

Profits and Gains of Business or Profession

Some Key Points : Recent Amendments

Section 28(vii)

Where any sum is received or receivable, in cash or kind, on account of any capital asset, (other than land or goodwill or financial instrument) towards demolition, destruction, discard or transfer is taxable under section 28(vii), if the whole of such expenditure towards the capital asset was allowed earlier as a deduction under section 35AD.

Increase in percentage of weighted deduction under section 35(2AA)

Section 35(2AA) provides for a weighted deduction of 175% in respect of amount paid to National Laboratory, or a University or an IIT or specified person with a specific direction that such sum shall be used for the purpose of an approved scientific research programme. The Finance Act, 2011 has increased the percentage of weighted deduction from 175% to 200% with effect from A.Y.2012-13.

Enhanced deduction for in-house research [Section 35(2AB)]

In the case of a company engaged in the business of bio-technology or in any business of manufacture or production of any article or thing, not being an article or thing specified in the Eleventh Schedule, expenditure (other than capital expenditure in the nature of cost of land or building) towards scientific research which is approved by the prescribed authority, **200% of the expenditure so incurred is eligible for deduction.**

Investment Linked Tax Deduction [Section 35AD]

The Finance (No.2) Act, 2009 has inserted section 35AD to provide impetus to certain specified businesses and the capital expenditure incurred thereof are deductible against income from such business. The unabsorbed portion of capital expenditure relating to the specified business is eligible for carry forward and set off under section 73A.

The term 'specified business' means any one or more of the following business, namely:—

- (i) Setting up and operating a cold chain facility;
- (ii) Setting up and operating a warehousing facility for storage of agricultural produce;
- (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.

- (iv) Building and operating a new hotel of two star or above category as classified by the Central Government.
- (v) Building and operating, anywhere in India, a new hospital with at least 100 beds for patients.
- (vi) Developing and building a housing project under a scheme for slum redevelopment or rehabilitation framed by the Central Government or State Government, as the case may be, and notified by the Board in this behalf in accordance with the guidelines, as may be prescribed.

The Finance Act, 2011 has extended the investment-linked tax deduction under section 35AD to two new businesses –

- (1) developing and building a housing project under a notified scheme for affordable housing framed by the Central Government or State Government; and**
- (2) production of fertilizer in India.**

One of the conditions is that the date of commencement of operations in the case of the two “specified businesses” of affordable housing projects and production of fertilizer in a new plant or in a newly installed capacity in an existing plant should be on or after 1st April, 2011.

The loss of an assessee claiming deduction under section 35AD in respect of a specified business can be set-off against the profit of another specified business under section 73A, irrespective of whether the latter is eligible for deduction under section 35AD. As assessee can, therefore, set-off the losses of a hospital or hotel which begins to operate after 1st April, 2010 and which is eligible for deduction under section 35AD, against the profits of the existing business of operating a hospital (with atleast 100 beds for patients) or a hotel (of two-star or above category), even if the latter is not eligible for deduction under section 35AD.

Expanded coverage of eligible business under section 36(1)(viii)

The Special Reserve created and maintained by specific entities of an amount not exceeding 20% of the eligible business is deductible under section 36(1)(viii). The entities eligible for such deduction are (i) financial corporations specified in section 4A of the Companies Act, 1956; (ii) financial corporations which are public sector companies; (iii) banking companies; (iv) co-operative banks other than those eligible for section 80-P deduction; (v) housing finance companies; and (vi) any other financial corporation including public companies.

In respect of entities referred to in (i) to (iv) above the ‘eligible business’ would mean the business of providing long term finance for –

- (A) Industrial or agricultural development;
- (B) Development of infrastructural facility in India; and
- (C) Development of housing in India.

Employer's contribution to the account of the employee under a Pension Scheme referred to in section 80CCD to be deductible as a business expenditure [Section 36(1)(iva) & 40A(9)]

- (i) Clause (iva) has been inserted in section 36(1) by the Finance Act, 2011, effective from A.Y. 2012-13, to provide that the employer's contribution to the account of an employee under a Pension Scheme as referred to in section 80CCD would be allowed as deduction while computing business income.
- (ii) However, the deduction would be restricted to 10% of salary of the employee in the previous year.
- (iii) Salary, for this purpose, includes dearness allowance, if the terms of employment so provide, but excludes all other allowances and perquisites.
- (iv) Correspondingly, section 40A(9), which provides for disallowance of any sum paid by an employer towards contribution to any fund or trust has been amended to exclude from the scope of its disallowance, contribution by an employer to the pension scheme referred to in section 80CCD, to the extent to which deduction is allowable under section 36(1)(iva).

Extended time for remitting the tax deducted at source [Section 40(a)(ia)]

The Finance Act, 2010 has amended section 40(a)(ia) with retrospective effect from 01.04.2010 (assessment year 2010-11 onwards) by extending the time limit for remitting the tax deducted at source.

In view of the change, the tax deducted at source if remitted before the 'due date' specified in section 139(1), such expenditure on which tax was deducted, would be eligible for deduction.

Where such remittance is made beyond the 'due date' specified in section 139(1) then such expenditure is deductible in computing the income of the previous year in which such tax payment was made.

Written down value for LLP on conversion of a company [Explanation 2C to Section 43(6)]

When a private company or unlisted company is converted into LLP and the conditions of section 47(xiiib) are satisfied, the actual cost of the block of assets in the case of LLP shall be the WDV of the block of assets as in the case of company on the date of its conversion into LLP. In other words, the WDV of the predecessor viz. company will be adopted as the WDV of the successor viz the LLP.

Amendment to nullify Doom Dooma India Ltd's case

The Apex Court, in *CIT v. Doom Dooma India Ltd* (222 CTR 105) had held that the language employed in section 43(6)(b) regarding depreciation 'actually allowed', where any income is partially agricultural and partially chargeable to tax under the head "Profits and

gains of business", the depreciation deducted in arriving at the taxable income alone can be taken into account for computing the WDV in the subsequent year. It was held that the interpretation is not in accordance with the legislative intent. Accordingly, Explanation 7 to section 43(6) was inserted by the Finance (No.2) Act, 2009 w.e.f. 01.04.2010.

As per the Explanation 7 to section 43(6), where the income of an assessee is in part from agriculture and partly chargeable under the head 'Profits and gains of business or profession', for computing the WDV of the asset 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.

Expanded application of presumptive income [Section of 44AD]

The Finance (No.2) Act, 2009 has substituted section 44AD w.e.f. 01.04.2011. The extended presumptive income determination scheme replaces the erstwhile section 44AD meant for civil construction contractors and section 44AF meant for retail traders.

As per the newly substituted provision, in the case of an eligible assessee engaged in eligible business, a sum equal to 8% of the total turnover or gross receipt or a sum higher than the aforesaid sum claimed to have been earned by the eligible assessee, shall be deemed to be Profits and Gains of business, which is chargeable to tax under the head 'Profits and gains of business or profession'.

The following are of the features of the scheme -

- (a) The gross receipt should not exceed ₹ 60 lacs in the previous year in which such presumptive income determination is opted for by the assessee.
- (b) The provisions of Chapter XVII-C relating to advance payment of tax will not apply.
- (c) All expenses and deductions allowable under sections 30 to 38 shall be deemed to have been already given to effect to and no further deduction under those sections shall be allowed.
- (d) In the case of firm, deduction under section 40(b) is allowable subject to the conditions contained therein.
- (e) 'eligible assessee' means an individual or HUF or a partnership firm (other than LLP) and who have not claimed deduction under section 10AA or deduction under any provisions of Chapter VI-A under the heading "C – Deductions in respect of certain incomes", in the relevant assessment year.
- (f) 'eligible business' means any business except the business of plying, hiring or leasing goods carriages referred to in section 44AE of the Act.
- (g) Section 44AD covers manufacturers, jobworkers, processing industry and wholesalers. It does not cover any notified profession.

Enhanced presumptive income in respect of plying, hiring or leasing of goods carriages [Section 44AE]

The Finance (No.2) Act, 2009 has substituted sub-section (2) to section 44AE and has enhanced the presumptive income from plying, hiring or leasing of goods carriages.

Income from heavy goods vehicles, shall be an amount equal to ₹ 5,000 for every month or part of a month during which the vehicle is owned by the assessee in the previous year or an amount claimed to have been actually earned from such vehicle – whichever is higher.

Income from other than heavy goods vehicles, shall be an amount equal to ₹ 4,500 for every month or part of a month during which the vehicle is owned by the assessee in the previous year or an amount claimed to have been actually earned from such vehicle – whichever is higher.

Section 44BB and section 44DA are mutually exclusive

The Finance Act, 2010 has clarified that the provisions of section 44BB will not apply to cases where the provisions of section 44DA would apply. Thus, income by way of royalties in the case of non-resident (not being a company) would be governed by section 44DA from the assessment year 2011-12 onwards.

Question 1

- (A) *Examine the taxability or allowability or otherwise in the following cases while computing income under the head "Profits and gains from business or profession" to be declared in the return of income for the financial year ended on 31.3.2012:*
- (i) *Amount received towards power subsidy with a stipulation that the same is to be adjusted in the electricity bills.*
 - (ii) *Donations received by a person in the course of carrying on vocation from his followers.*
 - (iii) *Profit derived by an assessee engaged in carrying the business as dealers in shares on exchange of the shares held as stock in trade of one Company with the shares of other Company.*
 - (iv) *Interest received by a contractor on the amount of compensation awarded by an arbitrator resolving the dispute relating to the work done.*
 - (v) *The amount of margin money forfeited by a bank on the failure of its constituents of not taking the delivery of the shares purchased by such bank on their behalf.*
 - (vi) *Depreciation on the "decoders" given on loan to the cable operators but owned by the assessee who is engaged in the business of distributing satellite channels.*
- (B) *X Co. Ltd. was amalgamated with Y Co. Ltd. on 30.04.2011. X Co. Ltd. was engaged in real estate and whereas Y Co. Ltd. was engaged in manufacture of textile articles. Y Co.*

Ltd. on amalgamation altered its objects clause of Memorandum of Association, to carry on real estate business.

The stock in trade of X Co. Ltd. (being vacant lands) was taken over at ₹ 140 lacs by Y Co. Ltd. as against their original cost of ₹ 125 lacs to X Co. Ltd. for the purpose of amalgamation. Y Co. Ltd incurred ₹ 25 lacs towards development of those lands obtained on amalgamation. It sold the entire land for ₹ 160 lacs during the year ended 31.03.2012.

Determine the tax implication of the transaction in the hands of Y Co. Ltd. for the assessment year 2012-13.

Answer

- (A) (i) Power subsidy received by the assessee is revenue in nature as it goes towards reduction of the electricity bills. Therefore, the subsidy is taxable as business income. It was so held by the Supreme Court in *CIT vs. Rajaram Maize Products (2001) 251 ITR 427*.
- (ii) Donations received by a person from his followers in the course of carrying on vocation for the furtherance of the objects of his vocation were receipts arising from the carrying on of his vocation and not casual or non-recurring receipts. The Supreme Court, in *Dr. K. George Thomas vs. CIT (1985) 156 ITR 412*, held that such donations are taxable as a business income as there is a direct nexus between the vocation carried on by the assessee and the receipt of such donation.
- (iii) The difference between the cost/book value of shares of the first company and the market value of shares of the new company on the date of such exchange has to be treated as profit derived by the dealer in shares (on exchange of shares held as stock-in-trade of first company with the shares of the new company) in the normal course of his business, and hence such profit is taxable as business income. It was so held by the Supreme Court in *Orient Trading Co. Ltd. vs. CIT (1997) 224 ITR 371*.
- (iv) Interest received by a contractor on the amount of compensation awarded by an arbitrator resolving the dispute relating to the work done is in the nature of receipt relating to the business of the contractor and shall be, thus, assessable as business income. This view was upheld by the Supreme Court, in *CIT vs. B. N. Agarwala and Co. (2003) 259 ITR 754*.
- (v) Since the bank is purchasing shares on behalf of the constituents, the forfeiture of margin money by the bank from the constituents for not paying the balance amount of purchase price and not taking delivery of shares purchased by the bank on their behalf is in the normal course of its banking business and hence, the forfeited amount is assessable as business income of the bank. The forfeited amount being revenue in nature cannot be adjusted against the purchase price of the shares. The

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Supreme Court, in the case of *CIT vs. Lakshmi Vilas Bank Ltd. (1996) 220 ITR 305*, has confirmed this view.

- (vi) Loan of decoders to cable operators is in the normal course of the assessee's business of distribution of satellite channels, and hence the same can be treated as use of asset for business purposes. Since the assessee is the owner of decoders used for business purposes, therefore, he is entitled to depreciation under section 32. The Delhi High Court, in *CIT vs. Turner International India (P) Ltd. (2008) 297 ITR 373*, has also confirmed this view.

- (B) The provisions of section 43C would be attracted in this case. Where an asset which becomes the property of an amalgamated company under a scheme of amalgamation is sold by the amalgamated company as its stock in trade, then, the cost of acquisition of the said asset to the amalgamated company in computing the profits and gains derived from sale of such asset would be the cost of acquisition of such asset to the amalgamating company plus the cost of any improvement incurred thereto and the expenditure incurred wholly and exclusively in connection with such transfer by the amalgamating company.

In this case, since the stock-in-trade of X Co. Ltd. is taken over by Y Co. Ltd. on amalgamation, the provisions of section 43C are attracted and the cost of acquisition of vacant lands to Y Co. Ltd. (the amalgamated company) will be ₹ 125 lacs, being the original cost of such lands to X Co. Ltd., the amalgamating company. Since the stock in trade of X Co. Ltd (being vacant land) is taken over by Y Co Ltd., which has altered its object clause on amalgamation to include real estate business, a view can be taken that the provisions of section 45(2) are not attracted in this case.

The business income of Y Co. Ltd. on sale of such lands would be calculated as under -

Particulars	₹ (in lacs)	
Sale price (in the hands of Y Co Ltd)		160
Less:		
Cost of acquisition under section 43C, being the original cost to the amalgamating company, X Co. Ltd	125	
Cost of improvement (incurred by Y Co. Ltd)	<u>25</u>	<u>150</u>
Taxable business income chargeable in the hands of Y Co. Ltd		<u>10</u>

Question 2

You are the auditor of Sigma Limited under section 44AB of the Income-tax Act, 1961. You have observed that during the previous year ended 31st March, 2012, the company has charged to Profit & Loss Account, a sum of ₹ 20 lacs, being loss due to fluctuation in foreign exchange rates arising on settlement of dues to a foreign company from whom one machine was imported in the previous year ended 31st March, 2011. The company's accounting policy of charging such exchange loss to Profit & Loss Account is in consonance with the Accounting

Standard 11 notified under the Companies (Accounting Standards) Rules, 2006. State the particulars to be provided in respect of the exchange loss in the Form 3CD (Statement of Particulars) forming part of the tax audit report.

Answer

Exchange fluctuation loss arising from settlement of liability in respect of capital asset is charged to profit and loss account as per Accounting Standard–11. However, the treatment of such loss for income-tax purpose is governed by section 43A of the Income-tax Act, 1961. Section 43A requires adjustment of such exchange loss to the actual cost of the asset as defined in section 43(1).

Clause 17(a) of Form 3CD requires the tax auditor to state whether an expenditure of capital nature has been debited to profit and loss account. Exchange loss, in the instant case, being an expenditure of capital nature is to be shown by the tax auditor against clause 17(a) of Form No.3CD.

Further, the tax auditor should also indicate addition by way of adjustment in respect of each asset/block of assets on account of change in rate of exchange of currency. This fact is required to be indicated against clause 14 of Form 3CD.

Question 3

R Limited transferred a building worth ₹ 25 lacs to the Chief Executive Officer, Mr. Mohan Lal, a resident individual on his retirement under an agreement for not carrying on any activity related to its business for a period of five years. In course of assessment under section 143(3), the Assessing Officer found that no tax had been deducted at source by R Limited and on that ground, he disallowed the expenditure by invoking the provision of section 40(a)(ia). Examine the correctness of the action of the Assessing Officer.

Answer

As per section 194J, any person, who is responsible for paying to a resident, any sum by way of fees for professional services, or fees for technical services or royalty or non- compete fees referred to in section 28(va) is required to deduct tax at source.

As per section 28(va), any sum received or receivable in cash or in kind under an agreement for not carrying out any activity in relation to any business is chargeable to income-tax under the head "Profits and gains of business or profession".

Therefore, the obligation to deduct tax under section 194J arises even if the non-compete fee is payable in kind. It is the responsibility of the payer to recover the amount of tax deductible from the recipient of the non-compete fee in kind.

Under section 40(a)(ia), non-deduction of tax at source in respect of the following amounts payable to a resident attracts disallowance –

1. Interest [Sections 193 & 194A];
2. Commission or Brokerage [Section 194H];

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3. Rent [Section 194-I];
4. Royalty [Section 194J(1)(c)];
5. Fees for professional services [Section 194J(1)(a)];
6. Fees for technical services [Section 194J(1)(b)]; and
7. Amount payable to a contractor or sub-contractor [Section 194C].

Therefore, in respect of fees for professional services, fees for technical services and royalty, disallowance is attracted if tax is not deducted at source under section 194J. However, non-compete fee is classified separately under section 194J(1)(d), in respect of which there is no specific provision in section 40(a)(ia) for disallowance in case of non-deduction of tax at source.

Therefore, the action of the Assessing Officer is not correct since even though tax is required to be deducted at source under section 194J, disallowance under section 40(a)(ia) would not be attracted.

Question 4

ILT Limited is engaged in manufacturing pipes and tubes. The profit and loss account of the company for the year ended 31st March, 2012 shows a net profit of ₹ 405 lacs. The following information and particulars are furnished to you. You are required to compute total income of the company for Assessment Year 2012-13 indicating reasons for treatment of each item.

- (i) *A group free air ticket was provided by a supplier for reaching a certain volume of purchase during the financial year 2011-12. The same is encashed by the company for ₹ 10 lacs in April 2012.*
- (ii) *A regular supplier of raw materials agreed for settlement of ₹ 8 lacs instead of ₹ 10 lacs for poor quality of material supplied during the previous year which was not given effect in the running account of the supplier.*
- (iii) *Andhra Bank sanctioned and disbursed a term loan in the financial year 2008-09 for a sum of ₹ 50 lacs. Interest of ₹ 8 lacs was in arrear. The bank has converted the arrear interest into a new loan repayable in ten equal instalments. During the year, the company has paid two instalments and the amount so paid has been reduced from Funded Interest in the Balance Sheet.*
- (iv) *The company remitted ₹ 5 lacs as interest to a company incorporated in USA on a loan taken two years ago. Tax deducted under section 195 from such interest has been deposited by the company on 15th July, 2012. The said interest was debited to profit and loss account.*
- (v) *Liquidated damage of ₹ 3 lacs received from KS Limited for delay in supply of plant and machinery has been shown under the head "Other income" in Profit & Loss Account.*
- (vi) *Sandeep, a sales executive stationed at HO at Delhi, was on official tour in Bangalore from 31st May, 2011 to 18th June, 2011 and 28th September, 2011 to 15th October, 2011 for the business development. The company has paid Sandeep's salary in cash, from its local office*

at Bangalore for the month of May, 2011 (payable on 1st June) and September 2011 (payable on 1st October), amounting to ₹ 25,000 and ₹ 27,000 respectively (net of TDS and other deduction), as Sandeep has no bank account at Bangalore. These were included in the amount of "salary" debited to Profit and Loss Account.

- (vii) The company has taken up initiative to restructure its debt and paid ₹ 20,000 to a finance company, M/s ABC Ltd., towards pre payment premium. As per the scheme, ₹ 50,000 loan was waived against its loan and B Limited directly credited it to its reserve account, considering loan waiver amount as capital receipt.
- (viii) The company has contributed Rs 50,000 to an electoral trust and the same stands included under the head "General Expenses".

Answer

Computation of total income of ILT Ltd. for the A.Y.2012-13

Particulars	₹ (in lacs)	
Profits and gains from business or profession		
Net profit as per profit and loss account		405
Add : Items debited to profit and loss account, but to be disallowed and items not considered in accounts but to be taxed [See Note 1 below]		
Value of group free air ticket provided by a supplier is taxable as business income under section 28(iv), as the value of any benefit, whether convertible into money or not, arising from business is taxable as business income.	10	
Amount waived by the supplier of raw materials is a deemed income under section 41(1), as the expenditure was allowed as deduction in the last year and there is a benefit by way of remission or cessation of a trading liability. The fact that effect was not given in the running account of supplier is not relevant.	2	
Interest payable outside India to a foreign company is not allowable since tax deducted by the assessee is not deposited during the previous year or in the subsequent year within the time prescribed under section 200(1) [Section 40(a)(i)]. In this case, the tax deducted was deposited after the prescribed date after the end of the previous year and therefore, the assessee can claim deduction only in the F.Y.2012-13.	5	
Contribution to electoral trust is not an allowable expenditure while computing business income. Hence, the same has to be added back, since it is included in general expenses.	<u>0.50</u>	<u>17.50</u>
		422.50

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Less: Amount of deduction allowable or amount credited to profit and loss account but not taxable [See Note 1 below]		
Under section 43B, interest on loan due to any scheduled bank, etc. is allowed as deduction, if such interest is actually paid irrespective of the method of accounting followed by the assessee. Conversion of arrear interest into a fresh loan by a bank cannot be considered as actual payment of interest. However, the amount of funded interest (i.e. converted loan) actually paid is allowable as deduction. Hence, ₹ 1,60,000, being two installments of ₹ 80,000 each, actually paid is deductible.	1.60	
Liquidated damages have been received due to delay in supply of plant and machinery by the supplier. As the liquidated damages relates to delayed supply of a capital asset, it is in the nature of capital receipt and not revenue receipt. As the amount has been wrongly credited to the profit and loss account, the same should be deducted.	3.00	
In the case of <i>CIT v. Gujarat Guardian Ltd. (2009) 177 Taxman 434 (Del.)</i> , it was held that pre-payment premium represents interest as per section 2(28A). Section 2(28A) defines interest to include any other charge in respect of money borrowed or debt incurred. Section 36(1)(iii) provides for deduction of interest paid in respect of capital borrowed for the purposes of business or profession. Under section 43B, such interest is allowable as deduction on actual payment. From a combined reading of section 2(28A), 36(1)(iii) and 43B it can be inferred that pre-payment premium is deductible as business expenditure in one lump-sum on actual payment.	0.20	<u>4.80</u>
Business Income		<u>417.70</u>
Gross total income		417.70
Less: Deduction under Chapter VI-A		
Deduction under section 80GGB in respect of contribution by the assessee company to an electoral trust.		<u>0.50</u>
Total Income		<u>417.20</u>

Notes

- Since the question is silent as to whether the net profit of ₹ 405 lacs is after taking into account the adjustments in (i) to (viii), the problem has been worked out on the assumption that except for items (iv), (v) (vi) and (viii) in respect of which there is a specific mention about inclusion, all other adjustments i.e. (i), (ii), (iii) and (vii) have not been given effect to in the profit and loss account.

2. In respect of payment of salary to sales executive in cash, no disallowance under section 40A(3) is to be made as such payment falls within the scope of Rule 6DD(1). Salary paid to him in cash is allowable as the executive was temporarily posted for a continuous period of more than 15 days in Bangalore, not being the place of his normal duty, tax was deducted from such salary under section 192 and he does not maintain any bank account in Bangalore. Therefore, no disallowance under section 40A(3) is attracted in respect of such salary.
3. Remission of principal amount of loan does not amount to income under section 41(1) or under section 28(iv), where there is a waiver of loan taken from a bank or financial institution, unless the loan is taken for a trading activity. It is assumed that such loan is not taken for a trading activity and therefore, waiver of loan cannot be treated as income.

Question 5

ITP Limited is engaged in growing and manufacturing tea in India. It commenced its operation from 1st April, 2011. It acquired plant and machinery, factory building and furniture at cost of ₹ 40 lacs, ₹ 25 lacs and ₹ 10 lacs, respectively, in the previous year 2011-12. All the assets were put to use for more than 180 days during the P. Y. 2011-12. Compute the written down value of each block of assets as on 1st April, 2012.

Answer

As per section 32, depreciation to be allowed has to be computed at the prescribed percentage on the written down value of any block of assets.

As per section 43(6), in the case of assets acquired before the previous year, the written down value means the actual cost to the assessee less all depreciation "actually allowed" to him under the Income-tax Act, 1961.

As per Rule 8 of the Income-tax Rules, 1962, only 40% of income from business of growing and manufacturing of tea in India is deemed to be income liable to tax. The balance 60% would be agricultural income, which is not chargeable to tax.

Explanation 7 to section 43(6) provides that in cases of composite income, for the purpose of computing written down value of assets acquired before the previous year, the total amount of depreciation shall be computed as if the entire composite income of the assessee is chargeable to tax under the head "Profits and gains of business or profession". The depreciation so computed shall be deemed to have been "actually allowed" to the assessee.

Therefore, even if only 40% of ITP Limited's income from sale of tea grown and manufactured in India is taxable, full depreciation (and not 40%) should be taken as "actually allowed" for the purpose of computing WDV. Accordingly, the WDV of each block as on 1st April 2012 will be as follows:

Plant & Machinery = ₹ 40 lacs – ₹ 6 lacs (15% of 40 lacs) = ₹ 34 lacs.

Building (Factory) = ₹ 25 lacs – ₹ 2.50 lacs (10% of 25 lacs) = ₹ 22.50 lacs.

Furniture = ₹ 10 lacs – ₹ 1 lacs (10% of 10 lacs) = ₹ 9 lacs.

Question 6

The residential premises of Mr.X, an income tax practitioner was searched under section 132. During the search, certain incriminating documents were seized. From the documents seized, it was revealed that he had been claiming and receiving income tax refunds by filing bogus TDS certificates with returns of income prepared by him, even in the names of non-existing persons. Discuss whether the refund collected illegally by Mr. X by producing bogus TDS certificates constitute income chargeable to tax.

Answer

The facts of the given case are similar to the facts of the case *CIT vs. K. Thangamani* (2009) 309 ITR 015 (Mad.).

On this issue, the Madras High Court observed that the income-tax authorities are not concerned about the manner or means of acquiring income, and allowing tainted income to escape the tax net would be nothing but a premium or reward to the person for doing illegal trade. The Income-tax Act, 1961 treats the income earned legally as well as illegal income alike. In the event of taxing the income of only those who acquire the same through legal manner, the tendency of those who acquire income by illegal means would increase. Therefore, even if the assessee has been prosecuted by the law enforcing authorities for commission of offence, the income earned by him would be an income liable for assessment. Illegality tainted with the earning has no bearing on its taxability.

Therefore, where the assessee has filed bogus TDS certificates and collected refund from the Income-tax Department, income received by the assessee by getting refund from the Income-tax Department constitutes income chargeable to tax.

Question 7

"Bhardwaj Textiles Ltd." had availed a term loan of ₹ 400 lacs from a nationalized bank for acquiring the fixed assets. However, due to financial difficulties, it could not meet its obligation for the last three years and decided to avail the benefit of "One Time Settlement Scheme" announced by the bank to reduce its NPA. The bank as per scheme allowed waiver of principal of ₹ 5 lacs and of outstanding interest of ₹ 20.30 lacs in total of ₹ 25.30 lacs. The company directly credited the amount so waived to the general reserve. The Assessing Officer contends that the entire amount so waived by the bank is chargeable to tax as business income under section 28(iv) or under section 41(1). Discuss the correctness of contention of the Assessing Officer.

Answer

The amount waived by the nationalized bank in respect of outstanding principal and interest is not assessable as business income applying the provisions of section 28(iv) [*Mahindra and Mahindra v. CIT* (2003) 261 ITR 501 (Bom)]. Section 28(iv) seeks to bring to charge the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession. The Bombay High Court pointed out that what was sought to be

taxed was a benefit or perquisite, that is, something received in kind. Waiver of term loan taken for acquiring fixed assets and interest on such term loan, cannot be said to be a benefit or perquisite, since what was waived was not in kind.

Section 41(1) has no application because there was no cessation of trading liability. The assessee had availed term loan for acquiring fixed assets which was not a trading liability but a capital liability. Section 41(1) can, inter alia, apply only where there is cessation of trading liability and not where there is cessation of capital liability. Therefore, the decision of the Bombay High Court in *Solid Containers Ltd. v. DCIT* (2009) 308 ITR 417 will not apply to this case which states that if the loan is taken for a trading activity and ultimately upon waiver the amount was retained in the business by the assessee then the waived amount shall become assessee's income and was assessable.

As regards the interest portion, the assessee could not have availed any deduction, in view of the provisions of section 43B. Section 41(1) is attracted only when an allowance or deduction is made in the previous year in respect of such expenditure and subsequently, any amount in respect of such expenditure is received in any later year. In this case, since interest was never allowed as deduction, section 41(1) is not attracted.

Therefore, the contention of the Assessing Officer is not correct.

Note: Similar ruling has been pronounced by the Madras High Court in *Iskraemeco Regent Ltd. v. CIT* (2011) 331 ITR 317 (Mad.), wherein it was held that, the waiver of principal amount and the interest in respect of the loan taken for purchase of capital asset would not amount to remission of a trading liability to attract the provisions of section 41(1) also such waiver cannot be treated as a benefit arising out of business and consequently, section 28(iv) will not apply in respect of such loan transaction.

Question 8

Examine the correctness or otherwise of the following case in the context of provisions contained in the Income-tax Act, 1961 relevant/applicable for the assessment year 2012-2013:

B. Ltd., the holding company of A. Ltd., had entered into an agreement by which the textile unit belonging to it was transferred to A. Ltd. The agreement also stipulates for the protection of service conditions and continuity of service of the workmen employed in the textile unit so transferred to/taken over by A. Ltd. B. Ltd. delivered the possession of the properties to A. Ltd. and also transferred all the employees working in the textile unit with the benefit of continuity of service and protection of service conditions. A. Ltd. claimed deduction for the amount of gratuity payment in respect of the workers of erstwhile textile unit of B. Ltd., who had retired during the relevant previous year. The Assessing Officer disallowed this claim of A. Ltd. on the ground that the liability towards gratuity payment to the employees of erstwhile company for the period prior to the takeover of the unit is not a revenue expenditure but is a capital expenditure.

Answer

The facts given in the problem are identical to the facts of the case decided by the Madras High Court in *Sree Akilandeswari Mills Pvt. Ltd. v. Dy. CIT* (2005) 274 ITR 1, where the Court has held that “the company, by virtue of the deed of transfer, had taken over the liability towards the employees of the transferor company and on the date of transfer, the liability relating to the gratuity was an ascertained liability on the basis of actuarial valuation. This also formed an integral part of the sale consideration to be discharged by making actual payment to the employee in subsequent years. The payment of gratuity, thus, was in the nature of a capital expenditure.”

In the given problem, A. Ltd., by virtue of the deed of transfer, had taken over the possession of the textile unit of B. Ltd. with a liability of the transferor company towards the continuity of service and the protection of service conditions of the employees on the date of transfer. The gratuity liability was, thus, also an ascertained liability on the basis of actuarial valuation payable to the employees retiring after the date of transfer.

Hence, in this case, the expenditure incurred by A Ltd. towards discharge of the gratuity liability of the employees of the unit taken over from B Ltd., is a capital expenditure. Therefore, the reasoning of the Assessing Officer is correct.

Note – The Supreme Court, in *CIT v. Hoogly Mills Co. Ltd.* (2006) 287 ITR 333, held that such expenditure was a capital expenditure as it was incurred for acquiring an asset of enduring nature. However, no depreciation is allowable in respect of gratuity liability even if it is regarded as capital expenditure.

Question 9

Explain in brief, the treatment as to their taxability and/or allowability, under the provisions of Income-tax Act, 1961, for the assessment year 2012-2013, in the following cases:

- (i) 'A' Ltd., an investment company, received dividend income of ₹ 1,00,000 on its investment in shares in domestic companies. It incurred interest expenditure of ₹ 2,00,000 on the borrowed capital utilized in the investment of shares.
- (ii) 'B' Ltd. is a company engaged in the business of financing and investment in shares. It suffered loss of ₹ 3,00,000 on account of futures and options, a transaction in the form of derivatives in which the underlying asset was shares.
- (iii) 'C' Ltd., which did not have any active business carried on by it incurred capital expenditure on scientific research amounting to ₹ 5,00,000 that related to its subsidiary companies.

Answer

- (i) The dividend income earned by 'A' Ltd. on the shares held as investment is exempt under the provisions of section 10(34). As per section 14A, no expenditure is allowable in respect of income which does not form part of total income. The interest paid on borrowed capital is an expenditure incurred in respect of shares purchased for

investment. Since the dividend income received on shares is exempt and does not form part of total income of 'A' Ltd., the interest expenditure is not allowable as deduction.

- (ii) A transaction in derivatives, in which underlying asset is shares, is exempt from the purview of the speculative transaction, in terms of clause (d) of the proviso to section 43(5). As per the said clause, an eligible transaction in respect of trading in derivatives carried out in a recognized stock exchange shall not be deemed to be a speculative transaction. Accordingly, in the given case, if the transaction falls within the meaning of "eligible transaction" as defined in the *Explanation* therein, then the loss would be treated as an ordinary business loss eligible for set-off loss as per normal set-off provisions. On the other hand, if the transaction does not fall within the meaning of "eligible transaction", the loss would be treated as a speculation loss and can be set-off only against speculative income.
- (iii) As per section 35(1)(iv), deduction in respect of capital expenditure on scientific research would be admissible under the provisions of section 35(2) only if the scientific research relates to the business carried on by the assessee.

However, in the given case, 'C' Ltd., did not have any active business carried on by it to which the said scientific research related to. The capital expenditure incurred by 'C' Ltd. related to its subsidiary companies. Therefore, 'C' Ltd. is not eligible for deduction under the provisions of section 35(1)(iv) read with section 35(2).

Question 10

Indian Gas Limited commenced its operation of the business of laying and operating a cross country natural gas pipeline network for distribution on 1st July, 2011. The company incurred capital expenditure of ₹ 300 lacs (including cost of land ₹ 45 lacs and cost of financial instrument ₹ 5 lacs) during the period from 1st April, 2010 to 30th June, 2011. The company did not claim deduction for such expenditure in the earlier assessment years. The entire expenditure was capitalised on 1st July, 2011. Further, during the previous year 2011-12 (from July 2011), the company incurred capital expenditure of ₹ 200 lacs exclusively for the said business.

- (i) *Compute the amount of deduction allowable under section 35AD assuming that the company has fulfilled all the conditions specified in section 35AD. ₹*
- (ii) *If the company has loss from such business in the assessment year 2012-13, how the same is to be set off and carried forward?*

Answer

- (i) Section 35AD provides for investment-linked tax incentive for specified business. One such specified business is 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. The benefit will be available in a case where the business relates to laying and operating a cross country natural gas pipeline network for distribution, if such business commences its operations on or after 1st April, 2007.

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Under section 35AD, 100% of the capital expenditure incurred during the previous year, wholly and exclusively for the above business would be allowed as deduction from the business income. However, expenditure incurred on acquisition of any land, goodwill or financial instrument would not be eligible for deduction.

Further, the expenditure incurred, wholly and exclusively, for the purpose of specified business prior to commencement of operation would be allowed as deduction during the previous year in which the assessee commences operation of his specified business. A condition has been inserted that such amount incurred prior to commencement should be capitalized in the books of account of the assessee on the date of commencement of its operations.

Therefore, the deduction admissible under section 35AD for A.Y. 2012-13 would be:

Particulars	₹
Capital expenditure incurred during the previous year 2011-12	200 lacs
Capital expenditure incurred during the period from 1st April 2010 to 30th June, 2011 (i.e. prior to commencement of business) and capitalized in the books of account on 1st July, 2011 (₹ 300 lacs - ₹ 50 lacs)	250 lacs
Total deduction under section 35AD for A.Y.2012-13	450 lacs

However, the actual deduction under section 35AD for A.Y. 2012-13 would be restricted to the profits derived from specified business for that year. The difference would be treated as loss from specified business to be carried forward as per section 73A.

- (ii) Section 73A provides that any loss computed in respect of the specified business shall be set off only against profits and gains, if any, of any other specified business. The unabsorbed loss, if any, will be carried forward for set off against profits and gains of any specified business in the following assessment year and so on. There is no time limit specified for carry forward and set-off and therefore, such loss can be carried forward indefinitely for set-off against income from specified business.

Question 11

The trading and profit and loss account of Pingu Trading Pvt. Ltd. having business of agricultural produce, consumer items and other products for the year ended 31.03.2012 is as under:

Trading Account		(Amount in Rupees)	
Opening Stock	3,75,000.00	Sales	1,55,50,000.00
Purchases	1,25,75,000.00	Closing Stock	4,50,000.00
Freight & Cartage	1,26,000.00		
Gross profit	29,24,000.00		
	1,60,00,000.00		1,60,00,000.00

Profit and Loss Account

Bonus to staff	47,500.00	Gross profit	29,24,000.00
Rent of premises	53,500.00	Income-tax refund	20,000.00
Advertisement	5,000.00	Warehousing charges	15,00,000.00
Bad Debts	75,000.00		
Interest on loans	1,63,500.00		
Depreciation	75,500.00		
Sales-tax demand paid	1,08,350.00		
Miscellaneous expenses	5,25,650.00		
Net profit of the year	33,90,000.00		
	44,44,000.00		44,44,000.00

On scrutiny of records, the following further information and details were extracted / gathered:

- (i) There was a survey under section 133A on the business premises on 31.3.2012 in which it was revealed that the value of closing stocks of 31.3.2011 was ₹ 8,75,000 and a sale of ₹ 75,000 made on 13.3.2012 was not recorded in the books. The value of closing stocks after considering these facts and on the basis of inventory prepared by the department as on 31.3.2012 worked out at ₹ 12,50,000, which was accepted to be correct and not disputed.
- (ii) Income-tax refund includes amount of ₹ 4,570 of interest allowed thereon.
- (iii) Bonus to Staff includes an amount of ₹ 7,500 paid in the month of December 2011, which was provided in the books on 31.03.2011.
- (iv) Rent of premises includes an amount of ₹ 5,500 incurred on repairs. The assessee was under no obligation to incur such expenses as per rent agreement.
- (v) Advertisement expenses include an amount of ₹ 2,500 paid for advertisement published in the souvenir issued by a political party.
- (vi) Miscellaneous expenses include:
 - (a) amount of ₹ 15,000 paid towards penalty for non-fulfillment of delivery conditions of a contract of sale for the reasons beyond control,
 - (b) amount of ₹ 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 junior advocate of High Courts normally charge only ₹ 25,000 for the same opinion,
 - (c) amount of ₹ 1,00,000 paid to an Electoral Trust.
- (vii) Sales-tax demand paid includes an amount of ₹ 5,300 charged as penalty for delayed filing of returns and ₹ 12,750 towards interest for delay in deposit of tax.
- (viii) The company had made an investment of ₹ 25 lacs on the construction of a warehouse

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in rural area for the purpose of storage of agricultural produce. This was made available for use from 15.09.2011 and the income from this activity is credited in the Profit and Loss account under the head "Warehousing charges".

(ix) Depreciation under the Income-tax Act works out at ₹65,000.

(x) Interest on loans include an amount of ₹20,000 on which tax not deducted was not deducted.

Compute the income chargeable to tax for assessment year 2012-13 of Pingu Trading Pvt. Ltd. Support your answer with working notes.

Answer

Computation of Income of Pingu Trading Pvt. Ltd. chargeable to tax for the A.Y.2012-13

Particulars		₹
Net profit as per profit and loss account		33,90,000
Add:	Difference in the value of stocks detected on survey under section 133A on 31.03.2012 chargeable as income (See Note 1)	<u>3,75,000</u>
		37,65,000
Less:	Income tax refund credited in the Profit and Loss Account, out of which interest is to be considered separately under the head "Income from other sources"	<u>20,000</u>
		37,45,000
Add:	<u>Expenses either not allowable or to be considered separately but charged in the profit & loss account</u>	
	Repair expenses on rented premises where assessee is under no obligation to incur such expenses are not allowable as per section 30(a)(i)	5,500
	Advertisement in the souvenir of political party not allowable as per section 37(2B) (See Note 3)	2,500
	Payment made to the wife of a director examined as per section 40A(2) and the excess payment made to be disallowed (See Note 5)	75,000
	Payment made to electoral trust (See Note 6)	1,00,000
	Penalty levied by the sales tax department for delayed filing of returns not allowable as being paid for infraction of law (See Note 7)	5,300
	Depreciation as per books	75,500
	Interest paid on loan without deduction of tax at source not allowable as per section 40(a)(ia)	20,000
		40,28,800
Less:	Depreciation allowable as per Income-tax Act, 1961	65,000
		39,63,800

Less:	Income from specified business (warehousing charges) credited to profit and loss account, to be considered separately (See Note 8)	15,00,000
	Income from business (other than specified business)	24,63,800
	Computation of income/loss from specified business (See Note 8)	
	Income from specified business	15,00,000
	Less: Deduction under section 35AD	25,00,000
	Loss from specified business to be carried forward as per section 73A	(10,00,000)
	Income from Other Sources	
	Interest on income-tax refund	4,570
	Gross Total Income	24,68,370
Less:	Deduction under section 80GGB	
	Contribution to political party (See Note 3)	₹ 2,500
	Contribution to an Electoral trust (See Note 7)	₹ 1,00,000
	Total Income	23,65,870

Notes :

- (1) The business premises were surveyed and differences in the figures of opening and closing stocks and sales were found which have not been disputed and accepted by the assessee. Therefore, the trading account for the year is to be re-casted to arrive at the correct amount of the gross profit/ net profit for the purpose of return of income to be filed for the previous year ended on 31.3.2012;.

RECASTED TRADING ACCOUNT

	₹		₹
Opening Stock	8,75,000	Sales (1,55,50,000 + 75,000)	1,56,25,000
Purchases	1,25,75,000	Closing Stock	12,50,000
Freight and Cartage	1,26,000		
Gross Profit	32,99,000		
	1,68,75,000		1,68,75,000

The difference of gross profit of ₹ 32,99,000 - 29,24,000 = ₹ 3,75,000 is to be added as income of the business for the year.

- (2) Bonus for the previous year 2010-11 paid after the due date for filing return for that year would have been disallowed under section 43B for the P.Y.2010-11. However, when the

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same has been paid in December 2011, it should be allowed as deduction in the P.Y.2011-12 (A.Y.2012-13). Since it is already included in the figure of bonus to staff debited to profit and loss account of this year, no further adjustment is required.

- (3) The amount of ₹ 2,500 paid for advertisement in the souvenir issued by a political party attracts disallowance under section 37(2B). However, such expenditure falls within the meaning assigned to "contribute" under section 293A of the Companies Act, 1956, and is hence eligible for deduction under section 80GGB.
- (4) The penalty of ₹ 15,000 paid for non-fulfilment of delivery conditions of a contract for reasons beyond control is not for the breach of law but was paid for breach of contractual obligations and therefore, is an allowable expense.
- (5) It has been assumed that ₹ 25,000 is the reasonable payment for the wife of Director, working as a junior lawyer, since junior advocates of High Courts normally charge only ₹ 25,000 for the same opinion and therefore, the balance ₹ 75,000 has been disallowed.
- (6) Payment to an electoral trust qualifies for deduction under section 80GGB. However, since the amount has been debited to profit and loss account, the same has to be added back for computing business income.
- (7) The interest of ₹ 12,750 paid on the delayed deposit of sales tax is for breach of contract and hence, is allowable as deduction. However, penalty of ₹ 5,300 for delay in filing of returns is not allowable since it is for breach of law.
- (8) Deduction under section 35AD is allowed in respect of capital expenditure incurred for setting up and operating warehousing facilities for storing agricultural produce. It is presumed that ₹ 25 lacs do not include expenditure on acquisition of any land.

The loss from specified business under section 35AD (warehousing) should be segregated from the income from other businesses, since, as per section 73A(1), any loss computed in respect of any specified business referred to in section 35AD shall not be set off except against profits and gains, if any, of any other specified business.

In view of the provisions of section 73A(1), the loss of ₹ 10 lacs from the specified business cannot be set-off against income from other businesses. Such loss has to be carried forward to be set-off against profit from specified business in the next assessment year.

Question 12

- (a) *A Company Ltd. issued 11% Debentures and raised ₹ 600 lacs. The debentures are redeemable after 6 years at a premium of 10%. The company wants to provide ₹ 10 lacs for meeting the premium on redemption of debentures and claimed the same as revenue expenditure. Is it a permissible deduction?*
- (b) *Balaram & Co., engaged in real estate business, acquired an old building for ₹ 75 lacs from Mr. X. The firm demolished the building and sold scrap materials for ₹ 5 lacs. The purchase consideration could not be paid immediately and therefore, it settled to pay in installments to Mr. X with interest @6% and the amount of interest was ₹ 4,50,000. The*

Assessing Officer treated the income from sale of scrap materials as business income, but whereas the claim of interest on delayed payment of purchase consideration claimed as revenue expenditure was disallowed. Decide the correctness of the action of assessee vis-a-vis the Assessing Officer.

Answer

- (a) The issue under consideration in this case is whether premium on redemption of debentures can be claimed on pro-rata basis over the life of the debentures.

In *Universal Cables Ltd. v. CIT* (2000) 243 ITR 371, the Calcutta High Court held that premium payable on redemption of convertible secured debentures issued during the year has to be spread over the period of debentures.

In *CIT v. S.M. Holding and Finance (P) Ltd.* (2003) 264 ITR 370, the Bombay High Court held that where zero-interest convertible debentures redeemable after ten years are issued at a premium, such premium has to be spread over the life of the debentures.

The Apex Court, in *Madras Industrial Investment Corporation Ltd v. CIT* (1997) 225 ITR 802, has held that the discount on issue of debentures has to be spread proportionately over the life of the debentures. Applying the same analogy, the amount payable by way of premium on redemption of debentures when set apart, is eligible for deduction, since the liability is ascertained and definite.

Therefore, in view of the above decisions, the company can claim deduction of ₹ 10 lacs as revenue expenditure during the year, since it represents pro-rata amount (i.e., one-sixth) of the premium of ₹ 60 lacs (being 10% of ₹ 600 lacs).

- (b) In this case, the assessee is engaged in real estate business in which acquisition and sale of immovable properties are regular in nature. When sale of scrap materials on demolition of building is assessed as business income, then, the payment of interest towards purchase price of stock-in-trade (building, in this case) is also to be treated as revenue in nature.

The Apex Court, in *Kerala Roadlines v. CIT* (2008) 299 ITR 343 (SC), held that when the amount realised on sale of scrap material of the structures standing on the lands is treated as business income, the interest on delayed payment of purchase price can be claimed as revenue expenditure.

Therefore, the treatment given by the Assessing Officer disallowing interest on delayed payment of purchase consideration is incorrect and the assessee is justified in claiming the interest on delayed payment of purchase consideration as revenue expenditure.

Question 13

During the year ended 31.3.2012, Geojit Marine Products Ltd. has made payment in cash to the tune of ₹ 60,000 on a single day to local fishermen, who regularly supply to them lobsters and crabs. Will such cash payments be hit by the provisions of section 40A(3) of the Income-tax Act, 1961? Will your answer be different, if such cash payments are made to a hawker who supplies lobsters and crabs?

Answer

Under section 40A(3), disallowance is attracted in the computation of income in a case where a payment or aggregate of payments exceeding ₹ 20,000 is made to a person in a day, otherwise than by an account payee cheque drawn on a bank or an account payee bank draft.

However, payment made otherwise than by an account payee cheque drawn on a bank or by an account payee bank draft exceeding ₹ 20,000 does not attract the aforesaid disallowance in certain circumstances as prescribed under Rule 6DD of the Income-tax Rules, 1962. Such exceptions, *inter-alia*, refer to payment made to the producer for the purchase of fish or fish products under sub-clause (iii) of clause (e) of Rule 6DD.

With regard to this sub-clause, the CBDT has, vide *Circular 10/2008 dated 5.12.2008*, issued the following clarifications –

- (i) The expression 'fish or fish products' would include 'other marine products such as crab, lobster etc.'.
- (ii) The 'producers' of fish or fish products would include, besides the fishermen, any headman of fishermen, who sorts the catch of fish brought by fishermen from the sea, at the sea shore itself and then sells the fish or fish products to traders, exporters etc.

In view of the above circular, cash payment of ₹ 60,000 made to local fishermen for supply of lobsters and crabs, would not be hit by the provisions of section 40A(3).

However, the above exception will not be available in respect of payment for the purchase of fish or fish products from a person who is not proved to be a 'producer' of these goods and is only a trader, broker or any other middleman, by whatever name called.

Therefore, the disallowance under section 40A(3) would be attracted if such cash payment of ₹ 60,000 on a single day is made to a hawker who supplies lobsters and crabs.

Question 14

Discuss the allowability of the following expenditure while computing income under the head "Profits and gains of business or profession" with the help of decided case laws –

- (a) *Expenses incurred on partly-convertible debenture; and*
- (b) *Expenditure incurred on MS Office software.*

Answer

- (a) The Madras High Court has, in *CIT v. South India Corporation (Agencies) Ltd. (2007) 290 ITR 217*, held that expenditure incurred on partly-convertible debentures is revenue expenditure eligible for deduction while computing business income. The High Court observed that the issue of shares is a future event, which may or may not happen. Since, at present, it is an expenditure incurred on the issue of debentures only, it is revenue expenditure eligible for deduction under section 37(1).
- (b) The Delhi High Court has, in *CIT v. GE Capital Services Ltd. (2008) 300 ITR 420*, held that only customized software can have an enduring value. The High Court observed that

MS Office software is not a customized software. Due to technological changes and the need to upgrade the software on a regular basis, it could not be said that the software is of an enduring nature. Therefore, the expenditure incurred on MS Office software is allowable business expenditure.

Question 15

XYZ Ltd. commenced operations of the business of laying and operating a cross-country natural gas pipeline network for distribution on 1st April, 2011. The company incurred capital expenditure of ₹ 32 lacs during the period January to March, 2011 exclusively for the above business, and capitalized the same in its books of account as on 1st April, 2011.

Further, during the financial year 2011-12, it incurred capital expenditure of ₹ 95 lacs (out of which ₹ 60 lacs was for acquisition of land) exclusively for the above business. Compute the deduction under section 35AD for the A.Y.2012-13, assuming that XYZ Ltd. has fulfilled all the conditions specified in section 35AD.

Answer

The amount of deduction allowable under section 35AD for A.Y.2012-13 would be –

Particulars	₹
Capital expenditure incurred during the P.Y.2011-12 (excluding the expenditure incurred on acquisition of land) = ₹ 95 lacs – ₹ 60 lacs	35 lacs
Capital expenditure incurred prior to 1.4.2011 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2011	<u>32 lacs</u>
Total deduction under section 35AD for A.Y.2012-13	<u>67 lacs</u>

Question 16

Mr. A, a civil contractor and builder, paid a compensation of ₹ 5 lacs to the tenants for vacating the premises. This was in pursuance of an agreement for development of the property. Mr. A claimed the expenditure as revenue expenditure. Discuss the correctness of the claim of Mr.A. Would the tax treatment of such compensation be different if Mr.A was not a civil contractor?

Answer

The Bombay High Court has, in *CIT v. Shriram Builcons Ltd. (2008) 306 ITR 328*, held that any compensation paid to tenants for vacating the premises in the course of business of the assessee, who was a civil contractor and builder, pursuant to an agreement for development of property, was revenue expenditure. However, if the assessee was not a civil contractor, then he would be subject to capital gains tax and the compensation so paid would be allowed as cost of improvement.

Question 17

- (a) A Ltd. paid IDBI a lump sum prepayment premium of ₹ 1.2 lacs on 7.4.2011 for restructuring its debts and reducing its rate of interest. It claimed the entire sum as business expenditure for the P.Y.2011-12. The Assessing Officer, however, held that the prepayment premium should be amortised over a period of 10 years (being the tenure of the restructured loan), and thus, allowed only 10% of the pre-payment premium in the P.Y.2011-12. Discuss, with reasons, whether the contention of A Ltd. is correct or that of the Assessing Officer.
- (b) Explain the tax treatment for depreciation on emergency spares (of plant and machinery) acquired during the year which, even though kept ready for use, have not actually been used during the relevant previous year.

Answer

- (a) This issue came up before the Delhi High Court in *CIT v. Gujarat Guardian Ltd (2009) 177 Taxman 434*. The Court observed that the assessee company's claim for deduction has to be allowed in one lump sum keeping in view the provisions of section 43B(d), which provide that any sum payable by the assessee as interest on any loan or borrowing from any financial institution shall be allowed to the assessee in the year in which the same is paid, irrespective of the periods, in which the liability to pay such sum is incurred by the assessee according to the method of accounting regularly followed by the assessee. The High Court concurred with the Tribunal's view supporting the assessee that in terms of section 36(1)(iii) read with section 2(28A), the deduction for pre-payment premium was allowable. Since there was no dispute that prepayment premium paid was nothing but interest and that it was paid to a public financial institution i.e. IDBI, the Court held that, in terms of section 43B(d), the assessee's claim for deduction has to be allowed in the year in which the payment has actually been made.

Therefore, applying the ratio of the above case, the contention of A Ltd. is correct and not that of the Assessing Officer.

Note – Section 36(1)(iii) provides for deduction of interest paid in respect of capital borrowed for the purposes of business or profession. Section 2(28A) defines interest to include, *inter alia*, any other charge in respect of the moneys borrowed or debt incurred. Section 43B provides for certain deductions to be allowed only on actual payment. From a combined reading of these three sections, it can be inferred that –

- (i) pre-payment premium represents interest as per section 2(28A);
 - (ii) such interest is deductible as business expenditure as per section 36(1)(iii);
 - (iii) such interest is deductible in one lump-sum on actual payment as per section 43B(d).
- (b) This issue was dealt with by the Delhi High Court in *CIT v. Insilco Ltd (2009) 179 Taxman 55*. The Court observed that the expression "used for the purposes of business"

appearing in section 32 also takes into account emergency spares, which, even though ready for use, yet are not consumed or used during the relevant period. This is because these spares are specific to a fixed asset, namely plant and machinery, and form an integral part of the fixed asset. These spares will, in all probability, be useless once the asset is discarded and will also have to be disposed of. In this sense, the concept of passive use which applies to standby machinery will also apply to emergency spares. Therefore, once the spares are considered as emergency spares required for plant and machinery, the assessee would be entitled to capitalize the entire cost of such spares and claim depreciation thereon.

Note – One of the conditions for claim of depreciation is that the asset must be “used for the purpose of business or profession”. In the past, courts have held that, in certain circumstances, an asset can be said to be in use even when it is “kept ready for use”. For example, depreciation can be claimed by a transport company on spare engines kept in store in case of need, though they have not actually been used by the company. Hence, in such cases, the term “use” embraces both active use and passive use for business purposes.

Question 18

The business profit of T Ltd., a tea growing and manufacturing company, is ₹120 lacs (before deduction under section 33AB) for the assessment year 2012-13. It deposits ₹ 50 lacs with NABARD for claiming deduction under section 33AB. It wants to claim set-off of brought forward business loss of ₹40 lacs. Find out the taxable income of T Ltd. for the assessment year 2012-13.

Answer

An assessee, engaged in growing and manufacturing tea in India, is entitled to a deduction under section 33AB, in respect of the amount deposited by the assessee to an account maintained with NABARD as per scheme approved by Tea Board, to the extent of lower of the following two amounts –

- (i) Amount deposited to the account maintained with NABARD within 6 months from the end of the previous year or before the due date for filing the return of income, whichever is earlier;
- (ii) 40% of profits of such business computed under the head “Profits and Gains of Business or Profession” before making any deduction under this section.

The above deduction will be allowed before setting off brought forward business loss under section 72.

Computation of taxable income of T Ltd. for the A.Y.2012-13

Particulars	₹ (in lacs)	₹ (in lacs)
Profit before deduction under section 33AB		120.00
Less: Deduction under section 33AB for deposit to the account with NABARD being lower of the following amounts:		

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Amount deposited with NABARD	50	
40% of business profit i.e., 40% of ₹ 120 lacs	<u>48</u>	<u>48.00</u>
		72.00
Less: 60% of ₹ 72 lacs, being agricultural income as per Rule 8		<u>43.20</u>
		28.80
Less: Set of brought forward loss under section 72		<u>28.80</u>
Taxable business income		<u>Nil</u>
Total Income		Nil

Note - The balance business loss of ₹ 11.20 lacs (i.e., ₹ 40 lacs – ₹ 28.80 lacs) can be carried forward to the next year, assuming that the time limit of 8 years for carry forward of business loss has not expired.

Question 19

Ishwar is a commission agent receiving commission from his principal. He collected certain amount as deposit towards sales tax and showed the amount so received under the head "Contingency deposit" in the Balance Sheet. He did not deposit the amount to the Government. The Assessing Officer invoked section 43B and added back the said amount to the business income of Ishwar. Examine the correctness of the action of the Assessing Officer.

Answer

The facts of the case are similar to that in *Ishwardas Sons v. CIT (2007) 295 ITR 473 (Ker)*. The issue is whether sales tax collected and kept as a contingency deposit can be considered as a trading receipt. The assessee collected certain amount as deposit towards sales tax and showed the amount so collected under the head "contingency deposit" account in the balance sheet. He did not deposit the amount to the Government. The Kerala High Court observed that the amount of sales tax collected formed part of the trading receipts of the assessee. The mere fact that the assessee created a head of account "Contingency Deposit" would not alter the nature of receipt. The court held that the sales tax collected by the assessee and shown under the head "Contingency Deposit" had to be considered as a trading receipt and included in the total income of the assessee. The disallowance under section 43B would be attracted for non-payment of sales tax collected irrespective of the nomenclature used and the accounting head under which it is categorized.

Therefore, the action of the Assessing Officer in adding back the amount by invoking section 43B in this case, is correct.

Question 20

The Net Profit of "Simran Ltd." for the year ended 31.3.2012 is ₹ 50 lacs after debit of the following:

(i)	Amount of ₹1,50,000 contributed to Employees Welfare Trust.
(ii)	Amount of ₹ 15,00,000 paid towards college fee and hostel expense for the MBA course of a close relative of a director.
(iii)	Amount of ₹ 3,00,000 incurred on installation of a traffic signal, so as to facilitate its employees coming to office to overcome traffic jam and save office time.
(iv)	Amount of ₹ 5,00,000 on the gift articles distributed to various dealers under sales incentive scheme.
(v)	Expenses of ₹ 5,00,000 incurred on the travelling of the wife of Managing Director, who accompanied him on a tour to U.K. on the invitation of Trade and Commerce Chamber, London.
(vi)	Amount of ₹ 3,00,000 paid on 11.5.2011 consequent upon change in currency rate due to exchange fluctuation in excess of the amount due to the suppliers of machinery.

Following further information are also provided by the company:

(a) Both the employees and employers contribution towards PF amounting to ₹ 2 lacs each for the month of March, 2012 were deposited on 1.7.2012.

(b) Provision for audit fees of ₹5 lacs made in the books for the year ended 31.03.2011 was paid to the auditors in September, 2011 after deducting tax under section 194J and the tax so deducted was remitted by 7.10.2011.

(c) A contractor who carried out repairing work in the office was paid in cash on 25.9.2011 by two vouchers No. 175 of ₹17,000 and No.180 of ₹ 8,000.

(d) TDS, out of payment of interest of ₹1 lac in February, 2012 and of ₹ 2 lacs in March, 2012, was remitted to the Government in July, 2012.

Compute the income chargeable to tax in A.Y. 2012-13 and work out the amount of tax payable on such income.

Answer

Computation of total income of Simran Ltd. for the A.Y.2012-13

Particulars	₹
Profits and gains of business or profession	
Net profit for the year as per P&L Account	50,00,000
Add: Expenses debited to Profit and Loss Account but not allowable	
(i) Contribution to Employees Welfare Trust disallowed under section 40A(9)	1,50,000
(ii) Expenses on the education of a relative of Director, who is not in employment of Simran Ltd., is not deductible under section 37 [Enkay (India) Rubber Co. Pvt. Ltd v. CIT (2003) 263 ITR 521 (Del)].	15,00,000

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	Hence, it should be added back to compute business income.	
(iii)	Expenses on installation of traffic signal, to facilitate its employees to overcome traffic jam and be on time, is an allowable expense under section 37(1)	--
(iv)	Expenses on distribution of gift articles to dealers under sales incentive scheme would promote goodwill and is made in the interest of business. Such gifts are prompted by commercial expediency and hence, the expenditure is allowable under section 37(1) [<i>CIT v. Avery Cycle Industries Ltd. (2006) 157 Taxman 381/ 298 ITR 0239 / 296 ITR 0393 (Punjab & Haryana)</i>]	--
(v)	Expenses on travelling to UK of the wife of Managing Director on the invitation of Trade and Commerce Chamber, London, is an allowable expense for the purposes of business	--
(vi)	Increase in liability due to change in currency rate and paid to the suppliers of machine is to be added to cost of the asset irrespective of the method of accounting as per section 43A. Hence, it should be added back to compute business income.	<u>3,00,000</u>
		69,50,000
Add	Employees contribution to PF to be included in income as per section 2(24)(x)	<u>2,00,000</u>
		71,50,000
Less	Expenditure allowable as deduction but not debited to profit and loss account (See Note below)	
(a)	Employers contribution towards PF paid before due date for filing of return is allowable as per section 43B	2,00,000
	Employees contribution to PF is not remitted before the due date under the PF Act. Therefore, it is not allowable as deduction under section 36(1)(va).	-
(b)	Provision for audit fees for the year ended 31-3-2011 for which tax was not deducted in the F.Y. 2010-11 but was deducted and paid in F.Y. 2011-12 is allowable in the year of payment as per the proviso to section 40(a)(ia).	5,00,000
(c)	Payment to a contractor for repairing work in a day by two vouchers in cash, the aggregate exceeding the limit of ₹ 20,000 is not an allowable expense as per section 40A(3).	-
(d)	Interest for the month of February & March, 2012, on which TDS was remitted to the Government before the due date of filing of return, is allowable as per section 40(a)(ia).	3,00,000

(e)	Depreciation on the amount of ₹ 3 lacs added in cost of machine @ 15% for the year	<u>45,000</u>	<u>10,45,000</u>
	Total income		<u>61,05,000</u>
	Computation of tax liability for A.Y.2012-13		
	Tax on ₹ 61,05,000 @ 30%		18,31,500
	Add: Education cess @ 2%	36,630	
	Secondary and higher education cess @ 1%	<u>18,315</u>	<u>54,945</u>
	Total Tax Payable		<u>18,86,445</u>

Note – The first sentence of the question states that the net profit of the company has been arrived at after debit of the following expenditure, which implies that the items of expenditure in serial nos. (i) to (vi) (given below the first sentence) have been debited to profit and loss account. Thereafter, the question states that following further information are also provided by the company, after which items in serial nos. (a) to (d) are given. From a plain reading of the question, it is apparent that items of expenditure in serial nos. (a) to (d) have not been debited to profit and loss account. Therefore, the deductibility or otherwise of these items of expenditure and taxability of any item of income have to be considered while computing the business income and dealt with accordingly. Accordingly, the items of expenditure in (a) to (d), which are allowable as per the provisions of the Act, have to be deducted while computing business income and no adjustment is required of items of expenditure disallowed since they have not been debited to profit and loss account.

Question 21

Sea Port Shipping Line, a non-resident foreign company operating its ships on the Indian Ports during the previous year ended on 31.3.2012, had collected freight of ₹ 100 lacs, demurrages of ₹ 20 lacs and handling charges of ₹ 10 lacs inclusive of an amount of ₹ 40 lacs collected in US dollars for the cargo booked for JNPT (Mumbai) from Antwerp. The expenses of operating its fleet during the year for the Indian Ports were ₹ 110 lacs. The company denies its liability to tax in India. Examine.

Answer

The provisions of section 44B would apply in this case. This section provides that in the case of an assessee, being a non-resident, engaged in the business of operation of ships, a sum equal to 7½% of the aggregate of the following amounts would be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession"

- (i) The amount paid or payable, whether within India or outside, 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.

- (ii) The amount received or deemed to be received in India by the assessee himself or by any other person on behalf of or on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

The above amounts will include demurrage charges and handling charges.

These provisions for computation of the income from the shipping business in case of non-residents would apply notwithstanding anything to the contrary contained in the provisions of sections 28 to 43A of the Income-tax Act, 1961.

Therefore, in this case, M/s. Sea Port Shipping Line is required to pay tax in India on the basis of presumptive tax scheme as per the provisions of section 44B. The assessee shall not be entitled to set off any of the expenses incurred for earning of such income. Therefore, the Shipping Line is required to pay tax @ 7½% on the total receipts of ₹ 130 lacs i.e., ₹ 9.75 lacs.

Question 22

Examine critically in the context of provisions contained in Income-tax Act, 1961 as to the correctness of the action or the treatment given in each of the following cases:

- (a) *Singhal Sons Mines, for acquiring rights for extracting minerals, had taken a mine on lease basis w.e.f. 31.08.2011 for a period of 15 years from Mr. Naresh against an amount of ₹ 30 lacs payable in three equal instalments on 31.08.11, 31.08.12 and 31.08.13. Amount of ₹ 10 lacs paid on 31.08.11 was charged as an expense in the mining account.*
- (b) *XYZ is engaged in the business of sale of Zinc Concentrate in India and in U.K. markets. However, in the P.Y. 2011-12, XYZ was engaged only in domestic activities. The company valued its closing stock on 31.03.12 on the basis of the price prevailing in London Metallic Exchange instead of price in the domestic market, as the price in London Metallic Exchange was lesser than the Indian rate.*

Answer

- (a) The assessee had acquired the mining rights after entering into the lease agreement against the payment of lease money in 3 installments. The assessee firm had charged the payment of ₹ 10 lacs made on 31.8.2011 in the previous year as revenue expenditure. The Apex Court, in the case of *Enterprising Enterprises v. DCIT (2007) 293 ITR 437*, on identical facts, had held that the payment of royalty or rent for the mining lease falls under revenue expenditure where it is paid on a year to year basis, but where the lease money is paid either one time or in installments then the same would be a capital expenditure. Accordingly, the amount of ₹ 10 lacs charged by the assessee in the mining account will not be allowed as revenue expenditure but shall be treated as capital expenditure.
- (b) The Supreme Court, in the case of *Hindustan Zinc Limited v. CIT (2007) 295 ITR 453*, observed that it was generally accepted as a rule of commercial practice and accountancy that the closing stock has to be valued on the basis of cost or market price, whichever is lower, and there should be no writing down in the value of goods except when there was an actual or anticipated loss. In that case, the assessee was engaged

only in domestic business activities and no export had taken place during the relevant previous year. Accordingly, the Supreme Court held that writing down the value of Zinc Concentrate by adopting the price of London Metallic Exchange as its net realizable value is incorrect as the same does not correspond with the term “actual or anticipated loss” in any manner, because prices in the domestic market were higher.

Therefore, in the case on hand, the action of the assessee to value the closing stock on the basis of the prices prevailing in the London Metallic Exchange is not correct, since in this case also, the assessee was engaged only in domestic business activities and no export had taken place during the relevant previous year. Hence, the assessee is required to adopt the net realizable value of the goods held in the closing stock, being the market price prevailing in the domestic market, or the cost price, whichever is lower, for valuation of its closing stock.

Question 23

- (a) Meghna Film Distributors have acquired the rights of exhibition of a feature film 'Nasha' in the territory of Rajasthan from the producers under an agreement executed on 11.06.11 against a consideration of ₹ 300 lacs. It thereafter executed a sub-agreement with a distributor to whom the rights of exhibition of the film in some of the areas of Rajasthan were assigned against an amount of ₹ 100 lacs. The film was released for exhibition on commercial basis on 25.12.11. Collection from the exhibition of film of "Meghna Film Distributors" for 25.12.2011 to 10.01.2012 was ₹ 50 lacs and thereafter up to 31.03.2012 was ₹ 190 lacs.

It asks you to clarify as to how these transactions will be reflected in the Income-tax return for A.Y. 2012-13. Would your answer be different if the film was released for exhibition on 11.01.2012?

- (b) *What meaning has been assigned to "Speculative transaction"? Narrate those transactions which shall not be treated as speculative transactions under the Income-tax Act, 1961.*

Answer

- (a) Meghna Film Distributors is engaged in the business of exhibition of feature films after taking the rights from the producers. The profits and gains of such business are to be computed as per the provisions given in Rule 9B of the Income-tax Rules, 1962.

Accordingly, the profits shall be worked out after deducting the amount paid towards cost of acquisition of film by the film distributor to the producer from the amount recovered by giving the rights of exhibition of film to sub-distributors and the receipts from exhibition of the feature films on commercial basis by the distributor himself where the film was released for exhibition on commercial basis before 90 days from the end of the financial year. If the film is not so released at least 90 days before the end of such previous year, the cost of acquisition shall be allowed to the extent of the amount realized by the film

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distributor and the balance shall be carried forwarded to the next following previous year and allowed as deduction in that year.

In the present problem, the agreement was executed on 11.06.2011 and the film also stands released for exhibition on commercial basis before 90 days from the end of the financial year i.e., on 25.12.11. Accordingly, the profit of the assessee will be computed as under: -

Particulars	₹
Collection from exhibition of film (₹ 50 lacs + ₹ 190 lacs)	240 lacs
Collection from sub-distributor	<u>100 lacs</u>
	340 lacs
Less : Cost of acquisition	
Amount paid to producer for exhibition rights of the film	<u>300 lacs</u>
Net income of film "Nasha"	<u>40 lacs</u>

Release of film for exhibition on commercial basis in the second case on 11.1.2012 i.e., less than 90 days before the end of the previous year. In this case, the profits of the assessee will be as under :-

Particulars	₹
Collection from exhibition of film (See Note Below)	190 lacs
Collection from sub-distributor	<u>100 lacs</u>
	290 lacs
Less : Cost of acquisition	
Amount paid to producer for exhibition rights of the film (₹ 300 lacs, but restricted to ₹ 290 lacs)	<u>290 lacs</u>
Net income of film "Nasha"	<u>Nil</u>

The balance of ₹ 10 lacs (i.e. ₹ 300 lacs – ₹ 290 las) has to be carried forward to the next following previous year and allowed as a deduction in that year i.e., F.Y.2012-13.

Note- Collection from exhibition of film from 25.12.2011 to 10.01.2012 amounting to ₹ 50 lacs is not considered in case of release of film on 11.01.2012 as it relates to a period before the date of release, so, it is relevant only in the first case when the film was released on 25.12.2011.

- (b) According to section 43(5), the expression "speculative transaction" means 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.

The following transactions shall not be deemed to be speculative transactions:

- (i) 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 the actual delivery of goods manufactured by him or merchandise sold by him; or
- (ii) 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
- (iii) 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; or
- (iv) an eligible transaction in respect of trading in derivatives carried out in a recognized stock exchange.

Question 24

Work out the taxable income for A.Y. 2012-13 of a partnership firm engaged in retail trade from the following particulars:

- (i) Net profit of ₹ 3,65,000 arrived at after debit of interest on capital of partners of ₹ 1,80,000 and salaries to working partners of ₹ 4,80,000.
- (ii) Total capital of the partners on which interest paid is debited in the profit and loss account was ₹ 10,00,000.

Answer

Computation of taxable income of the partnership firm for A.Y.2012-13

Particulars	₹	₹
Net Profit as per profit and loss account		3,65,000
Add : Interest on Capital		1,80,000
Salaries to Partners		<u>4,80,000</u>
		10,25,000
Less : Interest on capital allowable @ 12% on ₹ 10 lacs		<u>1,20,000</u>
Book Profits		9,05,000
Less: Admissible amount of salary as a percentage of book profits or actual paid, whichever is less		
90% of ₹ 3,00,000	2,70,000	
60% of ₹ 6,05,000	<u>3,63,000</u>	
	<u>6,33,000</u>	
Since, the actual salary of ₹ 4,80,000 paid to the working partners is lesser than the admissible amount of ₹ 6,33,000, the entire amount of ₹ 4,80,000 is allowable as deduction.		<u>4,80,000</u>
Taxable Income		<u>4,25,000</u>

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Note: It is presumed that the salary and interest payments are authorized by the partnership deed.

Question 25

The net result of the business carried on by a branch of foreign company in India for the year ended 31.03.2012 was a loss of ₹100 lacs after charge of head office expenses of ₹200 lacs allocated to the branch. Explain with reasons the income to be declared by the branch in its return for the assessment year 2012-13.

Answer

Section 44C restricts the allowability of the head office expenses to the extent of lower of an amount equal to 5% of the adjusted total income or the amount actually incurred as is attributable to the business of the assessee in India.

For the purpose of computing the adjusted total income, the head office expenses of ₹ 200 lacs charged to the profit and loss account have to be added back.

The amount of income to be declared by the assessee for A.Y. 2012-13 will be as under:

Particulars	₹(in lacs)
Net loss for the year ended on 31.03.2012	(100)
Add: Amount of head office expenses to be considered separately as per section 44C	<u>200</u>
Adjusted total income	100
Less: Head Office expenses allowable under section 44C is the lower of	
(i) ₹ 5 lacs, being 5% of ₹ 100 lacs and	
(ii) ₹ 200 lacs.	<u>5</u>
Income to be declared in return	<u>95</u>

Question 26

Atul Housing Finance Co. Ltd., engaged in the business of providing long-term finance for construction or purchases of houses in India for residential purposes, provides you the following particulars from its accounts for the year ended on 31.3.2012 and seeks your opinion as to availability of deduction under section 36(1)(viii) and the amount thereof:

Profits from the business computed as per Part D of Chapter IV of the Income-tax Act, 1961, but before claiming deduction under section 36(1)(viii) is ₹560 lacs

-Paid-up share Capital	₹ 500 lacs
-General Reserve	₹ 100 lacs
-Balance in reserve created u/s 36(1)(viii) on 31.3.2011	₹ 1,100 lacs

Answer

According to section 36(1)(viii), a special deduction is allowed to specified entities engaged in eligible business. A housing finance company is a specified entity which is eligible for deduction under section 36(1)(viii) in respect of profits derived from the eligible business of providing long-term finance for construction or purchase of houses in India for residential purposes. The quantum of deduction, however, should not exceed 20% of the profits derived from eligible business computed under the head "Profits and gains of business or profession" carried to a special reserve account.

However, where the aggregate amount carried to such reserve account exceeds twice the amount of paid up share capital and general reserve, no deduction shall be allowed in respect of such excess.

Atul Housing Finance Co. Ltd. is, therefore, a specified entity engaged in carrying on the eligible business of providing long-term finance for the construction or purchase of houses in India for residential purposes and accordingly, it is entitled to claim the deduction under section 36(1)(viii).

The maximum deduction would be ₹ 112 lacs (20% of ₹ 560 lacs, being the profits for the year). However, in such a case, the aggregate amount carried to special reserve account i.e. ₹ 1,212 lacs (₹ 1,100 lacs + ₹ 112 lacs) would exceed twice the amount of paid-up share capital and general reserve i.e., ₹ 1,200 lacs (2 x 600 lacs). Therefore, deduction will not be allowed under section 36(1)(viii) in respect of the excess ₹ 12 lacs (₹ 1,212 lacs – ₹ 1,200 lacs). Deduction under section 36(1)(viii) for the A.Y. 2012-13 would be ₹ 100 lacs (₹ 1,200 lacs – ₹ 1,100 lacs).

Question 27

Explain the meaning of "eligible expense" for the purpose of claiming benefit of section 35D.

Answer

The following are the expenditure eligible for amortization as a preliminary expense under section 35D -

- (a) Expenditure in connection with –
 - (i) the preparation of feasibility report;
 - (ii) the 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 assessee's business.
- (b) legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting up to conduct the business of assessee.

- (c) Where the assessee is a company, in addition to the above, expenditure incurred –
 - (i) by way of legal charges for drafting the Memorandum and Articles of Association of the company;
 - (ii) on printing the Memorandum and Articles of Association;
 - (iii) by way of fees for registering the company under the Companies Act, 1956;
 - (iv) in connection with the issue, for public subscription, of the shares in or debentures of the company, being underwriting commission, brokerage and charges for drafting, printing and advertisement of the prospectus; and
- (d) such other items of expenditure (not being expenditure eligible for any allowance or deduction under any other provision of the Act) as may be prescribed by the Board for the purpose of amortisation.

In the case of expenditure specified in item (a) above, the work in connection with the preparation of the feasibility report or the project report or the conducting of market survey or any other survey or the engineering services referred to must be carried out by the assessee himself or by a concern which is for the time being approved in this behalf by the Board.

Question 28

Intelysis Limited charged depreciation on its fixed assets at the rates prescribed in the Income-tax Rules in its accounts consistently. The Assessing Officer disallowed the same and considered depreciation computed at the rates prescribed in the Companies Act, 1956, for the purpose of computation of 'book profit' under section 115JB of the Income-tax Act, 1961 for the assessment year 2012-13. Examine the correctness of the action of the Assessing Officer.

Answer

This issue was settled by the Supreme Court in *Malayala Manorama Co. Ltd. v. CIT (2008) 300 ITR 251*. The Apex Court observed that for the purpose of computation of book profit under section 115JB, the Assessing Officer's power is restricted to examining whether the books of account are certified by the authorities under the Companies Act, 1956 as having been properly maintained in accordance with the Companies Act, 1956. Thereafter, he only has the limited power of making additions and deductions as provided for in Explanation 1 to section 115JB. The Assessing Officer does not have the jurisdiction to go behind the net profit shown in the profit and loss account except to the extent provided in Explanation 1 to section 115JB.

Where an assessee is consistently charging depreciation in its books of account at the rates prescribed in Income-tax Rules, 1962 and the accounts of the assessee have been prepared and certified as per the provisions of the Companies Act, 1956, the Assessing Officer does not have any jurisdiction under section 115JB to rework the net profit of the assessee by substituting the rates of depreciation prescribed under the Companies Act, 1956.

Applying the ratio of the Supreme Court decision to this case, it may be concluded that the action of the Assessing Officer is not correct.

Note - The rates of depreciation prescribed in Schedule XIV to the Companies Act, 1956 are the minimum rates at which depreciation is to be charged in the profit & loss account. The rates prescribed in the Income-tax Rules, 1962 are higher than those prescribed in the Companies Act, 1956. A company is, therefore, not precluded from adopting higher rates of depreciation, if the circumstances justify. Thus, even if a company adopts the higher rates of depreciation prescribed in the Income-tax Rules, 1962, it can be said that the company has prepared the accounts in the manner provided under the Companies Act, 1956.

Question 29

'X' Ltd., transferred its fertilizer business to a new company 'Y' Ltd., by way of demerger with effect from appointed date of 1.4.2011 after satisfying the conditions of demerger. Further information given:

- (a) *WDV of the entire block of plant and machinery held by 'X' Ltd. as on 1.4.2011 is ₹ 100 crores;*
- (b) *Out of the above, WDV of block of plant and machinery of fertilizer division is 70 crores;*
- (c) *'X' Ltd. has unabsorbed depreciation of ₹ 50 lacs as at 31.3.2011;*

On the above facts:

- (i) *You are required to explain the provisions of the income-tax as to the allowability of depreciation, post-merger, in the hands of 'X' Ltd. and 'Y' Ltd. as at 31.3.2011 duly calculating the depreciation.*
- (ii) *State how the unabsorbed depreciation has to be dealt with for the assessment year 2012-13.*

Answer

- (i) In the case of a demerger, satisfying the conditions as laid down in section 2(19AA), the depreciation claim is governed by the provisions as under:
 - (1) As per the *Explanation 7A* of section 43(1), where in a scheme of demerger, if the demerged company transfers any capital asset to the resulting company, being an Indian company, the actual cost of the capital asset transferred 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.
 - (2) The resulting company will be entitled to depreciation on the written down value of the block of assets transferred to it, which will be the written down value of the transferred assets of the demerged company immediately before the demerger [Explanation 2B to section 43(6)].
 - (3) *Explanation 2A* to section 43(6) provides that the written down value of the block of assets in the hands of the demerged company shall be the written down value of the block of assets of the demerged company for the immediately preceding previous

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year as reduced by the written down value of the assets transferred to the resulting company pursuant to the demerger.

- (4) As per the above provisions, the calculation of depreciation on plant and machinery in the hands of 'X' Ltd. and 'Y' Ltd. is as under:

WDV of plant and machinery	'X' Ltd.	'Y' Ltd.
	₹ in crores	
As at 1 st April, 2011	30.00	70.00
Less: Depreciation @ 15%	4.50	10.50
WDV as at 31 st March, 2012	25.50	59.50

Note – It is presumed that Y Ltd. is an Indian company

(ii) Set-off of unabsorbed depreciation:

- (i) As per section 72A(4), on demerger, the unabsorbed depreciation directly relatable to the undertakings transferred to the resulting company is allowed to be carried forward and set off in the hands of the resulting company.
- (ii) Where such unabsorbed depreciation is not directly relatable to the undertaking transferred to the resulting company, it has to 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.
- (iii) The demerged company and the resulting company would be allowed to carry forward and set-off their respective portion of unabsorbed depreciation, as calculated above, for an unlimited period as per section 32(2).

Question 30

Specify all those public facilities which have been notified by CBDT as infrastructure facility for the purpose of section 36(1)(viii).

Answer

The CBDT, vide Notification No. SO 1153(E) dated 20.07.2006, has notified the following public facilities as infrastructure facility for the purpose of section 36(1)(viii):

- (1) Inland Container Depot and Container Freight Station notified under the Customs Act, 1962
- (2) Mass Rapid Transit system
- (3) Light Rail Transit system
- (4) Expressways
- (5) Intra-urban or semi-urban roads like ring roads or urban by-passes or flyovers
- (6) Bus and truck terminals

- (7) Subways
- (8) Road dividers
- (9) Bulk Handling Terminals which are developed or maintained or operated for development of rail system
- (10) Multilevel Computerised Car Parking.

Question 31

M/s. Nagdiwala Enterprises, a partnership firm constituted by a doctor and a non-doctor engaged in running a multispeciality hospital, seeks your opinion in the context of provisions of the Act as to allowability/chargeability of the following transactions for preparing its return for A.Y. 2012-13:

- (a) *Depreciation on the instruments, imported from U.K. for ₹ 2 lacs cleared by customs on 22.3.2012 on payment of duty of ₹ 1 lac, installed and ready for use on 26.3.2012. Only one operation with the help of such instruments was performed till 31.3.2012.*
- (b) *The book profits calculated as per section 40(b) are ₹ 3 lacs and payment of salary to working partners was ₹ 1 lac. Clause for payment of salary to working partners though appears in the deed, but the same is silent as to quantum and the manner of distribution.*
- (c) *Salary of ₹ 10,000 p.m. paid to the wife of a partner for working as an anesthetist. The normal salary of an anesthetist in the town is ₹ 7,500 p.m. or less.*
- (d) *Purchase of medicines in cash on 18.12.2011 for ₹ 35,000.*
- (e) *Revenue expenditure of ₹ 10,000 incurred for promoting family planning amongst its employees.*
- (f) *Interest of ₹ 3,000 paid on an overdraft of ₹ 1 lac taken for making payment of installment of advance tax of ₹ 1.25 lacs.*

Answer

The allowability/chargeability of each of the transactions entered into by M/s Nagdiwala Enterprises for the purpose of computation of income for Assessment Year 2012-13 shall be as under:-

- (a) The surgical instruments used by a firm engaged in the business of running a hospital are covered under the category of Plant & Machinery, on which the rate of depreciation is 15%. The depreciation on the instruments imported from U.K. is allowable to the firm since the same were put to use during the previous year ended on 31.3.2012 because of performing of one operation. However, the same were used in the previous year for less than 180 days and accordingly the allowable depreciation will be one half of the normal depreciation. The cost of instruments is ₹ 3 lacs and the amount of depreciation thereon works out to ₹ 22,500 [$3,00,000 \times 15\% \times 50\%$].

- (b) As per section 40(b), payment of remuneration to a working partner is allowable as deduction only if it is authorised by and in accordance with the terms of the partnership deed. *CBDT Circular No.739 dated 25.3.96* clarifies that no deduction in respect of remuneration paid to partners is allowable 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. If the partnership deed contains a clause for payment of salary to working partners without specifying the manner of quantification or manner of distribution of such salary, the payment of salary to the working partners cannot be construed to be authorised by and in accordance with the partnership deed.
- (c) Section 40A(2) provides that if any expenditure in respect of which payment has been made to, *inter alia*, any relative of the partner of a firm and the Assessing Officer is of the opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the services for which the payment is made, then disallowance under this section is attracted to the extent the same is excessive or unreasonable. In this case, salary of ₹ 10,000 p.m. is paid to the partner's wife, who is working as an anesthetist. The fair market value of a similar service is ₹ 7500 p.m. Therefore, disallowance under section 40A(2) is attracted to the extent of ₹ 2500 p.m., since to that extent, the same is excessive.
- (d) Section 40A(3) provides for 100% disallowance of an expenditure, in respect of which payment is made in a sum exceeding ₹ 20,000 otherwise than by way of account payee cheque or account payee bank draft. Therefore, the entire amount of ₹ 35,000 incurred for purchase of medicines in cash is disallowed under section 40A(3).
- (e) Section 36(1)(ix) provides for deduction in respect of expenditure incurred by companies to promote family planning amongst its employees. However, since the assessee in this case is a partnership firm, such expenses are not allowable as deduction under section 36(1)(ix).
- (f) Interest on the overdraft taken for making payment of installment of advance tax is not allowable under section 37(1) since it is not an expenditure wholly and exclusively incurred for the purpose of business as held by the Apex Court in the case of *East India Pharmaceutical Works Ltd. v. CIT (1997) 224 ITR 627*.

Question 32

Raja Ltd., made a provision on 31.3.2012 of ₹ 85,500 against a bill of supplier of raw material by charging the amount to profit and loss account and claimed deduction thereof while computing the income chargeable to tax for A.Y. 2012-13. The amount of ₹ 40,000 not paid to the party till 31.3.2012 was paid in cash on 11.6.2012. The Assessing Officer issued show cause notice to the company to rectify the computation of income for the A.Y. 2012-13 on account of payment made in cash on 11.6.2012.

Can the Assessing Officer do so?

Answer

Section 40A(3A) provides that where an allowance has been made in the assessment for any year in respect of any liability for any expenditure incurred by the assessee and subsequently, during any previous year, the assessee makes any payment in respect of such liability in a sum exceeding ₹ 20,000 otherwise than by an account payee cheque drawn on a bank or by an account payee bank draft, the payment so made shall be deemed to be profits and gains of business or profession of the subsequent year.

Section 40A(3A) is attracted in this case since the company has made a cash payment of ₹ 40,000 in respect of a liability incurred and allowed earlier. Accordingly, ₹ 40,000/-, will be added in the computation of income for the A.Y. 2013-14 (considering that the payment was made on 11.6.2012).

The action of the Assessing Officer to issue show cause notice to rectify the computation of income of earlier assessment year is not valid. The payment would go to increase the assessable income of the assessee for the previous year relevant to the assessment year in which such payment is made.

Question 33

“Easy Call Ltd.”, to provide telecom services in Mumbai, obtained a licence on 11.4.2009 for a period of 10 years ending on 31.3.2019 against a fee of ₹ 27 lacs to be paid in 3 installments of ₹ 10 lacs, 9 lacs and 8 lacs by April, 2009, April, 2010 and April, 2011 respectively.

Explain, how the payment made for licence fee shall be dealt with under the Income-tax Act, 1961 and work out the amount, if any, deductible in this respect out of income chargeable to tax for A.Y. 2012-13.

Answer

The payment made for acquiring the licence to operate telecom services in Mumbai shall be subject to deduction as per the scheme in section 35ABB. As per section 35ABB, any amount actually paid for obtaining licence to operate telecommunication services shall be allowed as deduction in equal installments during the number of years for which the license is in force. If the payment is made before the commencement of business, the deduction shall be allowed beginning with the year of commencement of business. In any other case, it will be allowed commencing from the year of payment. Deduction shall be allowed up to the year in which the license shall cease to be in force.

The amount of deduction available for A.Y. 2012-13 is ₹ 3 lacs as worked out below:-

(1)	(2)	(3)	(4) = (3)/(2)
Previous year of payment	Unexpired period of license	Installment paid (₹)	Deduction in respect of each installment (₹)
2009-10	10 years	10,00,000	1,00,000
2010-11	9 years	9,00,000	1,00,000
2011-12	8 years	8,00,000	1,00,000
		<u>27,00,000</u>	<u>3,00,000</u>

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The deduction under section 35ABB from assessment year 2012-13 onwards till A.Y. 2019-20 will be ₹ 3 lacs each year.

Note – It is assumed that the company has commenced business during the P.Y.2009-10.

Question 34

GP Ltd. was incorporated on 31.12.2010 for manufacture of tyres and tubes for motor vehicles. The manufacturing unit was set up on 30.4.2011. The company commenced its manufacturing operations on 1.5.2011. The total cost of the plant and machinery installed in the unit is ₹ 100 crores. The said plant and machinery included second hand plant and machinery bought for ₹ 10 crores and new plant and machinery for scientific research relating to the business of the assessee acquired at a cost of ₹ 10 crores.

Compute the amount of depreciation allowable under section 32 of the Income-tax Act, 1961 in respect of the assessment year 2012-13. Furnish explanations in support of your computation.

Answer

Computation of depreciation allowable for the A.Y. 2012-13 in the hands of GP Ltd.

Particulars		₹ in crores	
Total cost of plant and machinery		100.00	
Less: Used for Scientific Research (Note 1)		<u>10.00</u>	
		<u>90.00</u>	
Normal Depreciation @ 15% on ₹ 90 crores			13.50
Additional Depreciation:			
Cost of plant and machinery		100.00	
Less: Second hand plant and machinery (Note 2)	10.00		
Plant and machinery used for scientific research, the whole of the actual cost of which is allowable as deduction under section 35(2)(ia) (Note 2)	<u>10.00</u>	<u>20.00</u>	
		80.00	
Additional Depreciation @ 20%			<u>16.00</u>
Depreciation allowable for A.Y.2012-13			<u>29.50</u>

Notes:

1. As per section 35(2)(iv), no depreciation shall be allowed in respect of plant and machinery purchased for scientific research relating to assessee's business, since the entire expenditure is deductible under section 35.
2. As per section 32(1)(ia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005 by an assessee engaged in the

business of manufacture or production of any article or thing, at the rate of 20% of the actual cost of such machinery or plant.

However, additional depreciation shall not be allowed in respect of, inter alia, –

- (i) any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person;
- (ii) 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 “Profit and gains of business or profession” of any one previous year.

In view of the above provisions, additional depreciation cannot be claimed in respect of -

- (i) Second hand plant and machinery; and
- (ii) New plant and machinery purchased for scientific research relating to assessee's business in respect of which the whole of the capital expenditure can be claimed as deduction under section 35(1)(iv) read with section 35(2)(ia).

Question 35

Mr. Sunil carried on the business of purchase and sale of agricultural commodities like paddy, wheat, etc. He borrowed loans from Punjab State Financial Corporation and State Bank of India and has not paid interest as detailed hereunder:

		₹
(i)	Punjab State Financial Corporation (Previous years 2008-09, 2009-10 & 2010-11)	36,00,000
(ii)	State Bank of India (Previous years 2009-10 & 2010-11)	72,00,000
		1,08,00,000

Both Punjab State Financial Corporation and State Bank of India, while restructuring the loan facilities of Sunil during the financial year 2011-12, converted the above interest arrear as loan repayable in 36 equal installments.

During the year ended 31.3.2012, Sunil paid six installments to Punjab State Financial Corporation and five instalments to State Bank of India.

Sunil claimed the entire interest of ₹ 1,08,00,000 as an expenditure while computing the income from business of purchase and sale of agricultural commodities for the financial year 2010-11.

Discuss whether his claim is valid and if not, what is the amount of interest, if any, allowable.

Answer

Section 43B allows deduction only on “payment” basis in respect of certain expenditure specified therein, irrespective of the method of accounting followed by the assessee. Such expenditure would be allowed as deduction in the previous year in which the liability to pay

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such sum was incurred only if the payment is made on or before the due date for filing the return of income under section 139(1). If the payment is made after the stipulated due date, deduction can be claimed only in the year of actual payment. Such specified expenditure include, *inter alia*,

- (1) interest on loan or borrowing from any public financial institution or a State financial corporation or a State industrial investment corporation; and
- (2) interest on any loan or advances from a scheduled bank.

A clarification has been given by way of Explanations 3C and 3D in section 43B. These *Explanations* clarify that if any sum payable by the assessee as interest on any such loan or borrowing or advance is converted into a loan or borrowing or advance, the interest so converted and not "actually paid" shall not be deemed as actual payment, and hence would not be allowed as deduction. The clarificatory explanations reiterate the rationale that conversion of interest into a loan or borrowing or advance does not amount to actual payment. Therefore, ₹ 1,08,00,000, being the aggregate of interest on loan (from a State Financial Corporation and a scheduled bank) converted into loan will not be allowed as deduction. Consequently, the claim of Mr. Sunil is not valid.

The manner in which the converted interest will be allowed as deduction has been clarified in *Circular No.7/2006 dated 17th July, 2006*. The unpaid interest, whenever actually paid to the bank or financial institution, will be in the nature of revenue expenditure deserving deduction in the computation of income. Therefore, irrespective of the nomenclature, the deduction will be allowed in the previous year in which the converted interest is actually paid.

Hence, the repayment of ₹ 16,00,000 during the financial the year 2011-12, as detailed hereunder, will be allowed as deduction while computing the business income of Mr. Sunil in the assessment year 2012-13.

Particulars	₹
Paid to Punjab State Financial Corporation (36,00,000 x 6/36)	6,00,000
Paid to State Bank of India (72,00,000 x 5/36)	10,00,000
	16,00,000

Question 36

Mr. Q, 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 ending 31.3.2012:

- (i) ₹ 2 crores in India on account of carriage of passengers from Chennai.
- (ii) ₹ 1 crore in India on account of carriage of goods from Chennai.
- (iii) ₹ 3 crores in India on account of carriage of passengers from Singapore.
- (iv) ₹ 1 crore in Singapore on account of carriage of passengers from Chennai.

The total expenditure incurred by Mr. Q for the purposes of the business during the year ending 31.3.2012 was ₹ 6.75 crores.

Compute the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" for the assessment year 2012-13.

Answer

Section 44BBA incorporates special provisions for computing profits and gains of the business of operation of aircraft in the case of non-residents. Section 44BBA starts with a non-obstante clause. Therefore, section 44BBA overrides the provisions contained in sections 28 to 43A. As such, the business income of Mr. Q is required to be computed in accordance with the provisions of section 44BBA.

Under section 44BBA(1), a sum equal to 5% of the aggregate of the amounts specified in sub-section (2) is deemed to be the profits and gains chargeable to tax under the head "Profits and gains of business or profession". Sub-section (2) specifies the following 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, livestock, 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 of passengers, livestock, mail or goods from any place outside India.

Keeping in view the provisions of section 44BBA, the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" is worked out hereunder -

	₹
Amount received in India on account of carriage of passengers from Chennai	2,00,00,000
Amount received in India on account of carriage of goods from Chennai	1,00,00,000
Amount received in India on account of carriage of passengers from Singapore	3,00,00,000
Amount received in Singapore on account of carriage of passengers from Chennai	1,00,00,000
	7,00,00,000

Income from business under section 44BBA at 5% of ₹ 7,00,00,000 is ₹ 35,00,000, which is the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" for the A.Y. 2012-13.

Question 37

XYZ Ltd. incurred expenditure amounting to ₹ 3,00,000 in connection with the issue of rights shares and ₹ 2,00,000 in connection with the issue of bonus shares during the year ending

31.3.2012. The company seeks your opinion in the matter of eligibility for deduction of the expenditure incurred from its business profits for the assessment year 2012-13.

Answer

The Supreme Court has, in *Brooke Bond India Ltd. v. CIT* (1997) 225 ITR 798 (SC), held that expenditure incurred by a company in connection with issue of shares with a view to increase its share capital is directly related to the expansion of its capital base and, therefore, constitutes a capital expenditure. The issue of rights shares results in expansion of the capital base of XYZ Ltd. Hence, expenditure of ₹ 3,00,000 incurred by the company in connection with the issue of rights shares is a capital expenditure and is not allowable as a business expenditure.

On the other hand, the issue of bonus shares does not result in inflow of fresh funds or increase in the capital employed. It is merely capitalization of reserves. The issue of bonus shares does not expand the capital base of the company. The total funds available with the company and its capital structure will remain the same on issue of bonus shares. The Supreme Court, in *CIT v. General Insurance Corporation* (2006) 286 ITR 232, considered this effect of issue of bonus shares and ruled that expenditure incurred in connection with the issue of bonus shares was allowable as revenue expenditure. Hence, the expenditure amounting to ₹ 2,00,000 incurred in connection with the issue of bonus shares is deductible from its business profits for the assessment year 2011-12.

Question 38

What is an adventure in the nature of trade? State the factors which are relevant in deciding whether a transaction is an adventure in the nature of trade.

Answer

The term "business" has been defined in section 2(13) of the Income-tax Act, 1961 to include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. Adventure in the nature of trade implies that the adventure has the characteristics of trade but not all of them. That indeed is the distinguishing mark of an adventure since if it possessed all the characteristics, it would be a full blown trade straightaway.

The Supreme Court has, in *G. Venkataswami Naidu & Co. v. CIT* (1959) 35 ITR 594 and *CIT v. H. Holck Larsen* (1986) 160 ITR 67, identified certain factors which are relevant in deciding whether a transaction is an adventure in the nature of trade.

In deciding whether a transaction is an adventure in the nature of trade, several factors are relevant such as, the motive, intention or purpose with which the article sold was bought earlier, the character of articles purchased and sold, that is, whether the articles are fit for sale as merchandise, ordinary occupation of the assessee, that is, whether he is a trader or not, whether the purchase of the commodity and its resale were allied to his usual trade or incidental to it, quantity of the commodity purchased and sold, acts prior to purchase showing a design or purpose, manner of disposal, similarity of transactions to operations usually

associated with trade or business, repetition of transactions, period of holding, circumstances that led to the sale, treatment in books of account etc. In each case, it is the total effect of all relevant factors and circumstances that determine the character of the transaction.

Question 39

A Hindu undivided family is carrying on the business of purchase and sale of food grains. The Karta of the family manages the business. Can the Hindu undivided family pay salary to the Karta and claim the payment made as a deduction from the profits of its business? If so, what are the conditions and limitations for such payment?

Answer

The Supreme Court has, in *Jugal Kishore Baldeo Sahai v. CIT* (1967) 63 ITR 238, held that if remuneration is paid to the karta of a Hindu undivided family (HUF) under –

- (i) a valid agreement which is bona fide and
- (ii) is in the interest of, and expedient for, the business of the family and
- (iii) the payment is genuine and not excessive,

such remuneration would be an expenditure laid out wholly and exclusively for the purpose of business of the family and would be allowable as a deduction while computing the income of the HUF. The test which should be applied for judging, what is a valid agreement is, whether the agreement for payment of salary to the karta was by or on behalf of all the members of the family and whether it was in the interests of the business of the family so that it could be justified on the grounds of commercial expediency.

Thus, the HUF can pay salary to the karta for services rendered by him to the business of the family under a valid agreement, which may be expressed or implied. Such payment will be eligible for deduction from the business profits of the HUF, if it is not excessive and is not unreasonable.

Question 40

X Ltd., is a company engaged in the business of growing, manufacturing and selling of tea.

For the accounting year ended 31st March, 2012, its composite business profits, before an adjustment under section 33AB of the Income-tax Act, 1961, were ₹ 60 lacs. In the year, it deposited ₹ 25 lacs with NABARD.

The company has a business loss of ₹ 10 lacs brought forward from the previous year.

The company withdrew in February, 2012 ₹ 20 lacs from the deposit account to buy a non-depreciable asset for ₹ 18 lacs and could not use the balance before the end of the accounting year. The withdrawal and the purchase were under a scheme approved by the Tea Board.

The non-depreciable asset was sold in November, 2012 for ₹ 29 lacs.

Indicate clearly the tax consequences of the above transactions and the total income for the relevant years.

Answer

Computation of total income of X Ltd. for A.Y.2012-13

Particulars		₹
(i)	Composite profits before allowing deduction under section 33AB	60,00,000
	Less: Deduction u/s 33AB	
	[Lower of 40% of ₹ 60 lacs (i.e. ₹ 24 lacs) or the actual amount deposited with NABARD (i.e. ₹ 25 lacs)]	24,00,000
		36,00,000
	As per Rule 8 of Income-tax Rules, 1962, 40% of this sum is subject to income-tax and the balance 60% is treated as agricultural income. Hence, the business income is 40% of ₹ 36 lacs	14,40,000
	Add: Non-utilisation of amount withdrawn: [i.e. (₹ 20 lacs – ₹ 18 lacs)] x 40% (See Note 1)	80,000
	Business income	15,20,000
	Less: Business loss brought forward from the previous year	10,00,000
	Total income	5,20,000
(ii)	Computation of total income of X Ltd. for A.Y.2013-14	
	Particulars	₹
	Business income (See Note 2)	7,20,000
	Capital gains (Short-term) (See Note 3)	11,00,000
	Total Income	18,20,000

Note 1

As per section 33AB amount withdrawn from deposit account maintained under this section if not utilized either wholly or in part, within that previous year, the whole of such amount which is not so utilized shall be deemed to be profits and gains of business and accordingly chargeable to income-tax as the income of that previous year [Section 33AB(7)].

Note 2 - Computation of business income

Since the asset is sold within 8 years, the cost of the asset i.e. ₹ 18 lacs should be treated as income since the same has been allowed as deduction in the assessment year 2012-13. However, out of this ₹ 18 lacs, 60% would be agricultural income and the balance 40% i.e. ₹ 7.2 lacs would be business income of A.Y.2013-14. This is because deduction under section 33AB was allowed in A.Y.2012-13 before disintegration of income into agricultural income and non-agricultural income.

Where any asset is sold or transferred within 8 years from the end of the year in which it was acquired, such part of the cost as is relatable to the deduction allowed under section 33AB(1) shall be deemed to be the profits and gains of business or profession of the previous year in which the asset is sold or otherwise transferred [section 33AB(8)]. In the problem the part of the cost of the asset as is relatable to the deduction allowed is not given. Therefore, the

entire cost is assumed as deduction allowed at the time of deposit. Accordingly, 40% of cost of the asset is taxed as business income.

Note 3 – Computation of Capital Gains

	₹
Sale Proceeds	29,00,000
Less: Cost of acquisition	18,00,000
Short term capital gains (since the period of holding is less than 36 months)	11,00,000

Question 41

State whether the provisions of section 41(1) of the Act can be applied to a case, where refund of excise duty has been obtained by the assessee on the basis of a decision of the CESTAT and where the matter has been taken up in further appeal to the Court by the Central Excise Department.

Answer

This question has been answered by the Apex Court in *Polyflex (India) Pvt. Ltd. v. CIT* [2002] 257 ITR 343. The Apex Court observed that in a case where a statutory levy in respect of goods dealt with by the assessee is discharged and subsequently the amount paid is refunded, it is the first part of section 41(1)(a) that more appropriately applies i.e. it will be a case where the assessee “has obtained any amount in respect of such expenditure”. It will not be a case of “benefit by way of remission or cessation” of a trading liability. Where expenditure is actually incurred by reason of payment of duty on goods and a deduction or allowance is given in the assessment of an earlier period, the assessee is liable to discharge that benefit as and when he obtains refund of the amount so paid. The possibility of the refund being set at naught on a future date will not be a relevant consideration. Once the assessee gets back the amount which was claimed and allowed as business expenditure during an earlier year, the deeming provision in section 41(1) comes into play and it is not necessary that the Revenue should await the verdict of a higher court. If the higher court upholds the levy at a later date, the assessee is not without remedy to get back the relief.

Therefore, the refund of excise duty pursuant to the decision of the CESTAT would be subject to tax by virtue of section 41(1) and it is not necessary that the Revenue should await the verdict of a higher court.

Question 42

A company engaged in textile manufacturing, debited to its Profit & Loss Account a sum of ₹ 6,00,000, being the interest on loan of ₹ 60,00,000 taken for financing its expansion scheme. The plant and machinery purchased for the project with the loan were not received during the year and those were still in transit at the end of the year. A sum of ₹ 60,000 was paid to a broker who arranged the loan. Discuss the admissibility or otherwise of the interest on borrowing.

Answer

Interest paid in respect of capital borrowed for the purposes of business or profession is admissible u/s 36(1)(iii). However, the proviso to section 36(1)(iii) says that interest paid in respect of capital borrowed for acquiring 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 first put to use will not be allowed as deduction.

In this case, the asset (plant & machinery) was not put to use till the end of the previous year. Therefore, interest of ₹ 6,00,000 will not be allowed as a deduction. However, the cost of the asset shall be increased by the amount of interest and depreciation shall be admissible on the enhanced cost of ₹ 66,00,000 once the asset is put to use.

As regards the brokerage of ₹ 60,000 paid to a broker for arranging the loan there are two possible views –

The first view is that since the definition of the term “interest” u/s 2(28A) includes service fee or other charges in respect of moneys borrowed, “brokerage” can be considered to fall under the scope of the term “other charges” and is therefore covered by the definition “interest”. Hence, brokerage of ₹ 60,000 for arranging the loan will be treated in the same way as interest and capitalized with the cost of the asset.

The alternate view is based on the High Court decision in *C. Moolchand v. CIT* (1956) 29 ITR 449 (Hyd.), where it was held that brokerage or commission paid to an agent for arranging a loan for the purpose of business is not allowable as deduction u/s 36(1)(iii), but allowable under section 37(1). As per this view, ₹ 60,000 paid to broker for arranging the loan is allowable under section 37(1).

Question 43

A partnership firm, consisting of three partners A, B and 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	59,00,000
Value of materials supplied by Government	<u>8,00,000</u>
Total value of contract	67,00,000

Each partner of the firm was entitled to draw ₹ 10,000 per month by way of salary as authorized by the terms of the partnership deed. Interest of ₹ 1,00,000 was also paid to partner C on the capital of ₹ 5,00,000 contributed by him. The profit as per books of accounts, before deduction of salary to partners and interest to partner C, as declared by the assessee in its return of income, amounted to ₹ 5,50,000. Compute the total income of the firm, applying the provisions of section 44AD.

Answer

As per section 44AD, in the case of an assessee, carrying on any business, whose gross receipts from such business does not exceed ₹ 60 lacs, a sum equal to 8% of the gross receipts paid or payable to the assessee or such higher sum as declared by the assessee in his return of income shall be deemed to be the income from such business.

"Gross receipts" will not include the value of material supplied by Government. Therefore, in this case, the gross receipts would be only ₹ 59,00,000.

8% of the gross receipts of ₹ 59 lacs will be ₹ 4,72,000. The profit as per books of accounts, before deduction of salary and interest to partners, is ₹ 5,50,000. Since profit as per books of account is ₹ 5,50,000, which is higher than 8% of the gross receipt, it will be adopted and on this working partner salary and interest to partners as per section 40(b) would be allowed.

Computation of allowable deduction in respect of salary and interest paid to partners –

The allowance of salary and interest paid to partners is subject to the conditions and limits specified in section 40(b). The allowable salary and interest has been worked out below –

Interest to partner C limited to 12% of ₹ 5,00,000 ₹ 60,000

Book Profits as per Explanation 3 to section 40(b)(v):

Profits as per books of accounts	5,50,000
Less: Interest allowed to C	<u>60,000</u>
Book Profits	<u>4,90,000</u>

Salary to partners – ₹ 1,20,000 × 3 = 3,60,000

This is within the ceiling limit provided in section 40(b)(v)

First ₹ 3,00,000 of book profits @ 90% 2,70,000

On the balance ₹ 1,90,000 of book profits @ 60% of ₹ 3,84,000 1,14,000

But actual salary paid is only ₹ 3,60,000 - which is eligible for deduction

Interest to partner C limited to 12% of ₹ 5,00,000 3,60,000
60,000

Total deduction allowable in respect of salary and interest 4,20,000

Income of the firm as per books (before allowing deduction in respect of salary and interest to partners) 5,50,000

Less: Salary and interest allowable as deduction 4,20,000

Total income of the firm 1,30,000

Question 44

A company had an inventory of closing stock on 31.3.2012, the cost of manufacture of which was ₹ 100 lacs. The goods were liable for excise duty. Since the excise duty was eligible for

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deduction only on actual payment, the company valued the closing stock at cost viz. ₹ 100 lacs. Discuss the position from the taxation point of view.

Answer

Under section 145A, the valuation of inventory has to be carried out by including the amount of duty actually paid **or incurred** by the assessee to bring the goods to the place of its location and condition on the date of valuation. Therefore, excise duty should be included in the valuation of closing stock as on 31.3.2012 and the deduction of such excise duty shall be available as per the provisions of section 43B.

Question 45

The WDV of Plant and Machinery on 01-04-2011 of X Ltd. engaged in manufacturing of PVC granules is ₹ 1,000 lacs. Company purchased additional plant and machinery for ₹ 800 lacs on 18-04-2011 inclusive of a second-hand machine imported from China of ₹ 200 lacs to increase its installed capacity of production from 1000 TPA to 1500 TPA. The production from new machine was taken w.e.f. 1-12-2011. Workout, by giving reasons, the amount of allowable depreciation.

Answer

Provisions of section 32(1)(ia) specify that the assessee engaged in the business of manufacture or production of any article or thing is entitled for an additional depreciation @ 20% of the actual cost of such plant & machinery acquired and installed after 31.3.2005.

It is further stated in the proviso to section 32(1)(ia) that the additional depreciation shall not be available in respect of those plant & machinery which, before its installation by the assessee, were used either within India or outside India by any other person.

The depreciation allowable will be as under:-

Particulars	Amount of Depreciation ₹ in lacs
Depreciation on WDV of machinery as on 1 st April ₹ 1000 lacs @ 15%	150
Depreciation on Plant & Machinery purchased on 18th April but actual production commenced w.e.f. 1 st December. Depreciation will be restricted to 50% of the normal depreciation i.e. 50% of (₹ 800 lacs x 15%)	60
Additional depreciation @ 20% of the actual cost of new Plant & Machinery. This depreciation is also to be restricted to 50% since production has commenced only on 1 st December. 50% of (20% of ₹ 600 lacs)	<u>60</u>
Total Depreciation	<u>270</u>

Note - Increase in capacity is not a condition or relevant factor for the purpose of getting additional / accelerated depreciation from the assessment year 2005-06 onwards.

Question 46

Alpha Ltd., a manufacturing company, which maintains accounts under mercantile system, has disclosed a net profit of ₹ 12.50 lacs for the year ending 31st March, 2012. You are required to compute the taxable income of the company for the Assessment year 2012-13, after considering the following information, duly explaining the reasons for each item of adjustment:

- (i) Advertisement expenditure includes the sum of ₹ 60,000 paid in cash to the sister concern of a director, the market value of which is ₹ 52,000.
- (ii) Legal charges include a sum of ₹ 45,000 paid to consultant for framing a scheme of amalgamation duly approved by the Central Government.
- (iii) Repairs of plant and machinery includes ₹ 1.80 lacs towards replacement of worn out parts of machineries.
- (iv) A sum of ₹ 6,000 on account of liability foregone by a creditor has been taken to general reserve. The same was charged to the Revenue Account in the Assessment Year 2009-10.
- (v) Sale proceeds of import entitlements amounting to ₹ 1 lac has been credited to Profit & Loss Account, which the company claims as capital receipt not chargeable to income-tax.
- (vi) Being also engaged in the biotechnology business, the company incurred the following expenditure on in-house research and development as approved by the prescribed authority:
 - (a) Research equipments purchased ₹ 1,50,000.
 - (b) Remuneration paid to scientists ₹ 50,000.

The total amount of ₹ 2,00,000 is debited to the Profit & Loss account.

Answer

Computation of taxable income of Alpha Ltd. for the A.Y. 2012-13

	Particulars	₹
	Net profit as per profit and loss account	12,50,000
1.	Add: (a) Items debited to profit and loss A/c but not deductible Payment of advertisement expenditure of ₹ 60,000	
	(i) ₹ 8,000, being the excess payment to a relative disallowed under section 40A(2)	(+) 8,000
	(ii) As the payment is made in cash and since the remaining amount of ₹ 52,000 exceeds ₹ 20,000, 100% shall be disallowed under section 40A(3)	(+) 52,000
2.	Legal charges for framing amalgamation scheme (deductible under section 35DD in five years). 1/5th of ₹ 45,000 i.e. ₹ 9,000 to be allowed in the current year. Balance ₹ 36,000 (₹ 45,000 - ₹ 9,000) is to be added back. (See Note below)	(+) 36,000

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3	Under section 31, expenditure relatable to current repairs regarding plant, machinery or furniture is allowed as deduction. The test to determine whether replacement of parts of machinery amounts to repair or renewal is whether the replacement is one which is in substance replacement of defective parts or replacement of the entire machinery or substantial part of the entire machinery - <i>CIT v. Darbhanga Sugar Co. Ltd. [1956] 29 ITR 21 (Pat)</i> . Here expenditure on repairs does not bring in any new asset into existence. Such replacement can only be considered as current repairs. Hence, no adjustment <i>Add:</i> Items chargeable as business income but not credited to profit and loss A/c	
4.	Liability foregone by creditor [taxable under section 41(1)]	(+) 6,000
5.	Sale proceeds of import entitlements. The sale of the rights gives rise to profits or gains taxable under section 28(iiiia). As the amount has already been credited to Profit and Loss Account, no further adjustment is necessary. <i>Less:</i> Amount not debited to profit and loss account but allowable as deduction	
6.	Expenditure on in-house research and development is entitled to a weighted deduction of 200% of the expenditure (both capital and revenue) so incurred under section 35(2AB)(1) = 2 x 2 lacs = 4 lacs Expenditure ₹ 2,00,000 already debited to Profit & Loss Account Additional deduction of ₹ 2 lacs is further allowed	(-) 2,00,000
Taxable Income		11,52,000

Note: As per the provisions of section 35DD, any expenditure incurred wholly and exclusively for the purpose of amalgamation, would be allowed as a deduction in 5 successive years (1/5th each year) commencing from the year in which the amalgamation takes place. The problem has been worked out on the assumption that the amalgamation has taken place during the previous year itself.

Question 47

By virtue of an agreement entered into on 1.9.2011 between X Ltd. and Y Ltd., X Ltd. agrees not to carry on any business relating to computer software in India for the next 3 years, for which Y Ltd. agrees to pay a sum of ₹ 12,00,000 to X Ltd. The said amount was paid on 1st December, 2011. Indicate treatment of such receipt in the hands of X Ltd. for the assessment year 2012-13?

Answer

As per section 28(va) the following sums received or receivable, in cash or kind under an agreement shall be taxable as income from business: (a) any sum for not carrying out any activity in relation to any business; or (b) any sum for 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.

The instant case clearly falls within the ambit of section 28(va)(a). As such, the receipt of ₹ 12,00,000 is chargeable to tax as business income in the hands of X Ltd

Question 48

You are engaged to carry out the tax audit of a firm under section 44AB and in carrying out this assignment, you are required to tackle the following issues. Indicate how you will deal with them.

- (i) *Duty of the auditor to report on a penalty or fine imposed on the firm.*
- (ii) *Expenditure incurred in respect of which payment has been made in a sum exceeding ₹ 20,000, otherwise than by account payee crossed cheque / bank draft.*
- (iii) *Sum payable as an employer by way of contribution to a provident fund.*
- (iv) *Particulars of loans or deposits exceeding the limit specified in section 269SS taken during the year.*
- (v) *Accounting ratios in a trading concern.*

Answer

- (i) In Form No.3CD the tax auditor has to specify the penalty or fine for violation of law and any other penalty or fine as well as expenditure incurred for any purpose which is an offence or which is prohibited by law.

The tax auditor should obtain in writing the details of all payments by way of penalty or fine for violation of law or otherwise and how such amount has been dealt with in the books of account. The tax auditor is not required to express any opinion as to the allowability or otherwise of the amount. He is only required to give details of such items as have been charged in the profit and loss account.

- (ii) The tax auditor should obtain a list of all payments in respect of expenditure exceeding ₹ 20,000 made during the year and it should also include the list of payments exempt as per Rule 6DD. The list should be verified with the books of account to ascertain whether the conditions are satisfied. Expenditure items in respect of which specific exemption has been granted are not required to be stated. Where there are practical difficulties in verifying whether payments have actually been made through account payee crossed cheques or account payee crossed bank drafts, suitable qualification should be made as under "It is not possible to verify whether the payment in excess of ₹ 20,000 has been

made otherwise than by account payee crossed cheques or account payee crossed bank drafts as necessary evidence is not in possession of the assessee".

Also, a certificate from the assessee must be obtained as regards whether all payments covered by section 40A(3) read with rule 6DD have been complied with or not by issuing account payee crossed cheques or bank draft. The receipt of certificate must be stated in the Form No.3CD in clause 17(h).

- (iii) In respect of provident fund contributions, detailed information is to be furnished with regard to amount received during the previous year, due date for payment, amount paid during the previous year, liability incurred during the previous year and discharge of such liability.

In view of the voluminous nature of the information the tax auditor can apply test checks and compliance tests to obtain satisfaction in this regard. In the case of big assessee, where the information to be stated is voluminous, the tax auditor may exercise his professional judgment and state only those cases where the actual date of payment is beyond the due date of payment.

- (iv) The particulars to be given in the case of loan or deposit accepted during the previous year exceeding the limit specified in section 269SS:
 - (a) Name and address and PAN (if available) of the lender or depositor.
 - (b) Amount of loans or deposit taken or accepted.
 - (c) Whether the loan was squared up during the previous year.
 - (d) Maximum amount outstanding in the account at any point during the previous year.
 - (e) Whether the loan or deposit was taken or accepted otherwise than by an account payee cheque or bank draft.

The tax auditor should verify all loans or deposits where the balance has reached ₹ 20,000 or more during the previous year, because the total of the deposits of ₹ 20,000 and above are covered even though each individual item may be less than ₹ 20,000. There are practical difficulties in verifying whether the loan or deposit is taken by crossed cheque or crossed draft. He should obtain a certificate from the assessee and accordingly report in clause 24 of Form 3CD.

- (vi) The accounting ratios to be given in the case of a trading concern are

Gross profit to turnover

Net profit to turnover

Stock in trade to turnover

Material consumed to finished products produced.

While calculating these ratios, the tax auditor should assign meanings to the above terms as understood by generally accepted accounting principles.

Question 49

- (i) A corporation was set up by the State Government transferring all the buses owned by it for a consideration of ₹ 75 lacs, which was discharged by the Corporation by issue of equity shares. The Corporation in its assessment claimed depreciation. Can the depreciation be denied in the Corporation's hands on the ground that there was no registration of the buses in favour of the Corporation?
- (ii) Ravi succeeded to his father's business in the year 2008. In the previous year ending 31.3.2012, Ravi has written off the balance in the name of 'Y' which relates to supply made by his father, when he carried on business. Ravi desires to know whether the write off could be eligible for deduction.

Answer

- (i) The decision of the Supreme Court in *Mysore Minerals Ltd v. CIT* (1999), 239 ITR 775 is relevant in the context of the facts stated. The term "asset used" in section 32 must be assigned a wider meaning and anyone in possession of property in his own title, exercising dominion over the property, to the exclusion of others and having the right to use and enjoy it, must be taken to be the owner.

Registration of the buses is only a formality to perfect the title and does not bar enjoyment. The Corporation cannot therefore be denied depreciation on the buses. A similar decision was also taken in *CIT v. J & K Tourism Development Corporation* 114 Taxman 734 (J&K).

- (ii) The deduction of bad debt is allowed if it is written off in the books of account of the assessee. In this case Ravi has succeeded to the business carried on by his father. Under clause (vii) of section 36(1) the amount has been written off in the books of account as irrecoverable is eligible for deduction provided the debt has been taken into account in computing the income of the business in an earlier previous year [vide section 36(2)].

Therefore, Ravi is eligible for deduction in respect of the amount due in the name of Y which is written off in the books of account as bad debt, even though the debt represents the amount due for the supplies made by previous owner viz. deceased father of Ravi. [*CIT v. T. Veerabhadra Rao K. Koteswara Rao and Co* (1985) 155 ITR 152 (SC)].

Question 50

A is an association governed by the provisions of Section 44A of the Income-tax Act, 1961. The subscription receipts for the year ended 31st March, 2012 were ₹ 3,60,000. The expenditure in the normal course of its activities was ₹ 3,85,000. Its other income taxable under the Act works out to ₹ 1,75,000. On these facts, you are consulted as to how A's taxable income will be determined for assessment year 2012-13.

Answer

Under section 44A, the income from subscriptions shall be set off against expenditure incurred solely for the protection or advancement of the interest of its members and if there is a deficiency it shall be first be set off against the association's income under the head "Profits and gains of Business or Profession" and if there is still a deficiency it shall be set off against income under any other head. This section supersedes the other provisions of the Act.

	₹
Income from subscription	3,60,000
Less: Expenses incurred in the course of its activities	3,85,000
Balance deficiency	(-)25,000
Less: Other income	1,75,000
Taxable income	1,50,000

There is a ceiling on the deduction admissible by way of deficiency being that it shall not exceed one-half of the income of the association. This ceiling has not been exceeded above [vide section 44A(3)].

Question 51

Praveen was a partner in a firm in his capacity as the Karta of his HUF. On the amounts deposited by the partners, the firm paid interest. Praveen, in his individual capacity had made deposits in the same firm in which he was a partner. The assessee claimed that the interest paid in his individual capacity should not be disallowed. The Assessing Officer did not agree and disallowed the interest paid to Praveen in his individual capacity. Discuss.

Answer

Explanation 1 to section 40(b) clearly states that where an individual is a partner in a firm, in a representative capacity, interest paid by the firm to such individual in his individual capacity shall not be taken into account for the purposes of clause (b) of section 40.

Since Praveen is a partner in his capacity as the karta of his HUF and the interest is paid by the firm in his individual capacity, such interest is not hit by the provisions of section 40(b).

This position was brought out by the Supreme Court in *Brij Mohan Das Laxman Das v. CIT* (1997) 223 ITR 825 and followed by the Madras High Court in a recent case *R.M.Appavu Chettiar Sons v. CIT* (2002) 256 ITR 289 (Mad). Therefore, the Assessing Officer's action in disallowing the interest paid to Praveen in his individual capacity is not correct.

Question 52

Write a note on: successor in business for the purpose of profits chargeable to tax under section 41 of the Income-tax Act, 1961.

Answer

For purposes of section 41(1) of the Income-tax Act, "successor in business" means –

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

Question 53

Capsule Ltd, during the financial year ending 31.3.2012 paid production bonus of an amount of ₹ 3 lacs pursuant to a settlement arrived with the workers in addition to the statutory payment of ₹ 1 lac as per the Payment of Bonus Act, 1965. On these facts, your advise is sought.

- (a) *Whether the sum of ₹ 3 lacs is deductible as per the provisions of section 36(1)(ii) of the Act?*
- (b) *If the claim is not so deductible, can it be claimed under any other provision?*

Answer

Section 36(1)(ii) refers to amounts payable as bonus or commission for services rendered where such sums would not have been payable to him as profits or dividend, if it had not been paid as bonus or commission. Rs 3 lacs paid as production bonus is deductible as per the provisions of section 36(1)(ii) subject to section 43B. In case production bonus is not deductible under section 36(1)(ii), it can be claimed as deduction under section 37(1), as the expenditure is laid out wholly and exclusively for business purposes.

Question 54

You are consulted on the justifiability of the following claims. Your advice is to be framed based on the provisions of the Income-tax Act, 1961.

- (i) *A company paid the full consideration for building for its Administrative office and occupied the same as the possession was taken. The Registration could not take place before the end of the previous year for some reason or other. Can the depreciation claim be made?*
- (ii) *Secret commission was paid and debited under Commission Account. Is it allowable expenditure.*

Answer

- (i) One of the conditions for the claim of depreciation under the provisions of section 32 of the Income-tax Act, 1961 is that the assessee should be the owner of the asset. In the facts of the given case, the asset is an immovable property, namely, buildings acquired for the administrative office. Full consideration has been paid. However, the registration could not take place before the end of the previous year.

The Supreme Court had an occasion to consider this issue in the case of *Mysore Minerals Ltd v. CIT* 239 ITR 775. The Supreme Court stated that the very concept of depreciation suggests that tax benefit on account of depreciation legitimately belongs to one who has invested in the capital asset and is utilizing the capital asset.

In the facts of the given case, though the document of title was not executed, the full consideration has been paid and the dominion over the property by taking possession excluded the owner who had to transfer the asset and therefore the right to use and occupy the property and enjoy it was exercised by taking possession and the execution of the formal deed of title may take place at any given point of time.

Following the decision of the Supreme Court, depreciation can be claimed in respect of the building that is acquired for the administrative office, though registration has not yet taken place.

- (ii) Secret commission is one of the forms of commission payment generally made by business organizations. Secret commission is a payment for obtaining business orders or contracts from parties and /or customers and paid to employees and / or officials of those parties and / or customers or companies from whom business orders are obtained by the assessee.

The Explanation to section 37(1) of Income-tax Act, 1961 provides 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 and no deduction or allowance shall be made in respect of such expenditure. In view of the Explanation, any expenditure incurred for a purpose which is an offence and prohibited by law cannot be allowed as expenditure. Therefore, secret commission payment, if it could be established as a payment for an offence prohibited by law, the same cannot be allowed deduction.

Question 55

An assessee purchases know-how for manufacture of fuel injection pipes on 10-04-2011. He wants proportional reduction for six assessment years under section 35AB of the Act commencing from assessment year 2012-13. Is this allowable?

Answer

Section 32 allows depreciation on intangible assets like know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, if they are acquired on or after 1st April, 1998.

The provisions of section 35AB applies only to acquisition of know how for purpose of business on or before 01.04.1998.

Since in this case the assessee had acquired the know-how after 1st April 1998, it is to be treated as capital expenditure and eligible for depreciation under section 32.

Question 56

M/s. PR and M/s. ST are firms with common partners carrying on different businesses. M/s. PR had taken a loan from M/s. ST for the purpose of its business. Interest on the loan for the year ending 31.3.2012 worked out to ₹ 20,000. M/s. PR deducted tax of ₹ 2,000 on interest and paid the balance sum of ₹ 18,000 in cash to M/s. ST on 31.3.2012. Tax deducted was remitted to the credit of the Central Government on 30.4.2012. How will you treat the interest paid while computing the total income of M/s. PR for the assessment year 2012-13?

Answer

Section 40(a)(ia) provides that interest paid shall not be allowed as deduction in computing business income, if tax deductible at source has not been deducted thereon or if deducted, has not been paid on or before the prescribed time. The time limit for remitting the TDS amount is upto the 'due date' for filing the return prescribed under section 139(1). Thus, the remittance on 30.04.2012 is in accordance with the provisions of law warranting no disallowance of expenditure.

Question 57

An Indian company is engaged in the manufacture and sale of coffee grown by it in its own estates. Will it be liable to tax under the Income-tax Act, 1961 and if so, how will its income be determined?

Answer

As per Rule 7B, 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 25% of such income shall be deemed to be income liable to tax.

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 from business and 40% of such income shall be deemed to be income chargeable to tax.

In computing such income, an allowance shall be made in respect of the cost of planting coffee plants in replacement of plants which have died or have become permanently useless in an area already planted, if such area has not previously been abandoned and for the purpose of determining the cost, no deduction shall be made in respect of the amount of any subsidy which under the provisions of section 10(31), is not includible in the total income.

Question 58

R Ltd. paid ₹ 5 lacs as sales commission to Mr. Francis (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 ended 31.3.2012. On these facts:

- (i) *Decide whether the commission is chargeable to tax in the hands of Mr. Francis in India.*
- (ii) *Decide about the deductibility of the commission payment in the assessment of R Ltd.*

Answer

- (i) A foreign agent of an Indian exporter operates in his own country and no part of his income arises in India. His commission is usually remitted directly to him and is, therefore, not received by him or on his behalf in India. Such an agent is not liable to income-tax in India on the commission. The commission paid to the non-resident agent of the Indian exporter for services rendered outside India is not chargeable to tax in India. Though the *Circular No.23, dated 23.7.1969* has been withdrawn clause (b) of the Explanation 1 to section 9(1) says that in the case of non-resident no income shall be deemed to accrue or arise in India in respect of activities which are confined to purchase of goods in India for the purpose of export. In the case of foreign non resident agent, there would be no activity within India. Therefore, commission income for booking orders by non-resident who remains outside India could not be subjected to tax in India.
- (ii) Section 40(a)(i) requires deduction of tax at source in respect of any interest, royalty, fees for technical services or other sum chargeable under this Act, which is payable outside India or in India to a non-resident. Since the non-resident agent has acted outside India his income would not be subjected to tax in India in view of clause (b) of the Explanation 1 to section 9(1). When the income is not chargeable to tax, the question of deducting tax at source does not arise. Hence, disallowance under section 40(a)(i) is not attracted, and the commission payment is deductible in the assessment of R Ltd.

Self-examination questions

1. Is it compulsory for an assessee to claim depreciation under section 32 of the Income-tax Act, 1961?
2. Write short notes on -
 - (i) Enhanced depreciation
 - (ii) Set-off and carry forward of unabsorbed depreciation.
3. Discuss the provisions dealing with the computation of business income on a presumptive basis in case of resident assessee.
4. Discuss the concept of "block of assets" under the Income-tax Act, 1961.
5. Which are the deductions allowable only on actual payment under section 43B?
6. Write short notes on the following -
 - (a) Compulsory maintenance of books of accounts
 - (b) Compulsory tax audit.
7. What is the tax treatment regarding cash payments in excess of limits prescribed in section 40A(3)?
8. Discuss the provision for computing income by way of royalties or fees for technical services as provided for in section 44DA.

9. What are the conditions to be satisfied for an expenditure to be allowed as deduction under section 37(1)?
10. The written down value of plant and machinery in the books of Alpha Ltd. is ₹ 75,00,000 as on 1st April, 2011, on which date, the installed capacity of the company was 12,000 tons. Alpha Ltd. borrowed ₹ 10,00,000@10%p.a. from ICICI Bank on 1.8.2011 for purchase of new plant and machinery for extension of its existing business, which would increase its installed capacity to 13,000 tons. The new plant and machinery was purchased on the same date but was put to use only w.e.f. 1.11.2011. Compute the depreciation admissible under section 32 for the A.Y.2012-13, assuming the applicable rate of depreciation on plant and machinery to be 15%.
11. A Ltd. was a wholly owned subsidiary company of B Ltd. An agreement was entered into between B Ltd. and A Ltd., by which the textile unit belonging to B Ltd. was transferred to A Ltd.. The agreement provided, inter-alia, for continuity of service of workmen who were employed in the textile unit of B Ltd. taken over by A Ltd. and the agreement also protected the conditions of service of workmen. B Ltd. delivered possession of the properties to A Ltd. and the employees of B Ltd. working in the textile unit were transferred to A Ltd. with the benefit of continuity of service. For the subsequent two assessment years, A Ltd. claimed deduction of a certain sum as gratuity payment to workers (who were erstwhile employees of B Ltd.), who had retired during the relevant previous years. The Assessing Officer disallowed the same on the ground that the liability of A Ltd. towards gratuity payment for the employees for the services rendered by them in the period prior to the takeover of the unit would be a capital expenditure. Is the reasoning of the Assessing Officer correct? Discuss.
12. Alpha Ltd., a running concern, received interest on the loans/advances made by it to its debtors. It contended that such interest was to be treated as business income. Discuss the correctness of the contention of Alpha Ltd., if such interest was not on account of delayed payment towards sales or compensation/damages or an item relatable to its business.
13. The assessee-firm had received a sum of money of ₹ 5,25,250 in the P.Y.2011-12 towards credit note of excise duty. Out of the said sum, the assessee did not refund an amount of ₹ 2,10,000 to its customers and credited the same to its profit and loss account. The amount has also been distributed amongst the partners. The Assessing Officer added the said amount to the total income of the assessee. On appeal, the Commissioner (Appeals), however, set aside the order of the Assessing Officer. Discuss, giving reasons, whether the Assessing Officer is correct or the Commissioner (Appeals) is correct?
14. Are expenditure incurred by a company on account of stamp duty and registration fees for the issue of bonus shares allowable as revenue expenditure?
15. XYZ Ltd. donated a bus to a school where the employee's children were studying and debited the same to the Workmen and Staff Welfare Account. It claimed the expenditure

as deduction on the ground that it was incurred wholly and exclusively for the purpose of the assessee's business. Discuss whether the contention of the assessee is correct.

16. The assessee was a dealer in two-wheelers manufactured by TVS Suzuki Ltd. It was carrying on its business in leasehold premises. The assessee constructed a ground floor above the existing basement floor according to the specifications given by TVS Suzuki Ltd. to all its dealers. As per the stipulation in the lease deed, reimbursement of such expenditure from the owner of the premises was also not possible. The assessee claimed the expenses incurred for construction as revenue expenditure for the relevant assessment year. Can such expenditure be allowed as a revenue expenditure?
17. Rallis Ltd. was situated in a remote place and its employees were the members of a club. The club was the only source of recreation to the employees. Rallis Ltd. paid a sum of ₹ 5 lakhs to the club for renovation and repairs of the club building which had been damaged. Rallis Ltd. claimed deduction of the same as business expenditure. Discuss whether its claim is tenable in law?
18. ABC Pvt. Ltd. had in the course of carrying on of its business, obtained unsecured loans from various creditors. In the light of the financial difficulties faced by the company, the creditors approached the High Court by filing various company petitions. During the course of those proceedings, a compromise was reached between the company and its creditors wherein, as per the terms of the compromise, certain creditors remitted unsecured loans amounting to ₹ 1,77,052 and interest amounting to ₹ 2,96,171. ABC Pvt. Ltd. declared such remitted interest as income liable to tax under section 41(1), while filing its return of income. The Assessing Officer, however, contended that the remittance of unsecured loan was also a benefit accruing to the company during the course of its business activity and brought the same to tax. Discuss the correctness of the contention of the Assessing Officer, keeping in mind that there was no allowance or deduction in any of the previous years in respect of such unsecured loan.
19. Alpha Ltd is a public limited company. As a good corporate citizen and as a measure of gaining goodwill of the people living in and around its industry, which is to some extent a polluting industry, it provided funds for establishing drinking water facilities to the residents in the vicinity of the refinery and also provided aid to the school run for the benefit of the children of those local residents. The Assessing Officer declined to allow that expenditure on the ground that it was not an item of expenditure incurred by the assessee for earning the income. The company, however, claimed that such social costs can be claimed as deduction. Is the claim of Alpha Ltd. tenable in law? Discuss.
20. The scheme of amalgamation of A Ltd. with B Ltd. was sanctioned by the High Court on 1.5.2011. However, the amalgamation was effective from 1.1.2011. A Ltd. incurred ₹ 2.3 lakhs during the previous year 2010-11 towards legal expenses in connection with its amalgamation with B Ltd. A Ltd. contended that such expenses were revenue in nature and hence, were to be allowed as deduction for previous year 2010-11. Discuss the correctness of the contention of A Ltd., if such amalgamation is resorted to by A Ltd. for

the smooth and efficient conduct of the business through the transferee-company, namely, B Ltd.

21. ABC Ltd. is a public sector undertaking. One of its objects is to promote co-operative societies. In the audited accounts for the relevant assessment year, investment in shares of various co-operative societies to the extent of ₹ 80 lakh had been written off in the profit and loss account considering the fact that the said co-operative societies were either defunct or under liquidation. The Assessing Officer disallowed the loss claimed by the assessee on the ground that it was a capital loss. Do you support the treatment given by the assessee or the view of the Assessing Officer. You are required to give your answer taking into account the following -
- (i) The memorandum and articles of association of the assessee did not provide for either withdrawing shares or transferring shares held in co-operative societies under any circumstance.
 - (ii) The reduction in value of shares was effected through book entries only and there was no actual transfer of shares.
22. (a) Can a bank guarantee be equated with actual payment as required under section 43B for allowance as deduction in computation of profits?
- (b) Can interest payable to sales tax department also be considered as a "tax" under the provisions of section 43B?

Answers

11. This issue came up before the Madras High Court in *Sree Akilandeswari Mills (P.) Ltd. v. Dy. CIT (2005) 145 Taxman 474 / 274 ITR 0001*. The High Court observed that as far as the gratuity liability is concerned, the obligation to pay gratuity on the part of the assessee to all its employees for the service rendered in a particular year is a definite and ascertainable liability on the basis of actuarial valuation. The assessee, by virtue of the deed of transfer, had taken over the liability of the transferor-company towards gratuity of the employees of the transferor-company on the date of transfer. The gratuity liability was an ascertained liability on the basis of actuarial valuation and this liability, which formed part of the sale consideration, was discharged later by actual payment by the assessee to the employees in subsequent years. The Court held that if an ascertained liability of the predecessor on the date of transfer was taken over by the successor in business, and later on it was discharged, the expenditure incurred would be capital in nature and is not allowable as business expenditure.

Hence, in this case, the expenditure incurred by A Ltd., towards discharge of the gratuity liability of the employees of the unit taken over from B Ltd., is a capital expenditure. Therefore, the reasoning of the Assessing Officer is correct.

12. The Allahabad High Court, in *CIT v. Radico Khaitan Ltd. (2005) 12 Taxman 681 / 274 ITR 0354*, observed that under section 14, the various heads of income have been specified. If an item does not fall under any of the heads enumerated in Heads A to E mentioned in

section 14, it would fall under the residuary head - Head F i.e. 'Income from other sources'.

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

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

- 13.** This question came up before the Allahabad High Court in *CIT v. London Machinery Company (2005) 146 Taxman 326*. The High Court observed that the provisions of section 41(1) would be attracted if the following conditions are satisfied –

- (1) 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.
- (2) Subsequently, during any previous year, the assessee must have obtained -
 - (i) any amount in respect of such loss; or
 - (ii) any benefit in respect of such trading liability by way of remission or cessation thereof.

In case either of the events mentioned in (2) above happen, the deeming provision enacted in the closing part of sub-section (1) of section 41 comes into play. Accordingly, the amount obtained by the assessee or the value of benefit accruing to him is deemed to be the profits and gains of business or profession and it becomes chargeable to income-tax as the income of that previous year. The transfer of unpaid excise credit to the profit and loss account of the assessee falls under the first clause of section 41(1) [as stated in 2(i) above] and is, therefore, chargeable to tax as profit of the year.

Therefore, in this case, the view taken by the Assessing Officer is correct since the first clause of section 41(1) is attracted. The amount of ₹ 2,10,000 on account of unpaid excise credit received by the assessee-firm and credited to its profit and loss account and not passed on to its customers is chargeable as profits of the firm for the previous year 2011-12.

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

stamp duty and registration fees for the issue of bonus shares is allowable as revenue expenditure.

15. This issue came up before the Rajasthan High Court in *CIT v. Rajasthan Spinning and Weaving Mills Ltd. (2006) 281 ITR 408*. The High Court observed that the contention of the assessee, that such expenses were incurred for the welfare of the children of staff/workmen of the company as part of the employee welfare expenses for the purpose of securing efficient services of such employees, was true. Since the assessee had not acquired any asset, it was not a capital expenditure. Therefore, the expenditure was deductible.

16. This question was answered by the Madras High Court in *CIT v. Hari Vignesh Motors P. Ltd. (2006) 282 ITR 0338*. The High Court observed that the assessee had undertaken the construction in view of the requirements of the business. The assessee did not acquire any capital asset by incurring the expenditure. As per the stipulation in the lease deed, reimbursement of such expenditure from the owner of the premises was also not possible. The High Court, therefore, held that the expenditure was revenue in nature and can be allowed as deduction.

17. This issue came up for consideration before the Calcutta High Court in *Assam Brook Ltd. v. Commissioner of Income-tax (2004) 139 Taxman 229*. The High Court observed that since the company was situated in a remote place, the club was the only source of recreation for its employees, who were also members of the club. So, if the assessee-company paid some amount for the upliftment/running of the club in an effective way, then such payment was made in the interest of the assessee, so that its employees remained happy and, consequently, the work of the assessee was not hampered in any way due to dissatisfaction on the part of the employees. As the payment of ₹ 5 lakhs was made by the assessee to the club keeping its business interest in mind, the said payment must be held to be business expenditure, and accordingly, as per section 37 the assessee-company was entitled to get deduction.
The claim of Rallis Ltd. is, therefore, tenable in law.

18. This issue came up for consideration before the Gujarat High Court in *CIT v. Chetan Chemicals (P.) Ltd. (2004) 139 Taxman 301*. The High Court observed that section 41(1) can be invoked only when an allowance or a deduction has been granted during the course of assessment for any year in respect of loss, expenditure or trading liability which is incurred by the assessee, and subsequently, during any previous year, the assessee obtains, whether in cash or in any other manner, any amount in respect of such trading liability by way of remission or cessation of such liability. In that case, either the amount obtained by the assessee or the value of the benefit accruing to the assessee can be deemed to be the profits and gains of a business or profession and can be brought to tax as income of the previous year in which such amount or benefit is obtained. In this case, since there had been no allowance or deduction in any of the

preceding years in respect of the unsecured loan, the provisions of section 41(1) cannot be applied to such loan.

Therefore, the amount of ₹ 1,77,052 arising as a result of remission of unsecured loans is not taxable in the hands of ABC Pvt Ltd.

19. The Madras High Court has recognized the relevance of social costs to business in deciding the case of *CIT v. Madras Refineries Ltd. (2004) 138 Taxman 261*. The High Court observed that the concept of business is not static. It has evolved over a period of time to include within its fold the concrete expression of care and concern for the society at large and the people of the locality in which the business is located in particular. Further, to be known as a good corporate citizen brings goodwill of the local community, as also with the regulatory agencies and the society at large, thereby creating an atmosphere in which the business can succeed in a greater measure with the aid of such goodwill. In this case, the High Court upheld the order of the Tribunal allowing deduction for the amount spent on bringing drinking water to the locality and in aiding a local school.

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

20. A similar question arose before the Gujarat High Court in *CIT v. Akme Electronics & Control (P.) Ltd. (2004) 137 Taxman 263*. The High Court held that when the legal expenses were to be paid in connection with the amalgamation of the assessee-company with another company, the liability to pay legal expenses arose in respect of the period when the amalgamating company still continued to exist. The effective date of amalgamation in many cases may even be a date prior to the date of sanction of the scheme, but so long as the scheme was not sanctioned, the transferor-company continued to exist and since the amalgamation was resorted to for the smooth and efficient conduct of the business through the transferee-company, the legal expenses were deemed to be laid out wholly and exclusively for the purpose of the business of the amalgamating assessee-company.

Therefore, in this case, the contention of A Ltd. is correct. A Ltd. can claim ₹ 2.3 lakhs as revenue expenditure for the previous year 2010-11, when A Ltd. continued to exist, since the scheme of amalgamation was yet to be sanctioned during that previous year.

21. This question came up before the Kerala High Court in *Kerala Small Industries Development Corporation Ltd. v. CIT (2004) 140 Taxman 509*. The High Court observed that the memorandum and articles of association of the assessee did not provide for either withdrawing shares or transferring shares held in co-operative societies under any circumstance. Therefore, the investment made by the assessee in the capital of cooperative societies could not be viewed as part of its trading/circulating capital. Hence, any loss on shares representing investment of the assessee cannot be termed as trading/revenue loss. The High Court further observed that reduction in value of shares was effected through book entries only and there was no actual transfer of shares.

Therefore, it could not even be construed as a capital loss arising out of trading in capital assets.

In view of the above decision, the loss in this case cannot be treated as a revenue loss. Further, since the reduction in value of shares was effected only through book entries, there has been no transfer as contemplated in section 2(47) and hence, there is no question of any capital loss.

- 22.** (a) The Rajasthan High Court, in *CIT v. Udaipur Distillery Co. Ltd. (2004) 134 Taxman 398*, observed that the requirement of section 43B is the actual payment and not deemed payment of any of the expenses (as specified in section 43B) incurred by the assessee during the relevant previous year for claiming the deduction. Furnishing bank guarantee cannot be equated with actual payment. Actual payment requires that money must flow from the assessee to the public exchequer as such as specified in section 43B.
- (b) The Rajasthan High Court, in *Mewar Motors v. CIT (2004) 135 Taxman 155*, opined that the amount of interest paid is part of the sales tax and the provisions of section 43B are applicable to it.