directing the Assessing Officer to make fresh assessment; Commissioner's order is received by the assessee on April 10, 2009)

(7) Suppose in (6) supra, the proceeding of the fresh assessment has been stayed from October 10, 2009 to October 25, 2009.

(8) Suppose in (6) supra, the proceeding of the fresh assessment has been stayed from November 10, 2009 to November 25, 2009 by the Supreme Court.

(9) Suppose in (6) supra, the proceeding of the fresh assessment has been stayed from December 10, 2009 to March 3, 2010.

Question (ID 05)

Can the Assessing Officer complete the assessment under Section 144 of the Income-tax Act, 1961 even though there is no failure on the part of the assessee under Section 139(1), (4), (5), 142(1), 142(2A) or 143(2) of the Act ? If so, under what situation ?

Question (ID 06)

A company submitted the return of income for assessment year on 10th July,AY. The Assessing Officer served a notice u/s 143(2) on the company on 14th August, AY in order to make assessment under section 143(3). Thereafter, on 1st September, AY, the Assessing Officer issued an intimation under section 143(1). Such intimation shows a demand for Rs.10,500 towards tax and interest. The company argues that the issue of intimation under section 143(1) is bad in law. Discuss.

RE-ASSESSMENT

Question (ID 01)

X Ltd. has leased out a house property owned by it to the customs authorities at a monthly rent of Rs. 40,000. The lease expired on December 31, 1989. X Ltd. gave notice for vacating the premises or alternatively for an increase in the rent of Rs. 60,000 per month with effect from January 1, 1990. The customs authorities continued to occupy the premises and did not agree to increase the rent. The dispute as to the fixation of rent was referred to arbitration in November 1990. The arbitration proceeding continued for about 2 years and finally an award was delivered in January 1993 fixing the rent at Rs. 60,000 per month with retrospective effect from January 1, 1990. The customs authorities disputed the award in the Delhi High Court and ultimately a decree was passed by the Delhi High Court in July 1993 in terms of the award. Thereupon, the customs authorities paid in August 1993 the additional arrear rent of Rs. 20,000 per month for the year 1992-93. In their income-tax returns in respect of the assessment years 1991-92, 1992-93 and 1993-94 X Ltd. had continued to declare its rental income at the old rate of Rs. 40,000 per month and had also indicated by a footnote the fact that its claim for increase in rent from Rs. 40,000 to Rs. 60,000 with effect from January 1, 1990 was disputed by the tenant and the matter was pending before the arbitrator/High Court. The Income-tax Officer on consideration of the aforesaid note completed the assessment of X Ltd., in respect of the assessment years 1991-92 and 1992-93 on November 30, 1993 under section 143(3) on the basis of the old rent of Rs. 40,000 per month as was being received "under protest" by X Ltd. In December 1993, the Income-tax Officer became aware of the decree passed by the Delhi High Court in terms of the award fixing the rent of Rs. 60,000 per month with effect from January 1, 1990. Advise whether the income-tax Officer should take action for assessing the additional rent of Rs. 20,000 per month now paid in August 1993; (a) by resort to the reassessment proceeding under section 147; (b) by resort to the rectification proceedings under section 154; (c) by initiating proceedings for revision under section 263; or (d) by assessing the entire arrear rent as income for the assessment year 1994-95 on the basis of receipt, as the company follows cash system of accounting.

Question (ID 02)

During the course of assessment proceedings, the assessee has, inter alia, filed copies of the loan accounts with confirmation letters. On that basis, genuineness of the loans was accepted without making any further enquiry and the assessments were completed under section 143(3). Thereafter, the premises of one S were searched by the department. Certain books and documents were seized. One such book was a diary in which the name of the assessee was noted S stated that the transactions noted by him in the aforesaid diary were bogus and that he was arranging havalas only for his clients. On the basis of the aforesaid information, the Assessing Officer formed reason to believe that certain loans taken by the assessee were not genuine and the assessee's income for the years in question had escaped assessment. He, therefore, initiates reassessment proceedings under section 147. Discuss whether the action of the Assessing Officer is justified.

Question (ID 03)

An assessment was completed in accordance with directions contained in a circular issued by the Central Board of Direct Taxes. Subsequently the Supreme Court held the circular to be invalid. Can the completed assessment be reopened ?

OR

The assessment was completed by the assessing officer. After that, a circular was issued by CBDT U/s.119. On the basis of that the A.O. initiated the assessment proceedings U/s.147 due to, concealment of income noticed. In the reassessment proceedings, the A.O. inter alia, made use of the provisions of the circular issued post assessment The assessee objected to this claiming that the said circular has no force. Discuss.

Question (ID 04)

R Bros., an AOP, had submitted its return of income on 31-7-AY showing an income of Rs. 47,200. No assessment was made on the return. Two of the members of the AOP had been assessed in respect of the share income from the AOP. In August of AY , the audit party points out of the Assessing Officer that R Bros. have claimed excessive depreciation of Rs. 3,000. The Assessing Officer has issued under section 148 on R Bros. seeking to assess the income of the AOP. Can this be done?

Question (ID 05)

1. An assessment was made on R originally in the status of a non-resident. In the re-assessment made under section 147, he is assessed as resident and ordinarily resident on the ground that the correct status was not disclosed in the return of income filed originally. Is the change of status valid in a re-assessment?

2. A non-resident individual was assessed originally on income arising in India on 8-3-2009 in respect of assessment year 2007-08. The Assessing Officer discovered an omission in the assessment and issued notice to the statutory agent on 10-12-2009 for re-assessment of the omitted income under section 147. Assuming that the statutory agent has been given notice of his appointment and has been heard u/s 163, how will he contest the validity of the re-assessment ?

3. An assessee filed a return showing, inter alia, a sum of Rs. 25,000 as capital receipt and hence not liable to tax. The Assessing Officer accepted the claim of the assessee and made the assessment on the income disclosed. Subsequently, a successor to the Assessing Officer came across a judgement of the high Court under which the amount claimed as exempt was held to be liable to tax, under identical circumstances. The assessment was re-opened under section 147. The assessee wants you to contend that the notice under section 147 is not valid. What is your opinion?

Question (ID 06)

Discuss the validity of the proceedings in the following cases.

(i) An Assessing Officer made an order of assessment on R determining the total income at Rs. 3,75,000 by an order, dated 19-12-2009 in respect of assessment year 2007-08. This was served on the assessee on 2-1-2010. A tax of Rs. 1,87,500 was determined subsequently and a demand notice was served on the assessee on 20-1-2010.

(ii) R Ltd. effected purchases of stock-in-trade of the value of Rs. 2,50,000 from G and Company during the financial year 2008-09. Vouchers in support of the purchases were produced before the Assessing Officer, who accepted the claim. Subsequently, the Assessing Officer, received specific information that the said purchases were not genuine and G and Company had denied the transaction. The Assessing Officer thereafter re-opened the assessment under section 147. R. Ltd. challenges the validity of the re-assessment on the ground that it had disclosed all the primary facts and the Assessing Officer ought to have verified the genuineness of the claim at the time of the original assessment.

Question (ID 07)

Examine the validity of the following:

1. An assessee was treated as an agent of a non-resident in respect of assessment year 2006-07 for which no return was filed suo moto. A notice under section 148 was, therefore, issued to him on 1-7-2009 calling upon him to file a return of income. The assessee raised an objection stating that the proceedings were not valid.
2. A firm consisting of partners R and G files a return of income in respect of the assessment year 2004-05 showing a total income of Rs. 86,000. The Assessing Officer is, however, of the opinion that the business of the firm belongs to R as proprietor and makes and assessment on him. In the appeal filed by R the appellate authority holds that the firm is genuine and, therefore, allows the appeal. The Assessing Officer issues a notice under section 148 and 15-4-2009 to the firm to assess the income which has escaped assessment.
3. A firm was assessed under section 143(3) on a total income of Rs. 1,00,000 in respect of assessment year 2003-04 on 20-4-2004. The assessment was reopened to re-assess an income of Rs. 49,000 which had escaped assessment by issue of a notice under section 148 on 15-1-2006 and the re-assessment was completed on 20-3-2006. The assessment of the partner, whose case had also been reopened along with that of the firm, was made on 15-4-2008, in order to give effect to higher share of remuneration, consequent on reassessment of the firm

RECTIFICATION OF MISTAKES

Question (ID 02)

(a) In an order of assessment, the assessee noticed a mistake for which application u/s 154 was moved and the order was rectified. Subsequently, the assessee moved further application for rectification u/s 154 which was rejected by the Assessing Officer on the ground that the order once rectified cannot be rectified again. Is the contention of the Assessing Officer correct ?

(b) The return for A.Y. 2001-02 was filed on time as per Section 139(1). The assessee during the course of assessment proceedings u/s 143(2), noticed certain omissions and therefore filed a revised return on 18.4.2003. The Assessing Officer ignoring the revised return so filed framed the order on 27.4.2003. Is the action of Assessing Officer correct ?

Question (ID 03)

EIH Private Ltd's assessment for assessment year 1996-97 was completed under Section 143(3) on 31st December, 1998. The company went in appeal to the Commissioner (Appeals) and the appeal was decided on 16th August, 2003 and the appeal effect was duly given by the Assessing Officer on 25th August, 2003. Thereafter, on 1st September, 2004 the Assessing Officer noticed a mistake in calculation of depreciation on a particular block of assets, which reduced the income by Rs.1.10 lakh. The assessing officer issued notice under section 154 for the purpose of rectifying the mistake. Is such rectification permissible?

POWERS OF CIT

Question (ID 01)

Case A : In the assessment made on a firm, the Assessing Officer made two specific additions, namely (i) Unexplained Cash Credit of Rs. 1 Lakh and (ii) Disallowance u/s 43B. The assessee filed an appeal before the CIT (Appeals) contesting the addition of cash credit and being unsuccessful, filed a further appeal before the Appellate Tribunal. In respect of the disallowance u/s 43B, it did not file any appeal, but made a revision petition u/s 264, to the CIT who dismissed it on the ground that the assessment was not subject matter of an appeal to the Appellate Tribunal. The assessee relied on a Board's circular under which the CIT was empowered to accept such a petition. Discuss the correctness of the view taken by the CIT.

Case B : The Commissioner of Income Tax can revise an order during the pendency of an appeal before the First Appellate Authority.

Case C : An assessee is aggrieved by the order of the Assessing Officer and requests you to contest the same by filing an appeal before the Commissioner of Income-tax (Appeals) as well as by filing a revision petition before the Commissioner u/s 264 of the Act. Can the assessee invoke both the remedies against the order of the Assessing Officer simultaneously?

Case D : An appeal was preferred by the assessee to the CIT (Appeals) against the order of assessment made by the Assessing Officer. The appeal was allowed by the CIT (Appeals). The assessee later found that he was entitled to a certain deduction, which was neither claimed by him nor allowed by the Assessing Officer in the course of assessment. The issue of deduction was not raised by the assessee in the appeal before the CIT (Appeals) and was not considered by the CIT (Appeals). Examine the power of the CIT to revise under section 264 the order of assessment in order to allow such deduction on an application by the assessee.

Question (ID 03)

An order of assessment was made by a Deputy Commissioner of Income Tax on 20.3.2007, disallowing, among others, the following claims of an assessee :

1. Technical Fees paid to a Non-resident Company	8,40,000
2. Salary paid to a technician	1,60,000
3. Travelling expenses incurred on the travel of the wife of the Manager	2,00,000
4. Salary paid to an employee – found to be in excess u/s 40A(2) of the Act	1,80,000

The assessee filed an appeal to the Commissioner of Income Tax (Appeals) against disallowances mentioned against items (i), (ii) and (iii) above.

In the course of the appeal proceedings, it was ascertained that the assessee had paid totally Rs. 16,80,000 as technical fees under a collaboration agreement, but the Assessing Officer after

examining the evidence produced, decided that 50% of the payment was capital expenditure. The assessee, in appeal, claimed that the interpretation placed by the Assessing Officer on the agreement was wrong and that the entire payment must be allowed as a deduction. Commissioner (Appeals) accepted this argument and deleted the addition of Rs. 8,40,000 made by the Assessing Officer. He also allowed in full the claim against item no. (ii) and upheld the disallowance of the claim against item No. (iii) above.

On notice dated 20.4.2009, Commissioner of Income Tax issued a notice u/s 263 of the Income Tax Act proposing to review the order of the assessment made on 20.3.2007, in regard to the claim of technical fees. He felt that the Assessing Officer must have concluded that the entire payment of technical fees was capital expenditure and to that extent, therefore, the order of assessment was prejudicial to the revenue.

Was the CIT justified in this action? Give reasons for your answer.

Question (ID 04)

The assessment of Ashok for Asst Year 2007-08 was completed u/s 143(3) on 15.1.2009. The CIT acting u/s 263 directed the Assessing Officer to add certain amount appearing in the Balance Sheet in Total Income of Ashok. Ashok did not challenge the order of the CIT u/s 263 by filing appeal to the Tribunal. The Assessing Officer passed a fresh assessment order on 1.10.2009 including the said amount in Total Income of Ashok pursuant to the order of the CIT.

Ashok disputed the fresh Assessment Order in appeal to CIT (Appeals) u/s 246A. The CIT (Appeals) dismissed the appeal on the ground that the Assessing Officer only complied with direction of the CIT u/s 263, which was not disputed by Ashok in appeal to Tribunal. Examine the correctness of the stand taken by the CIT (Appeals).

Question (ID 05)

An assessee disclosed, Inter alia, the value of a property sold by him for an apparent consideration of Rs. 5 lakhs and the resultant capital gains at Rs. 1 lakh. This was accepted by the Assessing Officer u/s 143(3) without making any enquiry with the parties to the transaction. The Commissioner of Income Tax acting u/s 263, set aside the assessment with a direction to enquire into the correct sale value in order to arrive at the capital gains chargeable to tax. Discuss the principle under which jurisdiction u/s 263 can be assumed by the CIT in the circumstances of the case.

Question (ID 06)

The return of Income filed by Mr. Kishore has been accepted under the provisions of Sec 143(1) of the Income Tax Act. Can the Commissioner of Income Tax interfere under his revisional powers and modify the assessment it –

(a) In a case where intimation is served u/s 143(1),
(b) In a case where no intimation is served.

Question (ID 07)

Assessment for A.Y. 03-04 was completed as per section 143(3) considering the various claims so made by the assessee on 23.12.2004. Subsequently, this was reopened u/s 147 on certain issues, but excluding the claim of the assessee as to "Lease Equalization Fund". The order of reassessment was

passed on 24.11.2007. The Commissioner within the powers vested u/s 263 passed an order on 11.1.2009 rejecting the claim of assessee as to "Lease Equalization Fund". The assessee challenges that the action of the CIT is not sustainable because barred by limitation.

Question (ID 08)

The assessment of Shah Ltd for the assessment year 1997-98 was completed under section 143(3) on 30.6.99. There was an audit objection that interest on borrowals ought to have been disallowed partly as there was diversion of borrowed funds to sister concerns without charge of interest. Shah Ltd did not accept the audit objection. On these facts.

(a) What are the options open to revenue to deal with audit objection.

(b) Can the assessment be re-opened.

Question (ID 10)

An assessee is aggrieved by the order of the Assessing Officer and requests you to contest the same by filing an appeal before the Commissioner of Income-tax (Appeals) as well as by filing a revision petition before the Commissioner under section 264 of the Act. Can the assessee invoke both the remedies against the order of the Assessing Officer simultaneously.

Question (ID 11) (Revision Class / Home work)

(a) J filed a return of income, in due time disclosing a total income of Rs.4 lakhs. The taxes due on the income were covered by taxes deducted at source, advance tax and self-assessment tax. The return was taken for scrutiny by the assessing officer, who made large additions to the income disclosed by J. On appeal, the High Court set aside the order of assessment and directed a fresh assessment to be made after hearing the parties. The court order had become final since neither party had preferred an appeal against it. The assessing officer did not make any fresh assessment with the result that the assessment became barred by time. J has filed a petition that since no assessment of his income had been made by the assessing officer, the entire taxes paid, including the pre-assessment payments, must be refunded to him. Is he justified in making this claim ? Discuss.

(b) An assessment was completed by the Assessing Officer under section 143(3) on the basis of return submitted and other information furnished by the assessee. The Assessing Officer accepted the cost of the land after waiting for a reasonable period for report of the valuation officer to whom a reference was made. Subsequent to receiving the report from the valuer, it revealed that there was a variation by about Rs.3.00 lacs. On the basis of this valuation report, the Commissioner issued notice under section 263 to set aside the completed assessment. Justify the action of the Commissioner.

(c) M filed return of income for claiming a refund of Rs.45,000. The said refund was granted and paid to the assessee on 1st March, AY after processing the return under section 143(1). Later on, the case was taken up for regular assessment by issue of notice under section 143(2) and the said assessment was completed on 16th August, resulting in demand of Rs. 2500. Is the assessee liable to pay interest on the amount of refund already granted to him and if so, what is the amount of such interest ?

(d) A search was initiated in the premises of an assessee on 11th November, and it was concluded on 14th November. What is the period of limitation for issue of notice for making assessment of preceding six assessment years ? In case assessment under Section 143(3) for one year back and appeal before CIT(A) for assessment year 4 years back are pending on 11th November, what would be the fate of such pending assessment and appeal ?

TAXATION OF GIFTS

Question (Gift ID 01)

X receivers the following gifts during the previous year -

1. On April 10 he gets a gift of Rs. 25,000 from his friend A.
2. On May, 1 he gets another gift of Rs. 500 from his friend A.
3. On June 1, he gets a gift of Rs. 26,000 from C, who is cousin of his father.
4. On July 18, he gets a gift of Rs. 5,000 from D, who is elder brother of his grandfather.
5. On July 20, he gets a gifts of Rs. 41,000 from his grandmother.
6. On the occasion of marriage of X, he gets Rs. 1,90,000 as gift on July 31, (out of which Rs. 1,00,000 is received from different relatives of X and Mrs. X and remaining amount is received from friends of X and Mrs. X).
7. A computer received from his employer (it was purchased for Rs. 40,000 by the employer on May 1, and given as gift on August 20).
8. On September 1, X purchases a house property from his friend for Rs. 35,000 (market value of the property is Rs. 6 lakh).
9. On September 1, he gets Rs. 80,000 from a notified public charitable institution.
10. X receives of Rs. 5,40,000 on September 30, under will of a person known to him.
11. On October 10, he gets a gift of Rs. 40,000 from his friend.
12. On December 12, he purchases a work of art for Rs. 72,000 from an exhibition in Chennai (the fair market value of the work of art on the date of purchase is Rs. 2,00,000).
13. On January 1, he purchases a commercial property for Rs. 8,00,000 (stamp duty value is Rs. 9,60,000).
14. On March 31, he gets a birthday gift by cheque of Rs. 11,000 from his friend.

Compute the amount chargeable to tax in the hands of X under the head "Income from other sources" for the assessment year.

Question (Gift ID 02)

Partnership firm M/s JK has made the investment in kaltax private limited of 215,000 shares (paid up Rs. 3.8 per shares) of face value 10 each. By making this investment the firm has brought its interest at 26 % in the company. Price paid for acquiring 215,000 shares is Rs. 32,00,000. Balance sheet of kaltax private limited as on 31st march is as under. (Rs. In lakhs)

Particulars	
Fixed Assets	150
Debtors	150
Inventories	75
Advance Tax	25
Total Assets	400

Liabilities	22
Paid Up Equity Share Capital (10,00,000 shares * 3.8 paid up) (FV 10 per share)	38
Paid Up Equity Share Capital (10,00,000 shares * 1.5 paid up) (FV 10 per share)	15
Paid Up Equity Share Capital (10,00,000 shares * 2.5 paid up) (FV 10 per share)	25
General Reserve	28
Share Premium	33
Revaluation Reserve	218
Contingent liabilities	21
Total LIabilities	400

Would your answer be different if the investment was made in 215,000 shares of 1.5 paid up, instead of 3.8 paid up.

RESIDENTIAL STATUS

Question 1

X is a foreign citizen, not being a person of Indian origin. Determine his residential status for the assessment year 2009-2010 on the assumption that during financial years 1994-1995 to 2008-2009 he was present in India as follows.

Financial years	
1994-1995	221 days
1995-1996	22 days
1996-1997	50 days
1997-1998	72 days
1998-1999	130 days
1999-2000	340 days
2000-2001	30 days
2001-2002	160 days
2002-2003	96 days
2003-2004	286 days
2004-2005	100 days
2005-2006	182 days
2006-2007	85 days
2007-2008	280 days
2008-2009	86 days

TAX INCIDENCE

Question 1
X furnishes the following particulars of his income earned during the previous year.

		Rs.
1.	Interest on German Development Bonds (one-sixth is received in India)	36,000
2.	Income from agriculture in Pakistan, received there but later on Rs. 86,000 is remitted to India	3,41,000
3.	Interest from property in USA received outside India [Rs. 92,000 is used in Canada for meeting the education expenses of X's son in Canada and Rs. 2,48,000 is later on remitted to India]	3,40,000
4.	Income earned from business in Iran which is controlled from New Delhi (Rs. 70,000 is received in India)	4,05,000
5.	Dividend paid by an India company on May10, but received outside India	1,95,800
6.	Past untaxed profit of 2005-2006 brought to India in may 2008	2,10,000
7.	Profits from a business in New Delhi and managed from outside India (60 per cent of the profit is received outside India)	92,000
8.	Profits on sale of a building in India but received in Nepal	18,74,000
9.	Pension from a former employer in India, received in Iran (amount net of standard deduction)	2,15,000
10.	Gift in foreign currency from a friend received in India on September 6,	80,000

Find out the gross total income of X if he is R & OR, R & NOR and NR.

SALARY INCOME

Question 1

X (66 years) is in the Central Government service till his retirement on May 31, 2005 when he joins A Ltd. In which 40 per cent equity shares are held by the Central Government, Punjab Government and the Reserve Bank of India. During the previous year, he gets the following from A Ltd.

		Rs. (per month)
1.	Basic salary	20,000
2.	Dearness allowance (half of which is part of salary for retirement purposes)	2,000
3.	Overtime allowance up to May 31 of previous year.	2,000
4.	Helper allowance for office use (expenditure : 800 per month)	1,000
5.	Medical bills reimbursement (out of which Rs. 12,000 is in respect of treatment in a Government's hospital)	44,000
6.	Free gas and electricity only for personal use	24,000
7.	Free telephone at residence	9,000
8.	Free lunch in office (amount paid directly to canteen @ Rs. 35 per day for 300 days)	10,500
9.	Interest-free loan for house (SBI lending rate as on April 1, : 10.25%)	2,00,000 for six years
10.	Earned leave encashment (as per service rules X is entitled for 2 days leave for each month of service and during 2008-2009, X has encashed 24 days leave earned during the year)	16,000
11.	Mediclaim insurance on life of X	5,060
12.	Mediclaim insurance premium on the life of X's brother who is not dependent upon (the amount is reimbursed to X)	4,100
13.	Leave travel concession for X and his family(no journey is undertaken)	46,500
14.	Up to May 31 , X has been paid house rent allowance (rent paid of Delhi : Rs. 4,000 per month)	4,000
15.	With effect from June 1, he has been provided a rent-free furnished house at Saket, New Delhi whose lease rent is (rent of furniture provided with effect from September 15, Rs. 20,000)	15,000
16.	Further, A Ltd. bears the following expenses in respect of the house – repairs of house	6,000
17.	Rent of air conditioning system (for the summer)	9,000
18.	Income of X from other sources is (which includes Government pension of Rs. 1,20,000).	6,80,267
19.	Company provides Mr. X with chauffer driven car, engine capacity more then 1.6 Liters, used partly for personal and official purposes. Expenses are met by employer.	
20.	Credit card payment for Mr. X personal purposes	9,860

Find out the taxable income of X on the assumption that X annually contributes Rs. 30,000 towards recognized provident fund and Rs. 10,000 in public provident fund.

Question 2 (Revision Class / Home work)
Mrs. X (age 62 years) an employee-director of XYZ Ltd., submits the following information relevant for the assessment year

		Rs.
1.	salary	2,56,000
2.	Entertainment allowance	1,06,000
3.	Bonus	1,11,200
4.	Education allowance (for her grandchildren)	2,000
5.	Income-tax penalty paid by employer	1,500
6.	Medical expenses reimbursed by employer	12,100
7.	Leave travel concession (actual expenditure on fare is more than Rs. 51,300)	51,300
8.	Free residential telephone	11,000
9.	Free refreshment during office hours	2,000
10.	Payment of electricity bills by employer	11,000
11.	Reimbursement of gas bills	11,500
12.	Professional tax paid by Mrs. X	1,650
13.	Furnished flat at concessional rate-lease rent of the house	1,60,800
14.	Cost of maintenance of grounds (including salary of gardener)	2,000
15.	Salary of two watchmen	11,000
16.	Salary of sweeper	6,200
17.	Rent of air-conditioner	2,000
18.	Cost of furniture	18,000
19.	Car (1900cc) owned by the employer – cost of car	6,70,000
20.	Maintenance of the car	48,000
21.	Salary of driver (10 per cent of the expenditure is attributable for the journey between office and residence and back)	24,000
22.	Arrears of bonus of 2004-2005 (not taxed earlier)	52,000
23.	Payment of delegation fee to FICCI for attending 30th All India conference of Corporate Managers and Tax Executives	3,000
24.	Employer's contribution towards recognized provident fund	47,920
25.	Interest credited in PF account @ 14 per cent (credited on August 10)	14,000
26.	Employer's contribution to superannuation fund	7,200
27.	Employer's contribution to approved gratuity fund on accrual basis	2,700
28.	Dividend from XYZ Ltd., a foreign company	57,880
29.	Agricultural income from Nepal	2,29,160
30.	Mrs. X is a retired Government employee. She gets a sum of as pension from the Government.	14,700 per month

31.	During the year Mrs. X makes the following contribution and expenditure (a) Rent of furnished house paid to the employer (b) Payment in respect of use of car As per service rule Mrs. X has to pay an amount equal to Rs. 2 per km., whenever car is used for personal purposes; however, nothing is payable in respect of journey from office to residence and back (c) Contribution towards recognized provident fund (d) Contribution towards superannuation fund (e) Insurance premium for a policy on the life of her husband (sum assured : Rs. 90,000) (f) Insurance premium for a policy of Rs. 10,000 on the life of her father (g) Deposit in 10 year account under the Post Office Savings Bank (CTD) Rules including advance deposit of April-May 2009 (h) Payment of school fees of 2 children Child.	 11,200 6,000 30,000 7,200 4,000 2,400 19,200
31.	XYZ limited paid Rs. 19,650 on account of membership fees and expenses for the club facilities utilised by the family.	
32.	Mrs. X owns a motor car, with engine capacity of 1,300 cc. expense on running and maintenance including chauffers salary are met by employer. Car is used partly for official and partly for personal purposes and expenses are fully met by employer.	37,690

Calculate the taxable income of Mrs. X if she resides in Bombay, on the assumption that X owns a residential house property at Bombay and Goa.

INCOME FROM HOUSE PROPERTY

Question 1

X owns a big house (erection completed on September 14, 2004) which is partly self-occupied and partly let out. Unit 1 (fifty per cent of the floor area) is let out for commercial purposes on a monthly rent of Rs. 6,000 (rent of 2 months could not be realized). Unit 2 (25 per cent of the floor area) is used by X for the purpose of his profession, while Unit 3 (the remaining 25 per cent), is utilized for the purpose of his residence. Other particulars of the house are as follows: municipal valuation: s. 80,000, standard rent under the Delhi Rent Control Act: Rs. 1, 40,000. Municipal tax : Rs. 10,812 (levied during the year), Rs. 10,000 (actually paid during the year 2008-09, Rs. 812 is, however, paid on April 30,2009), repairs : Rs. 8,000, ground rent : Rs. 16,800, annual charge created by will by father in favor of Mrs. X : Rs. 14,000 and insurance premium : Rs. 12,000. Income of X from profession is Rs. 62,000 (without debiting house rent and other incidental expenditure); cost of construction of the house: Rs. 8,00,000; rate of depreciation: 10 per cent SLM in books of accounts. (as per income tax depreciation for the unit 2 is Rs. 13,122).

X has a substantial interest in ABC Ltd., a closely-held company. For financing the construction of the house property he has borrowed: Rs. 2,00,000 @ 6 per cent from ABC Ltd. the amount of loan was treated as dividend under section 2 (22) (e) in the assessment of X for the assessment year 2002-03. However, as per contract with the company, he is liable to pay interest on January 1 every year.

Determine the taxable income of X, on the assumption that he maintains books of account on the basis of mercantile system.

Question 2 (Revision Class / Home work)

X has the following properties:

1. Flat in Bombay purchased on June 1, which is let out on a monthly rent of Rs. 2,000. The building in which the flat is located was completed on May 1,. The flat was let out from August 1,
2. Flat in Delhi (construction completed on May 10, 2008), which is self-occupied.
3. God own in Calcutta constructed in 2005 which is let out on a monthly rent of Rs. 8,000 (it remains vacant for ½ month). The expenses actually incurred during the year against rental income are :

	Bombay Rs.	Delhi Rs.	Calcutta Rs.
Municipal taxes actually paid during the previous ending March 31,	7,000	2,400	11,000
Building co-operative maintenance charges	2,000	900	--
Electricity charges	--	4,200	6,800
Fire insurance premium	--	--	2,600
Collection charges	750	--	1,400
Repairs	320	1,900	14,000

The following further in formations are given:

1. The flat in Delhi, if let out, would fetch a monthly rent of Rs. 7,000; however, standard rent of the house according to the Delhi Rent Control Act is Rs. 6,000 per month.

2. Other data regarding flat in Bombay and go down in Calcutta is as follows :

	Bombay flat Rs.	Calcutta godown Rs.
Municipal valuation (annual)	21,600	70,000
Fair rent (annual)	22,000	75,000
Standard rent (annual)	22,500	74,000
Unrealized rent	200	4,000

3. X carries on a business in which he suffered a loss of Rs. 600 during the year.
4. X received a consolidated salary of Rs. 14,000 per month during the year from a part time employment which he holds.
5. X took a loan of Rs. 1,80,000 on March 31, 2004 from a bank at 24 per cent per annum to construct the house.

Compute x's total income.

INCOME FROM OTHER SOURCES

Question: 1

X who maintains books of account on mercantile basis, holds following securities on April 1,

1) Rs. 50,000 7% securities of the Tamil Nadu Government; and
2) Rs. 61,000 14% non-listed debentures of ABC Ltd.

Interest on both the cases is payable on December 1 every year.

On August 1, X borrows Rs. 33,000 at 7 per cent per annum and invests it in 8 per cent securities of the Central Government purchased at Rs. 110 (par rate : Rs.100) (due date of interest January 1and July 1 every year). On August 31, he further borrows Rs. 40,000 at 8 per cent per annum for investing it in 10 per cent listed debentures of DEF Ltd. (date of payment of interest : April 15 every year). Interest on borrowing for the period ending March 31, is however, paid by X on April 15 AY. He pays 2 per cent commission to his bank on net amount of interest realized. His income from other sources is Rs. 86,000. Determine the taxable income of X.

Can he claim deduction in respect of (a) whole of the interest payable on Rs. 33,000, borrowed for investing in Government securities, even if it exceeds income accrued, (b) interest payable on Rs. 40,000 borrowed for the purpose of investing in debentures of DEF Ltd. even if during the previous year the investment does not yield any income.

Question 2 (Revision Class / Home work)

Find out the income chargeable to tax in the following cases.

1. On May 5, X borrows Rs. 1,00,000 at the rate of 9 per cent per annum from a bank to invest in public issue of 10 per cent debentures of A Ltd. A Ltd. allots debentures on May 10, (as per terms of allotment interest is payable every year on November 30. However, the first interest on November 30, would be for the period commencing May 10, to November 30)
2. On April 18, Y borrows Rs. 2,00,000 at the rate of 8 per cent per annum from a bank to invest in public issue of 9.5 per cent debentures of B Ltd. B Ltd. allots debentures on April 30, (as per terms of allotment interested is payable every year on May 15; however, the first interest would be payable only on May 15 next year, for the period commencing April 30, to May 15)
3. On June 6, Z borrows Rs. 4,00,000 at the rate of 10 per cent per annum from a bank to purchase (ex interest) 11 per cent debentures of C Ltd. from B (purchase consideration being Rs. 4,00,000 interest payable by C Ltd on June 30) Interest payable by C Ltd every year on June 30. However at the time of purchase of debentures from B, Z has agreed that interest received by him on June 30, would be given to B. Cost of acquisition of these debentures in the hands of B was Rs. 3,80,000 (date of acquisition being June 17, 1985).