

FINAL COURSE STUDY MATERIAL

PAPER 7

Direct Tax Laws

Assessment Year 2014-15

[Relevant for May 2014 and
November 2014 Examinations]

Volume – I



BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

This study material has been prepared by the faculty of the Board of Studies. The objective of the study material is to provide teaching material to the students to enable them to obtain knowledge and skills in the subject. Students should also supplement their study by reference to the standard text book(s). In case students need any clarifications or have any suggestions to make for further improvement of the material contained herein they may write to the Director of Studies.

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SYLLABUS

PAPER – 7 : DIRECT TAX LAWS

(One paper — Three hours – 100 Marks)

Level of Knowledge: Advanced knowledge

Objectives:

- (a) To gain advanced knowledge of the provisions of direct tax laws,
- (b) To acquire the ability to apply the knowledge of the provisions of direct tax laws to various situations in actual practice.

Contents:

- I. The Income-tax Act, 1961 and Rules thereunder (90 marks)
- II. The Wealth-tax Act, 1957 and Rules thereunder (10 marks)

While covering the direct tax laws, students should familiarise themselves with considerations relevant to tax management. These may include tax considerations with regard to specific management decisions, foreign collaboration agreements, international taxation, amalgamations, tax incentives, personnel compensation plans, inter-relationship of taxation and accounting, with special reference to relevant accounting standards and other precautions to be observed to maximise tax relief. Further, they should have a basic understanding about the ethical considerations in tax management and compliance with taxation laws.

Note – If new legislations are enacted in place of the existing legislations relating to income tax and wealth tax, the syllabus will accordingly include such new legislations in the place of the existing legislations with effect from the date to be notified by the Institute.

A WORD ABOUT STUDY MATERIAL

Direct Tax Laws is one of the core competence areas of the Chartered Accountants. A thorough knowledge of direct tax laws is, therefore, necessary for the students of the CA Final course. In the Final course, "Direct Tax Laws" constitutes Paper 7. Students are expected to acquire advanced knowledge of the provisions of direct tax laws after undergoing this course and apply such knowledge to various situations in actual practice.

The first part of this Study Material deals with income-tax. There are 28 chapters under income-tax. The second part of this Study Material is on wealth-tax. There are 3 chapters under wealth-tax. The subject matter in this Study Material is based on the law as amended by the Finance Act, 2013, and applicable for A.Y.2014-15. In this Study Material, efforts have been made to present the complex direct tax laws in a lucid manner.

The Study Material on Direct Tax Laws is made in three volumes for ease of handling by the students. Volume I contains Chapters 1-14 of Income-tax, and Volume II contains Chapters 15-28 of Income-tax and Chapters 1-3 of Wealth-tax. Volume III is the Practice Manual.

The taxation laws in our country undergo many amendments. In order to help the students to update their knowledge relating to the statutory and judicial developments in the field of direct and indirect tax laws, the Board of Studies brings out, every year, two publications, namely "Supplementary Study Paper" and "Select Cases in Direct and Indirect Tax Laws". This is an essential read for all our students.

A word of advice to the students – please make it a habit of referring to the bare acts as often as possible. This will not only facilitate the process of understanding the law and the sequence of sections in these Acts, but will also equip them with the professional expertise that is expected.

The main features of this edition of the Study Material are -

- The amendments made by the Finance Act, 2013 and incorporated in this Study Material have been tabulated chapter-wise with the corresponding section reference and given as "Significant Additions/Amendments in this Edition" in the next four pages.
- In the Study Material, the latest amendments i.e., the amendments made by the Finance Act, 2013 and notifications and circulars issued between 1.7.2012 and 30.4.2013 have been given in ***bold and italics***. Tabular presentations and diagrams have been inserted at the relevant places for explaining the amendments.
- The new illustrations as well as the illustrations which have undergone changes due to these amendments have been given in shaded background.

- Certain sections of the Income-tax Act, 1961 contain references to specific provisions of the Companies Act, 1956. The corresponding sections under the Companies Act, 2013 have been given as a footnote at the relevant places in this Study Material solely for the information of the students, since the Income-tax Act, 1961 is yet to be amended to incorporate references to the sections under the Companies Act, 2013.
- Feedback form is given at the end of the Study Material. The students are encouraged to give their feedback/suggestions.

These features would aid the students in the learning process. Finally, we would welcome suggestions to make this book more helpful and 'student-friendly'. In case you need any further clarification/guidance, you may send your queries at priya@icai.in

Happy Reading and Best Wishes!

DIRECT TAX LAWS

SIGNIFICANT ADDITIONS / AMENDMENTS IN THE EDITION

Chapter No.	Particulars	Section
	Income-tax	
1.	Basic Concepts	
	Rebate of up to ₹ 2,000 for resident individuals having total income of up to ₹ 5 lakh	87A & 87
3.	Incomes which do not form part of total income	
	Exemption under section 10(10D) not available in respect of any sum received by any person under "keyman insurance policy" assigned to keyman before maturity	10(10D)
	Exemption of any income of a securitization trust from the activity of securitization	10(23DA) & 10(35A)
	Exemption of income of Investor Protection Fund set up by depositories	10(23ED)
	Certain Alternative Investment Funds (AIFs) recognized by SEBI to enjoy "pass-through" status, subject to satisfying certain conditions	10(23FB)
	Exemption of income received by an investor on account of buy-back of unlisted shares of a domestic company	10(34A)
	Scope of exemption of income received in India in Indian currency by a foreign company expanded	10(48)
	Exemption in respect of income of National Financial Holdings Company Ltd.	10(49)
	Clarification on issues relating to export of computer software	10AA
	Rules governing functioning of an electoral trust for claim of exemption under section 13B	Rule 17CA
	Electoral Trusts Scheme Notified	
6.	Profits and gains of business or profession	
	Manufacturing companies investing more than ₹ 100 crore in new plant and machinery during the period from 1.4.2013 to 31.3.2015 entitled to investment allowance@15%	32AC

	Deduction in respect of bad debts written off to be allowed to the extent the same is in excess of the credit balance in the provision for bad and doubtful debts made under section 36(1)(viia), irrespective of whether the same relates to rural advances or urban advances	36(1)(vii)
	Deduction for commodities transaction tax paid in respect of taxable commodities transactions	36(1)(xvi)
	Inadmissibility of expenses incurred in providing freebies to medical practitioner by pharmaceutical and allied health sector industry	37(1)
	Trading in commodity derivatives not a speculative transaction	43(5)
	Disallowance of royalty, licence fee, service fee etc. levied exclusively on State Government Undertakings by the State Government	40(a)(iib)
	Stamp duty value of land and building to be taken as the full value of consideration in respect of transfer, even if the same are held by the transferor as stock-in-trade	43CA
7.	Capital Gains	
	Modification in parameters defining scope of land falling outside the ambit of "Agricultural land" and consequently, within the definition of "Capital Asset" and related amendment in the definition of "agricultural income"	2(14) & 2(1A)
	Cost Inflation Index for F.Y.2013-14 notified	48
8.	Income from other sources	
	Immovable property received by an individual or HUF for inadequate consideration taxable if the difference between the stamp duty value and actual consideration exceeds ₹ 50,000.	56(2)(vii)
	Manner of determination of FMV of unquoted equity shares for the purposes of section 56(2)(vii)/(viia)/(viib)	Rules 11U & 11UA
11.	Deductions from Gross Total Income	
	Life insurance premium up to 15% of "minimum capital sum" assured to qualify for deduction under section 80C, in respect of policies issued on or after 1.4.2013, where the insurance is on the life of a person with disability or severe disability or a person suffering from disease or ailment	80C & 10(10D)

	Deduction under section 80CCG to be available for three consecutive years to a resident individual, being a new retail investor having gross total income upto ₹ 12 lakh, for investment in listed equity shares as well listed units of equity oriented fund as per notified scheme	80CCG
	Deduction to be available in respect of contribution to CGHS and such other schemes within the overall limit specified thereunder	80D
	Additional deduction in respect of interest on loan taken for acquisition of residential house property	80EE
	Donation to National Children's Fund to qualify for 100% deduction	80G
	Cash donations to political parties and electoral trusts not to qualify for deduction	80GGB & 80GGC
	Extension of sunset clause for tax holiday under section 80-IA for power sector undertakings	80-IA(4)(iv)
	Only Indian companies deriving profits from manufacture of goods in a factory to be eligible for deduction under section 80JJAA in respect of additional wages paid to new regular workmen employed in such factory	80JJAA
13.	Assessment of various entities	
	Income-tax@25% in case of royalty and fees for technical services received by a non-corporate non-resident or a foreign company under an agreement entered into after 31.3.1976	115A
	Dividends received by Indian companies from specified foreign companies to be entitled to concessional rate of tax for one more year	115BBD
	Dividend received from a foreign subsidiary on which tax is payable under section 115BBD by the domestic holding company to be reduced from the amount declared, distributed or paid by way of dividend by it, for levy of additional income-tax	115-O
	Levy of additional income-tax on distributed income of a domestic company on account of buy-back of unlisted shares	115QA/115QB/ 115QC
	Rationalisation of rates of additional income-tax on income distributed by mutual funds	115R

Levy of additional income-tax on income distributed by securitization trusts	115TA/115TB/ 115TC
"Tax due", for the purposes of recovery from partners of LLPs and directors of private companies in liquidation, respectively, to include interest, penalty or any other sum payable under the Income-tax Act, 1961	167C & 179

***Note:** In the above table the amendments/additions have been indicated against the chapters where they have been primarily dealt with at length. Some of the amendments may have also been referred to or discussed in other related chapters. In addition, the illustrations in each chapter have been modified to give effect to the amendments by the Finance Act, 2013. New illustrations have also been added to explain the application of some of the amendments.*

STUDY PLAN – KEY TO EFFECTIVE LEARNING

Direct Tax Laws is one of the core competence areas of the chartered accountants. It is considered to be the most dynamic subject of the chartered accountancy course. The tax laws of the country undergo significant changes every year on the passing of the annual Finance Act. Apart from these major amendments which take place every year, notifications and circulars are issued by the CBDT from time to time to implement the provisions of the Act and clarify issues regarding the meaning and scope of certain provisions. Further, decisions are pronounced by various courts interpreting the provisions of law.

As a student, coming out successfully in the paper on Direct Tax Laws with a good score is indeed a challenging task. Planning your study in a methodical manner well in advance of your examination is very crucial for success in examination. Adherence to the study plan is equally important. Ultimately, it is the level and depth of your preparation which will determine how well you perform in the examination.

Know your syllabus and expected level of knowledge

Before starting your preparation, it is important that you are aware of the scope of syllabus and the level of knowledge expected.

The syllabus of Final Paper 7: Direct Tax Laws covers the Income-tax Act, 1961 and Rules thereunder and the Wealth-tax Act, 1957 and Rules thereunder. You are expected to have acquired advanced knowledge of the provisions of direct tax laws as well as the ability to apply the knowledge of the provisions of direct tax laws to various situations in actual practice.

The division of marks is 90 for income-tax and 10 for wealth-tax.

The requirement of advanced knowledge implies that you have to perfect your logical and analytical reasoning, as well as interpretation of the relevant legal provisions. You have to look at the provisions and their application from several angles. You should prepare yourself to attempt complex questions and problems based on application and interpretation of provisions of law, including recent amendments, and case laws.

Be informed of the Finance Act and Assessment Year relevant for your examination

The Finance Act of a particular year would be applicable for the May and November examinations of the next year. For instance, the Income-tax Act, 1961 and Wealth-tax Act, 1957 as amended by the Finance Act, 2013 would be applicable for May, 2014 and November 2014 examinations. The relevant assessment year for May 2014 and November 2014 examinations is, therefore, A.Y.2014-15.

You are expected to be updated with the notifications, circulars and other legislative amendments made upto 6 months prior to the examination. For May examination, such amendments made upto 31st October of the previous year would be relevant and for November examination, such amendments made upto 30th April of that year would be relevant.

Draw up a detailed study plan and allocate time for each topic/chapter of the subject

Preparing a comprehensive study time table well in advance would be of great help in organizing your study in an effective manner. Allocate sufficient number of hours every week for the subject of Direct Tax Laws.

The next step is to estimate the time to be allocated for each topic/chapter of the subject. The scope of syllabus, the contents of each chapter in the Study Material and Practice Manual would help you to broadly assess the time which each topic of the subject would consume. Of course, you have to keep some percentage margin over and above the time assessed by you to take care of possible difficulty in understanding or interpreting concepts, particularly relating to international taxation and certain aspects of procedural law.

Make full use of all the knowledge inputs of BOS

The Board of Studies brings out various publications from time to time with a view to assist the students in education. You are advised to make full use of the Study Material and other educational inputs provided to you. These educational inputs are also hosted at the BOS Knowledge Portal under the students' section of the Institute's website www.icai.org. The intention of creation of this portal is primarily to ensure free and unrestricted flow of knowledge and information to the students across the country by way of easy access to the latest publications of the Institute. Our efforts will, however, bear fruit only if you make it a habit to browse the portal as often as possible and assimilate the knowledge inputs contained therein. It is of utmost importance that you read these knowledge inputs to attain conceptual clarity, to remain updated with the developments in all the subjects and also to acquire the ability to apply the concepts to solve practical problems. Some of the important publications of BOS in the area of Direct Tax Laws are -

Publication	Objective	Key Features
Study Material	The aim of the Study Material is to build a strong conceptual base by explaining the complex direct tax laws in a lucid manner. <i>The October, 2013 edition of the Study Material is based on the provisions of law as amended by the Finance Act, 2013 and applicable for A.Y.2014-15. This edition is, therefore, relevant for May 2014 and November 2014 examinations.</i>	• The chapters relating to substantive and procedural law are organised in a logical sequence for clear comprehension; • The provisions of law have been explained in a lucid manner to facilitate easy understanding; • Illustrations have been given, wherever possible, to explain the provisions of law; • New illustrations and illustrations which have undergone a change due to amendments in law have been given in shaded background. • The latest amendments have been indicated in <i>bold italics</i>;

		The Circulars/Notifications issued by the CBDT have been discussed along with the respective sections to which they relate.
Supplementary Study Paper	This is a very important knowledge input in the area of Direct Tax Laws explaining the amendments made by the relevant Finance Act and latest circulars and notifications issued by CBDT. <i>The Supplementary Study Paper-2013 explains the amendments made by the Finance Act, 2013 and significant circulars and notifications issued between 1.7.2012 and 30.4.2013. This publication is relevant for May 2014 and November 2014 examinations.</i>	- The Supplementary Study Paper is also divided into chapters, so that you can co-relate the same with the Study Material; - Illustrations have been given, wherever possible, for better understanding of the amendments; - Related sections are grouped together and explained to facilitate interlinking and reading of interconnected provisions; - In respect of each notification, the relevant provision of the Act which confers the power to issue such notification is described briefly, so that you can relate the notification to the appropriate provisions of the Act.
Select Cases in Direct and Indirect Tax Laws – An Essential Reading for the Final Course	Significant Court rulings are reported to help you understand the interpretation of the provisions of law by judicial forums. <i>The September 2013 edition of this publication is relevant for May 2014 and November 2014 examinations.</i>	- Important decisions of the Supreme Court, High Court and Authority for Advance Rulings are reported for an insight on the interpretation of the specific provisions of law; - The case laws are grouped chapter-wise to enable you to co-relate the same with the provisions contained in the parallel chapter of the Study Material; - The case laws, when read in conjunction with the Study Material, will enable you to appreciate the issues involved in interpreting and applying the provisions of law to practical situations.
Practice Manual	The Practice Manual has also been grouped chapter-wise and contains a variety of problems in each topic for the	The questions in each chapter of the Practice Manual are taken from the past 13 years question papers set at the Final level. In addition, other

	better understanding and application of the concepts explained in the Study Material. <i>In the October 2013 edition of the Practice Manual, the questions and answers are based on the provisions of law as amended by the Finance Act, 2013 and are hence, relevant for May 2014 and November 2014 examinations. The relevant assessment year is A.Y.2014-15.</i>	questions from past RTPs etc. are also included; • The questions are adapted as per the provisions of law as amended by the latest relevant Finance Act; • Answers to the questions are based on the provisions of law as amended by the latest relevant Finance Act;
Revision Test Papers (RTP)	The RTPs are prepared with the twin objective of – (1) updating you on the latest developments on the statutory and judicial front. (2) helping you to self-assess the effectiveness of your study and revision by solving the questions given in Part III independently and comparing the same with the answers given.	• The RTP is divided into three parts – Part I : Statutory Update – Latest Notifications & Circulars Part II : Judicial Update – Latest Case Laws Part III : Questions & Answers - A Self-assessment test. The questions in Part III are framed to test your awareness and understanding of the provisions of income-tax law and wealth-tax law, particularly the latest developments, both on the statutory as well as on the judicial front, as well as your ability to analyse and interpret the provisions of law.
Suggested Answers	As the name depicts, this publication contains the questions set at the CA examination, as well as the suggested answers to such questions.	• The answers are prepared with a view to assist the students in education; • The Suggested Answers generally represent the ideal manner in which questions should be answered; • Therefore, it contains references to case laws, sections (including sub-sections and clauses), notifications and circulars issued by the CBDT;

		• In solutions to computational problems, the reasons for treatment of items are explained by way of Notes, giving reference to the related provisions of law and/or court rulings.

Step I – Study the “Study Material” for conceptual clarity

Be clear with the concepts

Ideally, when you take up any topic for study, you must first go through the relevant chapter of the Study Material for building a strong conceptual base. Make sure you read the Study Material updated on the basis of the provisions of law as amended by the Finance Act relevant for your examination. In case you have the earlier edition of the Study Material, then, you must go through the Supplementary Study Paper, which explains the amendments made by the Finance Act relevant for your examination.

Refer the Bare Acts

Do keep the Bare Acts i.e., Income-tax Act, 1961 and Wealth-tax Act, 1957 by your side for reference purposes. This will facilitate understanding of the language of law and the logical sequence of the sections.

Jot down key points for easy revision

Make it a habit to jot down the key points, if any, in each topic, and particularly, in your problem areas. This would facilitate revision, especially when you have a limited time of just one day before each examination.

Read the related provisions together

While reading the chapters in the Study Material, you should keep in mind that each chapter cannot be read on a stand-alone basis. Moreover, for proper appreciation of the income-tax law, inter-linking and combined reading of sections is an essential pre-requisite. The provisions contained in a chapter, say, Assessment of Various Entities, have to be read along with the provisions relating to business taxation, capital gains, deductions from gross total income etc., which are discussed in separate chapters of the Study Material.

Step II – Stay current with the “Supplementary”

You are advised to update yourself with the help of Supplementary Study Paper which is brought out every year. In this publication, the amendments made in direct tax laws by the Finance Act of that year are categorized chapter-wise and explained with the aid of illustrations and tabular presentations to facilitate easy understanding. The related sections are grouped together and discussed at one place in the Supplementary Study Paper and therefore, you would not face any difficulty in combined reading and understanding of the interconnected provisions.

Further, the latest notifications and circulars issued by the CBDT are also explained in the Supplementary Study Paper. Accordingly, the Supplementary Study Paper-2013 explains the

amendments made by the Finance Act, 2013 and significant notifications and circulars issued between 1.7.2012 and 30.4.2013.

Even if you have the latest Study Material, we would still advise you to go through the Supplementary Study Paper, since the amendments are discussed in detail therein. It would also help you understand and assimilate the recent amendments in a more effective manner.

Step III – Apply the concepts to solve practical problems in the Practice Manual

After reading each chapter in the Study Material and the corresponding chapter of the Supplementary Study Paper, try to work out the problems in the parallel chapter of the Practice Manual on your own, and thereafter compare your answers with the answers given therein. This would help you to identify your mistakes and also learn from your mistakes. Further, this process would help in revision of the concepts and principles contained in each chapter of the Study Material and application of the same while solving practical problems.

In the Practice Manual, the problems are solved with complete working notes and reasoning for treatment of various items by way of notes following the main solution. Court rulings have also been adequately discussed in the answers to case law based questions. You should carefully study the rationale of the court rulings in connection with the issue raised in the question.

Once you complete study of all the topics in the syllabus, try solving the problems in the Practice Manual once again to test if you are clear with all the concepts or whether there are still any grey areas which require further understanding.

Step IV – Update & Revise with the aid of the RTP

Update yourself on the statutory front

The Study Material is generally updated on the basis of the Finance Act of that year and notifications and circulars issued upto a particular date, i.e., 30th April of that year. The Study Material, so updated, would be relevant for May and November examinations held in the following year. However, for the May examination to be held in the following year, the significant notifications and circulars issued upto 31st October of the previous year are relevant. The RTP for May examination, therefore, contains the significant notifications and circulars issued between 1st May and 31st October of the previous year. Likewise, for the November examination of the following year, the significant notifications and circulars issued upto 30th April of that year are relevant. The RTP for November examination would, therefore, contain the significant circulars and notifications issued between 1st May of the previous year and 30th April of the year.

For instance, the October 2013 edition of the Study Material is updated on the basis of the amendments made by the Finance Act, 2013 and circulars and notifications issued upto 30th April, 2013. This edition of the Study Material is relevant for May 2014 and November 2014 examination. However, for May 2014 examination, the amendments made by circulars and notifications issued between 1st May, 2013 and 31st October, 2013 are also relevant, and hence, the same would be given in the RTP for May 2014 examination. Likewise, for November 2014 examination, the amendments made by circulars and notifications issued

between 1st May, 2013 and 30th April, 2014 would be relevant, and the same would be given in the RTP for November 2014 examination.

Update yourself on the judicial front

It is very important that you understand the rationale of court rulings vis-à-vis the relevant provisions of law. The publication "Select Cases in Direct & Indirect Tax Laws – An Essential Reading for the Final Course" is a compilation of select recent significant judicial decisions, which, when read in conjunction with the Study Material will enable you to appreciate the significant issues involved in interpreting and applying the provisions of tax laws.

Revise what you have learnt

Appropriately, the first round of study should be concluded at least three months before the examination; the initial round/rounds of revision should be done in the penultimate two months prior to the examination and the final revision in the last month before the examination wherein all the loose ends should be sorted out. Solving the questions and problems in the Revision Test Papers would help you to self-assess the effectiveness of your study and revision.

Step V - Check your level of preparation

Solve past years' question papers and compare with Suggested Answers

You should also make an honest attempt to solve the immediately preceding examination papers within a time span of three hours and compare your answers with the Suggested Answers published by the Board of Studies. This will help you to identify the areas where you are deficient and enable you to take corrective steps to avoid such mistakes in your examination.

However, remember that Suggested Answers are prepared on the basis of the provisions applicable for the assessment year relevant for that particular examination. For example, the Suggested Answers for May 2013 examination are based on the provisions applicable for A.Y.2013-14. In case you are appearing for the examination in May 2014 or November 2014, the relevant assessment year would be A.Y.2014-15. Therefore, while checking your answers with the answers given in the Suggested Answers, you should keep in mind that your answer would vary to the extent of amendments made by the Finance Act, 2013 and notifications and circulars issued after 31.10.2012.

Solve Mock Test Papers

You may also try attempting Mock Test Papers hosted on the Institute's website www.icai.org to complete the process of revision. You may also appear for the Mock Tests conducted at the regional offices and branches of the Institute and check your level of progress.

Face the examination with confidence

Having prepared well for the examination, it is also important that you approach the examination with a positive attitude. Do keep in mind the following points to score well in this paper -

- (i) ***Answer the questions with due emphasis on provisions of the law*** - Support your answers/conclusions with proper reasoning. Answers should be based on relevant legal provisions or judicial decisions rather than a mere common sense and/or guess work.

- (ii) ***Support your treatment with provisions of law and/or case laws*** - In respect of computational problems, the reasoning for treatment of various items should be given in your answer. The length and depth of reasoning to be given would depend on the marks allotted for the question. For example, in case of a problem on computation of total income of a firm or company, where the question specifically requires treatment of various items, you are expected to give the reasons for treatment of each item supported by the relevant provisions of law and/or case law, by way of notes below the main solution depicting the additions and deductions to arrive at the total income.
- (iii) ***Supplement your computation with Working Notes*** - Give complete working notes while solving computational problems. For example, if you are computing allowable salary of working partners as part of computation of total income of a firm, the working note should specify the limits under section 40(b)(v) for allowability of salary based on book profits of the firm. The book profit to be taken into consideration for calculating these limits should also be worked out.
- (iv) ***Relate and apply ratio of court rulings to case-law based questions*** - While answering case-law based questions, you must first relate the facts and the issue raised in the question with the facts and issue raised in the case decided by the Court. Thereafter, you may briefly discuss the rationale of the court ruling (giving reference to the appropriate provisions of law) and apply the ratio to the case on hand. Finally, write the conclusion to the issue raised in the question. For example, if the question requires you to examine the correctness of the contention of the Assessing Officer, then, your conclusion must address this question i.e. whether or not the contention of the Assessing Officer is correct applying the ratio of the court ruling to the facts given in the question.
- (v) ***Try to quote/cite relevant section numbers/case laws*** – Quoting section numbers and citing case laws would definitely add value to your answers. However, it is better not to quote than to quote a wrong section number/case law.
- (vi) ***State your assumptions/views clearly*** - Since the provisions of tax laws are subject to different interpretations by various courts, there are possibility of alternate views in the tax treatment of a particular item of income or expense or loss or deduction. Sometimes, there may be different points of view even on procedural law based provisions. As a student, you should state your view/assumption clearly and proceed to answer the question on that basis.
- (vii) ***Avoid using short forms*** – Use of short forms like AO, ITO, IT Act, WT Act etc. should be avoided. Write the full names of the statutes, like, “Income-tax Act, 1961” or “Wealth-tax Act, 1957”.
- (viii) ***Present your answers well*** - Make sure that your handwriting is neat and legible. Answer all parts of a question one after the other. Do not answer different parts of the same question at different places.
- (ix) ***Follow instructions given on the cover page of answer paper***- Pay heed to the instructions given on the cover page of the answer paper.

Volume – 1

INCOME TAX

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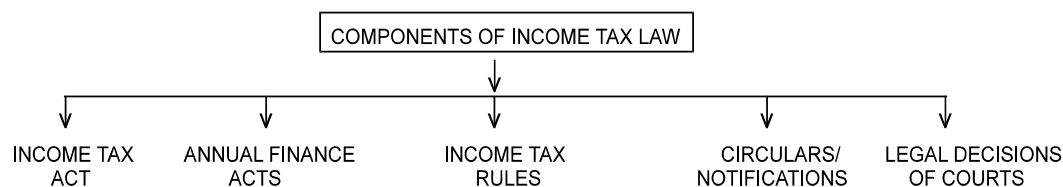
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1.1 Overview of income-tax law in India

Income-tax is a tax levied on the total income of the previous year of every person. A person includes an individual, Hindu Undivided Family (HUF), Association of Persons (AOP), Body of Individuals (BOI), a firm, a company etc. Income-tax is the most significant direct tax. The income-tax law in India consists of the following components–



The various instruments of law containing the law relating to income-tax are explained below:

Income-tax Act : The levy of income-tax in India is governed by the Income-tax Act, 1961. In this book we shall briefly refer to this as the Act. This Act came into force on 1st April, 1962. The Act contains 298 sections and XIV schedules. These undergo change every year with additions and deletions brought about by the Finance Act passed by Parliament. In pursuance of the power given by the Income-tax Act, 1961 rules have been framed to facilitate proper administration of the Income-tax Act.

The Finance Act : Every year, the Finance Minister of the Government of India presents the Budget to the Parliament. Part A of the budget speech contains the proposed policies of the Government in fiscal areas. Part B of the budget speech contains the detailed tax proposals. In order to implement the above proposals, the Finance Bill is introduced in the Parliament. Once the Finance Bill is approved by the Parliament and gets the assent of the President, it becomes the Finance Act.

Income-tax Rules: The administration of direct taxes is looked after by the Central Board of Direct Taxes (CBDT). The CBDT is empowered to make rules for carrying out the purposes of the Act. For the proper administration of the Income-tax Act, the CBDT frames rules from time to time. These rules are collectively called Income-tax Rules, 1962. It is important to keep in mind that along with the Income-tax Act, 1961, these rules should also be studied.

Circulars and Notifications: Circulars are issued by the CBDT from time to time to deal with certain specific problems and to clarify doubts regarding the scope and meaning of the provisions. These circulars are issued for the guidance of the officers and/or assesseees. The department is bound by the circulars. While such circulars are not binding the assesseees they

can take advantage of beneficial circulars.

Case Laws: The study of case laws is an important and unavoidable part of the study of income-tax law. It is not possible for Parliament to conceive and provide for all possible issues that may arise in the implementation of any Act. Hence the judiciary will hear the disputes between the assessee and the department and give decisions on various issues. The Supreme Court is the Apex Court of the country and the law laid down by the Supreme Court is the law of the land. The decisions given by various High Courts will apply in the respective states in which such High Courts have jurisdiction.

1.2 Charge of Income-tax

Section 4 of the Income-tax Act, 1961 is the charging section which provides that:

- (i) Tax shall be charged at the rates prescribed for the year by the annual Finance Act.
- (ii) The charge is on every person specified under section 2(31);
- (iii) Tax is chargeable on the total income earned during the previous year and not the assessment year. (There are certain exceptions provided by sections 172, 174, 174A, 175 and 176);
- (iv) Tax shall be levied in accordance with and subject to the various provisions contained in the Act.

This section is the back bone of the law of income-tax in so far as it serves as the most operative provision of the Act. The tax liability of a person springs from this section.

1.3 Rates of Tax

Income-tax is to be charged at the rates fixed for the year by the annual Finance Act. Section 2 of the Finance Act, 2013 read with Part I of the First Schedule to the Finance Act, 2013 specifies the rates at which income-tax is to be levied on income chargeable to tax for the A.Y. 2013-14. Part II lays down the rate at which tax is to be deducted at source during the financial year 2013-14 from income subject to such deduction under the Act; Part III lays down the rates for charging income-tax in certain cases, rates for deducting income-tax from income chargeable under the head "salaries" and the rates for computing advance tax for the financial year 2013-14 i.e. A.Y.2014-15. Part III of the First Schedule to the Finance Act, 2013 will become Part I of the First Schedule to the Finance Act, 2014 and so on.

The slab rates applicable for A.Y.2014-15 are as follows:

(1) Individual / Hindu Undivided Family (HUF) / Association of Persons (AOP) / Body of Individuals (BOI) / Artificial Juridical Person.

- (i) where the total income does not exceed ₹ 2,00,000 Nil;
- (ii) where the total income exceeds ₹ 2,00,000 but does not exceed ₹ 5,00,000 10% of the amount by which the total income exceeds ₹ 2,00,000
- (iii) where the total income exceeds ₹ 30,000 plus 20% of the amount

₹ 5,00,000 but does not exceed ₹ 10,00,000	by which the total income exceeds ₹ 5,00,000;
(iv) where the total income exceeds ₹ 10,00,000	₹ 1,30,000 plus 30% of the amount by which the total income exceeds ₹ 10,00,000.

Illustration: Mr. X has a total income of ₹ 12,00,000. Compute his gross tax liability.

Tax liability = ₹ 1,30,000 + 30% of ₹ 2,00,000 = ₹ 1,90,000

Alternatively:

Tax liability :

First ₹ 2,00,000	- Nil
Next ₹ 2,00,000 – ₹ 5,00,000	- @ 10% of ₹ 3,00,000 = ₹ 30,000
Next ₹ 5,00,000 – ₹ 10,00,000	- @ 20% of ₹ 5,00,000 = ₹ 1,00,000
Balance i.e. ₹ 12,00,000 – ₹ 10,00,000	- @ 30% of ₹ 2,00,000 = ₹ 60,000
Total tax = ₹ 1,90,000	

It is to be noted that for a senior citizen (being a resident individual who is of the age of 60 years but not more than 80 years at any time during the previous year), the basic exemption limit is ₹ 2,50,000. Further, resident individuals of the age of 80 years or more at any time during the previous year, being very senior citizens, would be eligible for a higher basic exemption limit of ₹ 5,00,000.

Therefore, the tax slabs for these assesseees would be as follows –

For senior citizens (being resident individuals of the age of 60 years or more but less than 80 years)

(i) where the total income does not exceed ₹ 2,50,000	Nil;
(ii) where the total income exceeds ₹ 2,50,000 but does not exceed ₹ 5,00,000	10% of the amount by which the total income exceeds ₹ 2,50,000;
(iii) where the total income exceeds ₹ 5,00,000 but does not exceed ₹ 10,00,000	₹ 25,000 plus 20% of the amount by which the total income exceeds ₹ 5,00,000;
(iv) where the total income exceeds ₹ 10,00,000	₹ 1,25,000 plus 30% of the amount by which the total income exceeds ₹ 10,00,000.

For resident individuals of the age of 80 years or more at any time during the previous year

(i) where the total income does not exceed ₹ 5,00,000	Nil;
(ii) where the total income exceeds ₹ 5,00,000 but does not exceed ₹ 10,00,000	20% of the amount ₹ 5,00,000 but does by which the total income exceeds ₹ 5,00,000;

1.4 Income Tax

- (iv) where the total income exceeds which ₹ 10,00,000 ₹ 1,00,000 plus 30% of the amount by the total income exceeds ₹ 10,00,000.
- (2) Firm/LLP
On the whole of the total income 30%
- (3) Local authority
On the whole of the total income 30%
- (4) Co-operative Society
- (i) Where the total income does not exceed ₹ 10,000 10% of the total income
- (ii) Where the total income exceeds ₹ 10,000 but does not exceed ₹ 20,000 ₹ 1,000 plus 20% of the amount by which the total income exceeds ₹ 10,000
- (iii) Where the total income exceeds ₹ 20,000 ₹ 3,000 plus 30% of the amount by which the total income exceeds ₹ 20,000
- (5) Company
- (i) In the case of a domestic company 30% of the total income
- (ii) In the case of a company other than a domestic company 40% on the total income
- However, specified royalties and fees for rendering technical services (FTS) received from Government or an Indian concern in pursuance of an approved agreement made by the company with the Government or Indian concern between 1.4.1961 and 31.3.1976 (in case of royalties) and between 1.3.1964 and 31.3.1976 (in case of FTS) would be chargeable to tax @50%.

The above rates are prescribed by the annual Finance Acts. However, in respect of certain types of income, as mentioned below, the Income-tax Act, 1961 has prescribed specific rates–

- (1) Section 112 has prescribed the rate of tax @20% in respect of long term capital gains. In case of non-corporate non-residents and foreign companies, long-term capital gains arising from transfer of unlisted securities would be subject to tax@10% without giving effect to indexation provision and currency fluctuation (For details, refer *Chapter 7 on "Capital gains"*)
- (2) Section 111A provides for a concessional rate of tax (i.e. 15%) on the short-term capital gains on transfer of -
- (i) an equity share in a company or
- (ii) a unit of an equity oriented fund.

The conditions for availing the benefit of this concessional rate are –

- (i) the transaction of sale of such equity share or unit should be entered into on or after 1.10.2004 and

- (ii) such transaction should be chargeable to securities transaction tax.
- (3) Section 115BB prescribes the rate of tax @30% for winnings from-
 - (i) any lottery; or
 - (ii) crossword puzzle; or
 - (iii) race including horse race; or
 - (iv) card game and other game of any sort; or
 - (v) gambling or betting of any form.

Surcharge

The rates of surcharge applicable for A.Y.2014-15 are as follows:

- (i) Individual/HUF/AOP/BOI/Artificial juridical person/Co-operative societies/Local Authorities/Firms/LLPs

Where the total income exceeds ₹ 1 crore, surcharge is payable at the rate of 10% of income-tax computed in accordance with the provisions of para (1)/(2)/(3)/(4) above or section 111A or section 112.

Marginal relief is available in case of such persons having a total income exceeding ₹ 1 crore i.e. the additional amount of income-tax payable (together with surcharge) on the excess of income over ₹ 1 crore should not be more than the amount of income exceeding ₹ 1 crore.

- (ii) Domestic company

- (a) In case of a domestic company, whose total income > ₹ 1 crore but is ≤ ₹ 10 crore

Where the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore, surcharge is payable at the rate of 5% of income-tax computed in accordance with the provisions of para (5)(i) above or section 111A or section 112. Marginal relief is available in case of such companies i.e. the additional amount of income-tax payable (together with surcharge) on the excess of income over ₹ 1 crore should not be more than the amount of income exceeding ₹ 1 crore.

Example 1

Compute the tax liability of X Ltd., a domestic company, assuming that the total income of X Ltd. is ₹ 1,01,00,000 and the total income does not include any income in the nature of capital gains.

Answer

The tax payable on total income of ₹ 1,01,00,000 of X Ltd. computed@ 31.5% (including surcharge@5%) is ₹ 31,81,500. However, the tax cannot exceed the tax of ₹ 30,00,000 payable on total income of ₹ 1 crore by more than ₹ 1,00,000, being the amount of total income exceeding ₹ 1 crore. Therefore, the tax payable on ₹ 1,01,00,000 would be ₹ 31,00,000 (₹ 30,00,000 + ₹ 1,00,000). The marginal relief is ₹ 81,500 (i.e., ₹ 31,81,500 - ₹ 31,00,000).

(b) In case of a domestic company, whose total income is > ₹ 10 crore

Where the total income exceeds ₹ 10 crore, surcharge is payable at the rate of 10% of income-tax computed in accordance with the provisions of para (5)(i) above or section 111A or section 112.

Marginal relief is available in case of such companies i.e. the additional amount of income-tax payable (together with surcharge) on the excess of income over ₹ 10 crore should not be more than the amount of income exceeding ₹ 10 crore.

Example 2

Compute the tax liability of X Ltd., a domestic company, assuming that the total income of X Ltd. is ₹ 10,01,00,000 and the total income does not include any income in the nature of capital gains.

Answer

The tax payable on total income of ₹ 10,01,00,000 of X Ltd. computed@ 33% (including surcharge@10%) is ₹ 3,30,33,000. However, the tax cannot exceed the tax of ₹ 3,15,00,000 (31.5% of ₹ 10 crore) payable on total income of ₹ 10 crore by more than ₹ 1,00,000, being the amount of total income exceeding ₹ 10 crore. Therefore, the tax payable on ₹ 10,01,00,000 would be ₹ 3,16,00,000 (₹ 3,15,00,000 + ₹ 1,00,000). The marginal relief is ₹ 14,33,000 (i.e., ₹ 3,30,33,000 - ₹ 3,16,00,000).

(iii) Foreign company**(a) In case of a foreign company, whose total income > ₹ 1 crore but is ≤ ₹ 10 crore**

Where the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore, surcharge is payable at the rate of 2% of income-tax computed in accordance with the provisions of paragraph (5)(ii) above or section 111A or section 112. Marginal relief is available in case of such companies i.e., the additional amount of income-tax payable (together with surcharge) on the excess of income over ₹ 1 crore should not be more than the amount of income exceeding ₹ 1 crore.

(b) In case of a foreign company, whose total income is > ₹10 crore

Where the total income exceeds ₹10 crore, surcharge is payable at the rate of 5% of income-tax computed in accordance with the provisions of para (5)(ii) above or section 111A or section 112.

Marginal relief is available in case of such companies i.e. the additional amount of income-tax payable (together with surcharge) on the excess of income over ₹10 crore should not be more than the amount of income exceeding ₹10 crore.

Rebate of up to ₹2,000 for resident individuals having total income of up to ₹5 lakh [New Section 87A]

In order to provide tax relief to the individual tax payers who are in the 10% tax slab, section 87A has been inserted to provide a rebate from the tax payable by an assessee, being an individual resident in India, whose total income does not exceed ₹5,00,000.

- (i) The rebate shall be equal to the amount of income-tax payable on the total income for any assessment year or an amount of ₹2,000, whichever is less.
- (ii) Consequently, any individual having total income up to ₹2,20,000 will not be required to pay any tax. Further, every individual having total income above ₹2,20,000 but not exceeding ₹5,00,000 shall get a tax relief of ₹2,000. In effect, the rebate would be the tax payable or ₹2,000, whichever is less.
- (iii) Further, the aggregate amount of rebate under section 87A shall not exceed the amount of income-tax (as computed before allowing such rebate) on the total income of the assessee with which he is chargeable for any assessment year.

“Education cess” and “Secondary and Higher education cess” on income-tax: The amount of income-tax as increased by the union surcharge, if applicable, should be further increased by an additional surcharge called the “Education cess on income-tax”, calculated at the rate of 2% of such income-tax and surcharge, if applicable. Education cess is leviable in the case of all assesseees i.e. individuals, HUF, AOP / BOI, firms, local authorities, co-operative societies and companies. Further, “Secondary and higher education cess on income-tax” @1% of income-tax plus surcharge, if applicable, is leviable to fulfill the commitment of the Government to provide and finance secondary and higher education.

1.4 Concept of Income

The definition of income as per the Income-tax Act, 1961, begins with the words “Income includes”. Therefore, it is an inclusive definition and not an exhaustive one. Such a definition does not confine the scope of income but leaves room for more inclusions within the ambit of the term. Certain important principles relating to income are enumerated below -

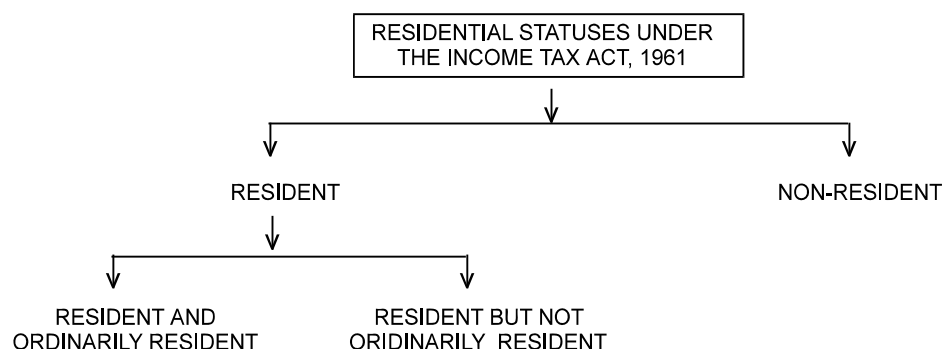
1.8 Income Tax

- Income, in general, means a periodic monetary return which accrues or is expected to accrue regularly from definite sources. However, under the Income-tax Act, 1961, even certain income which do not arise regularly are treated as income for tax purposes e.g. Winnings from lotteries, crossword puzzles.
- Income normally refers to revenue receipts. Capital receipts are generally not included within the scope of income. However, the Income-tax Act, 1961 has specifically included certain capital receipts within the definition of income e.g. Capital gains i.e. gains on sale of a capital asset like land.
- Income means net receipts and not gross receipts. Net receipts are arrived at after deducting the expenditure incurred in connection with earning such receipts. The expenditure which can be deducted while computing income under each head [For knowing about heads of income, see step 2 of para 1.5 below] is prescribed under the Income-tax Act, 1961.
- Income is taxable either on due basis or receipt basis. For computing income under the heads "Profits and gains of business or profession" and "Income from other sources", the method of accounting regularly employed by the assessee should be considered, which can be either cash system or mercantile system.
- Income earned in a previous year is chargeable to tax in the assessment year. Previous year is the financial year, ending on 31st March, in which income has accrued/ received. Assessment year is the financial year (ending on 31st March) following the previous year. The income of the previous year is assessed during the assessment year following the previous year. For instance, income of previous year 2013-14 is assessed during the year 2014-15. Therefore, 2014-15 is the assessment year for assessment of income of the previous year 2013-14.

1.5 Total Income and Tax Payable

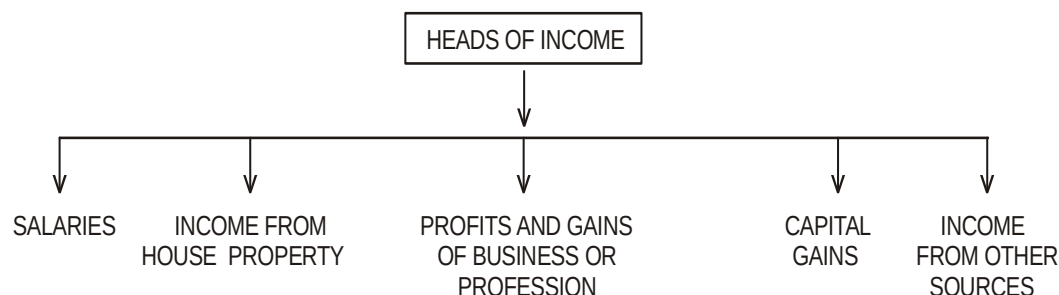
Income-tax is levied on an assessee's total income. Such total income has to be computed as per the provisions contained in the Income-tax Act, 1961. Let us go step by step to understand the procedure of computation of total income for the purpose of levy of income-tax

Step 1 – Determination of residential status: The residential status of a person has to be determined to ascertain which income is to be included in computing the total income. The residential statuses as per the Income-tax Act, 1961 are shown below –



In the case of an individual, the duration for which he is present in India determines his residential status. Based on the time spent by him, he may be (a) resident and ordinarily resident, (b) resident but not ordinarily resident, or (c) non-resident. The residential status of a person determines the taxability of the income. For e.g., income earned outside India will not be taxable in the hands of a non-resident but will be taxable in case of a resident and ordinarily resident.

Step 2 – Classification of income under different heads: The Act prescribes five heads of income. These are shown below –



These heads of income exhaust all possible types of income that can accrue to or be received by the tax payer. Salary, pension earned is taxable under the head “Salaries”. Rental income is taxable under the head “Income from house property”. Income derived from carrying on any business or profession is taxable under the head “Profits and gains from business or profession”. Profit from sale of a capital asset (like land) is taxable under the head “Capital Gains”. The fifth head of income is the residuary head under which income taxable under the Act, but not falling under the first four heads, will be taxed. The tax payer has to classify the income earned under the relevant head of income.

Step 3 – Exclusion of income not chargeable to tax: There are certain income which are wholly exempt from income-tax e.g. Agricultural income. These income have to be excluded and will not form part of Gross Total Income. Also, some incomes are partially exempt from income-tax e.g. House Rent Allowance, Education Allowance. These incomes are excluded only to the extent of the limits specified in the Act. The balance income over and above the prescribed exemption limits would enter computation of total income and have to be classified under the relevant head of income.

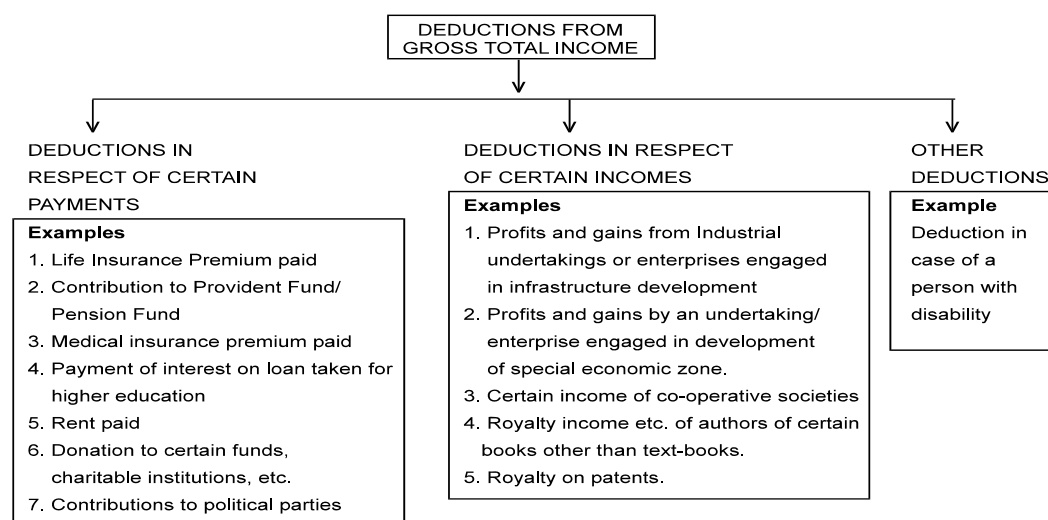
Step 4 – Computation of income under each head: Income is to be computed in accordance with the provisions governing a particular head of income. Under each head of income, there is a charging section which defines the scope of income chargeable under that head. There are deductions and allowances prescribed under each head of income. For example, while calculating income from house property, municipal taxes and interest on loan are allowed as deduction. Similarly, deductions and allowances are prescribed under other heads of income. These deductions etc. have to be considered before arriving at the net income chargeable under each head.

Step 5 – Clubbing of income of spouse, minor child etc.: In case of individuals, income-tax is levied on a slab system on the total income. The tax system is progressive i.e. as the income increases, the applicable rate of tax increases. Some taxpayers in the higher income bracket have a tendency to divert some portion of their income to their spouse, minor child etc. to minimize their tax burden. In order to prevent such tax avoidance, clubbing provisions have been incorporated in the Act, under which income arising to certain persons (like spouse, minor child etc.) have to be included in the income of the person who has diverted his income for the purpose of computing tax liability.

Step 6 – Set-off or carry forward and set-off of losses: An assessee may have different sources of income under the same head of income. He might have profit from one source and loss from the other. For instance, an assessee may have profit from his textile business and loss from his printing business. This loss can be set-off against the profits of textile business to arrive at the net income chargeable under the head “Profits and gains of business or profession”. Similarly, an assessee can have loss under one head of income, say, Income from house property and profits under another head of income, say, Profits and gains of business or profession. There are provisions in the Income-tax Act, 1961, for allowing inter-head adjustment in certain cases. Further, losses which cannot be set-off in the current year due to inadequacy of eligible profits can be carried forward for set-off in the subsequent years as per the provisions contained in the Act.

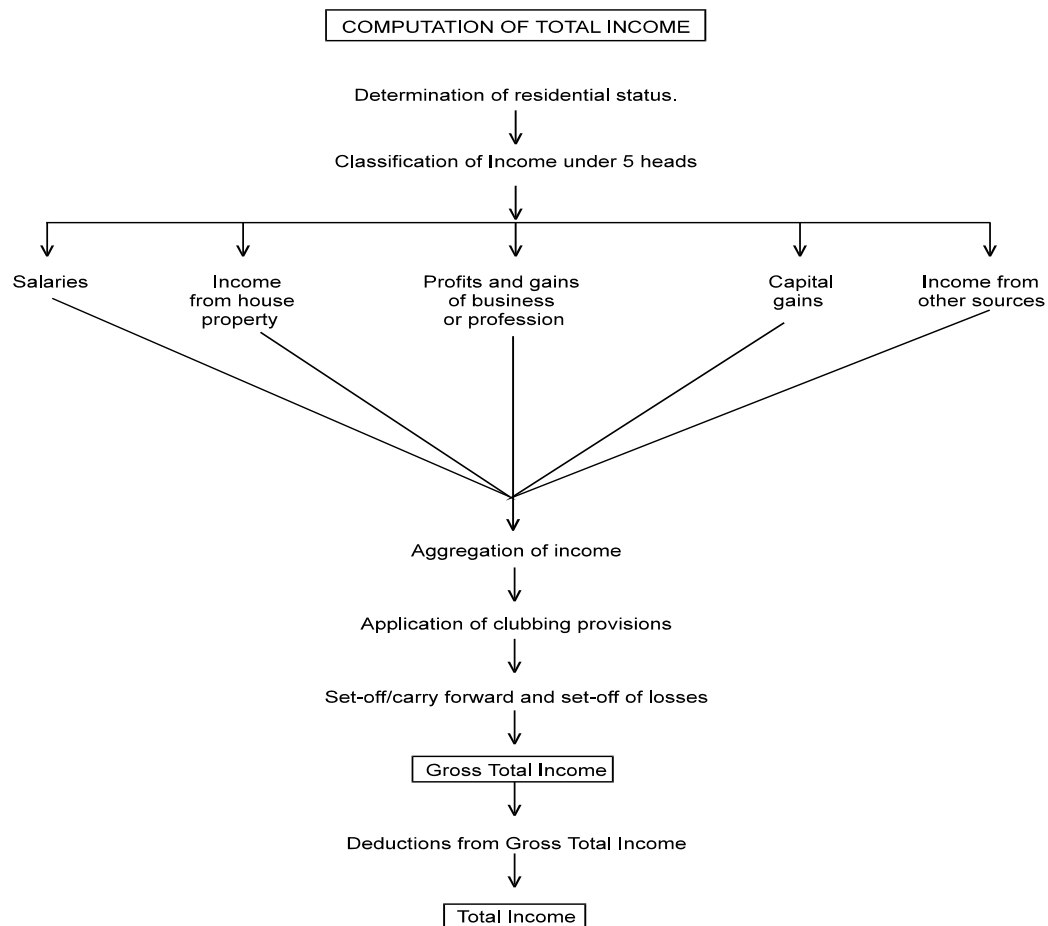
Step 7 – Computation of Gross Total Income: The final figures of income or loss under each head of income, after allowing the deductions, allowances and other adjustments, are then aggregated, after giving effect to the provisions for clubbing of income and set-off and carry forward of losses, to arrive at the gross total income.

Step 8 – Deductions from Gross Total Income: There are deductions prescribed from Gross Total Income. These deductions are of three types –



Step 9 – Total income: The income arrived at, after claiming the above deductions from the Gross Total Income is known as the Total Income. It is also called the Taxable Income. It should be rounded off to the nearest multiple of ₹ 10.

The process of computation of total income is shown hereunder –



Step 10 – Application of the rates of tax on the total income: The rates of tax for the different classes of assesses are prescribed by the Annual Finance Act.

For individuals, HUFs etc., there is a slab rate and basic exemption limit. At present, the basic exemption limit is ₹ 2,00,000 for individuals. This means that no tax is payable by individuals with total income of up to ₹ 2,00,000. Those individuals whose total income is more than ₹ 2,00,000 but less than ₹ 5,00,000 have to pay tax on their total income in excess of ₹ 2,00,000 @ 10% and so on. The highest rate is 30%, which is attracted in respect of income in excess of ₹ 10,00,000.

For firms and companies, a flat rate of tax is prescribed. At present, the rate is 30% on the whole of their total income.

The tax rates have to be applied on the total income to arrive at the income-tax liability.

Step 11 Surcharge / Rebate under section 87A

Surcharge: Surcharge is an additional tax payable over and above the income-tax. Surcharge is levied as a percentage of income-tax. In case where the total income of an individual, HUF, AOP, BOI, Firm, LLP exceeds ₹1 crore, surcharge is payable at the rate of 10% of income-tax. In case of domestic companies, surcharge is payable @5% of income-tax, if the total income exceeds ₹1 crore and @10% of income-tax, if the total income exceeds ₹10 crore. In case of foreign companies, surcharge is payable @2% of income-tax, if the total income exceeds ₹1 crore and @5% of income-tax, if the total income exceeds ₹10 crore.

Rebate under section 87A: In order to provide tax relief to the individual tax payers who are in the 10% tax slab, section 87A has been inserted to provide a rebate from the tax payable by an assessee, being an individual resident in India, whose total income does not exceed ₹5,00,000. The rebate shall be equal to the amount of income-tax payable on the total income for any assessment year or an amount of ₹2,000, whichever is less.

The following table indicates the applicability of surcharge/rebate u/s 87A in case of individuals -

Level of Total Income	Surcharge	Rebate u/s 87A
≤ ₹5,00,000	Not applicable	Income-tax on total income or ₹2,000, whichever is less
≥ ₹5,00,000 ≤ ₹1,00,00,000	Not applicable	Not applicable
≥ ₹1,00,00,000	10% of income-tax	Not applicable

Step 12 – Education cess and secondary and higher education cess on income-tax: The income-tax, as increased by the surcharge or as reduced by the rebate under section 87A, if applicable, is to be further increased by an additional surcharge called education cess @2%. The education cess on income-tax is for the purpose of providing universalized quality basic education. This is payable by all assesseees who are liable to pay income-tax irrespective of their level of total income. Further, “secondary and higher education cess on income-tax” @1% of income-tax plus surcharge, if applicable, is leviable to fulfill the commitment of the Government to provide and finance secondary and higher education.

Step 13 – Advance tax and tax deducted at source: Although the tax liability of an assessee is determined only at the end of the year, tax is required to be paid in advance in certain installments on the basis of estimated income. In certain cases, tax is required to be deducted at source from the income by the payer at the rates prescribed in the Act. Such deduction should be made either at the time of accrual or at the time of payment, as prescribed by the Act. For example, in the case of salary income, the obligation of the employer to deduct tax at source arises only at the time of payment of salary to the employees. Such tax deducted at source has to be remitted to the credit of the Central Government through any branch of the RBI, SBI or any authorized bank. If any tax is still due on the basis of return of income, after adjusting advance tax and tax deducted at source, the assessee has to pay such tax (called self-assessment tax) at the time of filing of the return.

1.6 Important Definitions

Section 2 gives definitions of the various terms and expressions used therein. In order to understand the provisions of the Act, one must have a thorough knowledge of the meanings of certain key terms like 'person', 'assessee', 'income', etc. To understand the meanings of these terms we have to first check whether they are defined in the Act itself. If a particular definition is given in the Act itself, we have to be guided by that definition. If a particular definition is not given in the Act, reference can be made to the General Clauses Act or dictionaries. Students should note this point carefully because certain terms like "dividend", "transfer", etc. have been given a wider meaning in the Income-tax Act than they are commonly understood.

Some of the important terms defined under section 2 are given below:

(1) Assessee [Section 2(7)]

Assessee means a person by whom any tax or any other sum of money is payable under this Act. It includes every person in respect of whom any proceeding has been taken for the assessment of his income or assessment of fringe benefits. Sometimes, a person becomes assessable in respect of the income of some other persons. In such a case also, he may be considered as an assessee. This term also includes every person who is deemed to be an assessee or an assessee in default under any provision of this Act.

(2) Assessment [Section 2(8)]

This is the procedure by which the income of an assessee is determined by the Assessing Officer. It may be by way of a normal assessment or by way of reassessment of an income previously assessed.

(3) Person [Section 2(31)]

The definition of 'assessee' leads us to the definition of 'person' as the former is closely connected with the latter. The term 'person' is important from another point of view also viz., the charge of income-tax is on every 'person'.

The definition is inclusive i.e. a person includes,

- (i) an individual,
- (ii) a Hindu Undivided Family (HUF),
- (iii) a company,
- (iv) a firm,
- (v) an AOP or a BOI, whether incorporated or not,
- (vi) a local authority, and
- (vii) every artificial juridical person e.g., an idol or deity.

We may briefly consider some of the above seven categories of assessee each of which constitutes a separate unit of assessment.

(i) **Individual** - The term 'individual' means only a natural person, i.e., a human being. It includes both males and females. It also includes a minor or a person of unsound mind. But the assessment in such a case may be made under section 161(1) on the guardian or manager of the minor or lunatic. In the case of deceased person, assessment would be made on the legal representative.

(ii) **HUF** - Under the Income-tax Act, 1961, a Hindu undivided family (HUF) is treated as a separate entity for the purpose of assessment. It is included in the definition of the term "person" under section 2(31). The levy of income-tax is on "every person". Therefore, income-tax is payable by a HUF. "Hindu undivided family" has not been defined under the Income-tax Act. The expression is however defined under the Hindu Law as a family, which consists of all males lineally descended from a common ancestor and includes their wives and unmarried daughters.

The relation of a HUF does not arise from a contract but arises from status. A Hindu is born into a HUF. A male member continues to remain a member of the family until there is a partition of the family. After the partition, he ceases to be a member of one family. However, he becomes a member of another smaller family. A female member ceases to be a member of the HUF in which she was born, when she gets married. Thereafter, she becomes a member of the HUF of her husband.

Some members of the HUF are called co-parceners. They are related to each other and to the head of the family. HUF may contain many members, but members within four degrees including the head of the family (kartha) are called co-parceners. A Hindu co-parcenary includes those persons who acquire by birth an interest in the joint coparcenary property. Only the coparceners have a right to partition.

A Jain undivided family would also be assessed as a HUF, as Jains are also governed by the laws as Hindus.

Schools of Hindu Law

There are two schools of Hindu law. They are –

- (1) Mithakshara school of Hindu law
- (2) Dayabhaga school of Hindu law

Mithakshara law is followed by entire India except West Bengal and Assam. There is a basic difference between the two schools of thought with regard to succession. Under the Mithakshara law, the inheritance is by birth. One acquires the right to the family property by his birth and not by succession irrespective of the fact that his elders are living. Thus every child born in the family acquires a right/share in the family property.

Dayabhaga law prevails in West Bengal and Assam. In Dayabhaga law, nobody acquires the right, share in the property by birth as long as the head of family is living, that is, the children do not acquire any right, share in the family property, as long as his father is alive and only on death of the father, the children will acquire right/share in the property. Thus, the father and his brothers would be the coparceners of the HUF.

(iii) **Company [Section 2(17)]** - For all purposes of the Act the term 'Company', has a much wider connotation than that under the Companies Act, 1956. Under the Act, the expression 'Company' means:

- (1) any Indian company as defined in section 2(26); or
- (2) any body corporate incorporated by or under the laws of a country outside India, i.e., any foreign company; or
- (3) any institution, association or body which is assessable or was assessed as a company for any assessment year under the Indian Income-tax Act, 1922 or for any assessment year commencing on or before 1.4.1970 under the present Act; or
- (4) any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by a general or special order of the CBDT to be a company for such assessment years as may be specified in the CBDT's order.

Classes of Companies

(1) **Domestic company [Section 2(22A)]** - means an Indian company or any other company which, in respect of its income liable to income-tax, has made the prescribed arrangements for the declaration and payment of dividends (including dividends on preference shares) within India, payable out of such income.

Indian company [Section 2(26)] - Two conditions should be satisfied so that a company can be regarded as an Indian company -

- (a) the company should have been formed and registered under any law relating to companies which was or is in force in any part of India, and
- (b) the registered office or the principal office of the company should be in India.

The expression 'Indian Company' also includes:

- (i) A corporation established by or under a Central, State or Provincial Act (like Financial Corporation or a State Road Transport Corporation),
- (ii) An institution or association or body which is declared by the Board to be a company under section 2(17)(iv) provided its registered or principal office is in India.
- (iii) in the case of the State of Jammu and Kashmir, a company formed and registered under any law for the time being in force in that State.
- (iv) in the case of any of the Union territories of Dadra and Nagar Haveli, Goa, Daman and Diu, and Pondicherry, a company formed and registered under any law for the time being in force in that Union territory.

Company in which public are substantially interested [Section 2(18)] - The following companies are said to be companies in which the public are substantially interested:

- (i) A company owned by the Government (either Central or State but not Foreign) or the Reserve Bank of India (RBI) or in which not less than 40% of the shares are held by the

Government or the RBI or corporation owned by that bank.

- (ii) A company which is registered under section 25 of the Companies Act, 1956¹ (formed for promoting commerce, arts, science, religion, charity or any other useful object).
- (iii) A company having no share capital which is declared by the Board for the specified assessment years to be a company in which the public are substantially interested.
- (iv) A company which is not a private company as defined in the Companies Act, 1956 and which fulfills any of the following conditions:
 - its equity shares should have, as on the last day of the relevant previous year, been listed in a recognised stock exchange in India; or
 - its equity shares carrying at least 50% (40% in case of industrial companies) voting power should have been unconditionally allotted to or acquired by and should have been beneficially held throughout the relevant previous year by (a) Government or (b) a Statutory Corporation or (c) a company in which public are substantially interested or (d) any wholly owned subsidiary of company mentioned in (c).
- (v) A company which carries on its principal business of accepting deposits from its members and which is declared by the Central Government under section 620A of the Companies Act² to be Nidhi or a Mutual Benefit Society.
- (vi) A company whose equity shares carrying at least 50% of the voting power have been allotted unconditionally to or acquired unconditionally by and were beneficially held throughout the relevant previous year by one or more co-operative societies.

Person having substantial interest in the company [Section 2(32)] – is a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend), whether with or without a right to participate in profits, carrying at least 20% of the total voting power.

Note: The main criterion is the 'beneficial' ownership and not 'legal' ownership. Therefore, the registered holder of even the majority of equity shares, would not fall within this definition if he has no beneficial interest in the shares. On the other hand, a person who is beneficially entitled to at least 20% of the equity share capital of a company would fall within this definition even if he is not the registered holder of any shares.

(2) Foreign company [Section 2(23A)] - Foreign company means a company which is not a domestic company.

(iv) Firm - The terms 'firm', 'partner' and 'partnership' have the same meanings as assigned to them in the Indian Partnership Act. In addition, the definitions also include the terms as they have been defined in the Limited Liability Partnership Act, 2008. However, for income-tax purposes a minor admitted to the benefits of an existing partnership would also be treated as partner. This is specified under section 2(23) of the Act. A partnership is the relation between

¹ Section 8 of the Companies Act, 2013

² Section 406 of the Companies Act, 2013

persons who have agreed to share the profits of business carried on by all or any of them acting for all. The persons who have entered into partnership with one another are called individually 'partners' and collectively a 'firm'.

Note:

- (i) Consequent to the Limited Liability Partnership Act, 2008 coming into effect in 2009 and notification of the Limited Liability Partnership Rules w.e.f. 1st April, 2009, the Finance (No.2) Act, 2009 has incorporated the taxation scheme of LLPs in the Income-tax Act, 1961 on the same lines as applicable for general partnerships, i.e. tax liability would be attracted in the hands of the LLP and tax exemption would be available to the partners. Therefore, the same tax treatment would be applicable for both general partnerships and LLPs.
- (ii) Consequently, the following definitions in section 2(23) have been amended -
 - (1) The definition of 'partner' to include within its meaning, a partner of a limited liability partnership;
 - (2) The definition of 'firm' to include within its meaning, a limited liability partnership; and
 - (3) The definition of 'partnership' to include within its meaning, a limited liability partnership.

The definition of these terms under the Income-tax Act would, in effect, also include the terms as they have been defined in the Limited Liability Partnership Act, 2008. Section 2(q) of the LLP Act, 2008 defines a 'partner' as any person who becomes a partner in the LLP in accordance with the LLP agreement. An LLP agreement has been defined under section 2(o) to mean any written agreement between the partners of the LLP or between the LLP and its partners which determines the mutual rights and duties of the partners and their rights and duties in relation to the LLP.

- (v) **Association of Persons (AOP)** - When persons combine together for promotion of joint enterprise they are assessable as an AOP when they do not in law constitute a partnership. In order to constitute an association, persons must join in a common purpose, common action and their object must be to produce income; it is not enough that the persons receive the income jointly. Co-heirs, co-legatees or co-donees joining together for a common purpose or action would be chargeable as an AOP.

Body of Individuals (BOI) – It denotes the status of persons like executors or trustees who merely receive the income jointly and who may be assessable in like manner and to the same extent as the beneficiaries individually. Thus co-executors or co-trustees are assessable as a BOI as their title and interest are indivisible. Income-tax shall not be payable by an assessee in respect of the receipt of share of income by him from BOI and on which the tax has already been paid by such BOI.

- (vi) **Local Authority** - The term means a municipal committee, district board, body of port commissioners or other authority legally entitled to or entrusted by the Government with the control or management of a municipal or local fund.

Note: A local authority is taxable in respect of that part of its income which arises from any business carried on by it in so far as that income does not arise from the supply of a

commodity or service within its own jurisdictional area. However, income arising from the supply of water and electricity even outside the local authority's own jurisdictional areas is exempt from tax.

(vii) **Artificial Persons** - This category could cover every artificial juridical person not falling under other heads. An idol, or deity would be assessable in the status of an artificial juridical person.

(4) Income [Section 2(24)]

Section 2(24) of the Act gives a statutory definition of income. This definition is inclusive and not exhaustive. Thus, it gives scope to include more items in the definition of income as circumstances may warrant. At present, the following items of receipts are included in income:—

- (1) Profits and gains.
- (2) Dividends.
- (3) Voluntary contributions received by a trust/institution created wholly or partly for charitable or religious purposes or by an association or institution referred to in section 10(21) or section (23C)(iiiad)/(iii ae)/(iv)/(v)/(vi)/(via) or an electoral trust –

Research association approved under section 35(1)(ii)	10(21)
Universities and other educational institutions	10(23C)(iiiad)/ (vi)
Hospitals and other medical institutions	10(23C) (iii ae) / (via)
Notified funds or institutions established for charitable purposes	10(23C)(iv)
Notified trusts or institutions established wholly for public religious purposes or wholly for public religious and charitable purposes	10(23C)(v)
Electoral trust	13B

- (4) The value of any perquisite or profit in lieu of salary taxable under section 17.
- (5) Any special allowance or benefit other than the perquisite included above, specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit.
- (6) Any allowance granted to the assessee to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living.
- (7) The value of any benefit or perquisite whether convertible into money or not, obtained from a company either by a director or by a person who has a substantial interest in the company or by a relative of the director or such person and any sum paid by any such company in respect of any obligation which, but for such payment would have been payable by the director or other person aforesaid.
- (8) The value of any benefit or perquisite, whether convertible into money or not, which is obtained by any representative assessee mentioned under section 160(1)(iii) and (iv), or

by any beneficiary or any amount paid by the representative assessee for the benefit of the beneficiary which the beneficiary would have ordinarily been required to pay.

- (9) Deemed profits chargeable to tax under section 41 or section 59.
- (10) Profits and gains of business or profession chargeable to tax under section 28.
- (11) Any capital gains chargeable under section 45.
- (12) The profits and gains of any insurance business carried on by Mutual Insurance Company or by a cooperative society, computed in accordance with Section 44 or any surplus taken to be such profits and gains by virtue of the provisions contained in the first Schedule to the Act.
- (13) The profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members.
- (14) Any winnings from lotteries, cross-word puzzles, races including horse races, card games and other games of any sort or from gambling, or betting of any form or nature whatsoever. For this purpose,
 - (i) "Lottery" includes winnings, from prizes awarded to any person by draw of lots or by chance or in any other manner whatsoever, under any scheme or arrangement by whatever name called;
 - (ii) "Card game and other game of any sort" includes any game show, an entertainment programme on television or electronic mode, in which people compete to win prizes or any other similar game.
- (15) Any sum received by the assessee from his employees as contributions to any provident fund (PF) or superannuation fund or Employees State Insurance Fund (ESI) or any other fund for the welfare of such employees.
- (16) Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy will constitute income.

"Keyman insurance policy" means a life insurance policy taken by a person on the life of another person where the latter is or was an employee or is or was connected in any manner whatsoever with the former's business.
- (17) Any sum referred to clause (va) of section 28. Thus, any sum, whether received or receivable in cash or kind, under an agreement for not carrying out any activity in relation to any business; or not sharing any know-how, patent, copy right, trade-mark, licence, franchise, or any other business or commercial right of a similar nature, or information or technique likely to assist in the manufacture or processing of goods or provision of services, shall be chargeable to income tax under the head "profits and gains of business or profession".
- (18) Any sum of money or value of property referred to in section 56(2)(vii) or section 56(2)(viii).
- (19) Any consideration received for issue of shares as exceeds the fair market value of the shares referred to in section 56(2)(vii).

Students should carefully study the various items of receipts included in the above definition. Some of them like capital gains are not revenue receipts. However, since they have been included in the definition, they are chargeable as income under the Act. The concept of revenue and capital receipts is discussed hereunder –

The Act contemplates a levy of tax on income and not on capital and hence it is very essential to distinguish between capital and revenue receipts. The distinction between capital and revenue receipts is somewhat blurred. Even then, capital receipts cannot be taxed, unless they fall within the scope of the definition of “income” and so the distinction remains real and most material for tax purposes.

Certain capital receipts which have been specifically included in the definition of income are Compensation for modification or termination of services, income by way of capital gains etc.

It is not possible to lay down any single test as infallible or any single criterion as decisive, final and universal in application to determine whether a particular receipt is capital or revenue in nature. Hence, the capital or revenue nature of the receipt must be determined with reference to the facts and circumstances of each case.

Distinction between capital and revenue receipts: The following are some of the important criteria which may be applied to distinguish between capital and revenue receipts.

- (1) A receipt referable to fixed capital would be a capital receipt whereas a receipt referable to circulating capital would be a revenue receipt. The former is exempt from tax while the latter is taxable. In cases where a capital asset is transmuted into income and the price realized on its sale takes the form of periodic payments (e.g., annuities and annual installment of capital), the receipt would be taxable even though it is referable to a capital asset.
- (2) Profits arising from the sale of a capital asset are chargeable to tax as capital gains under section 45 whereas profits arising from the sale of a trading asset being of revenue nature are taxable as income from business under section 28 provided that the sale is in the regular course of assessee's business or the transaction constitutes an adventure in the nature of trade.
- (3) Profits arising from transactions which are entered into in the course of the business regularly carried on by the assessee, or are incidental to, or associated with the business of the assessee would be revenue receipts chargeable to tax. For example, a banker's or financier's dealings in foreign exchange or sale of shares and securities, a shipbroker's purchases of ship in his own name, a share broker's purchase of shares on his own account would constitute transactions entered and yielding income in the ordinary course of their business. If transactions are partly in the course of and partly outside the regular trading activity of the assessee, the income arising therefrom must be segregated and allocated between the two parts and treated accordingly for tax purposes.
- (4) In the case of profit arising from the sale of shares and securities the nature of the profit has to be ascertained from the motive, intention or purpose with which they were bought. If the shares were acquired as an investor or with a view to acquiring a controlling interest or for obtaining a managing or selling agency or a directorship the profit or loss on their sale would be of a capital nature; but if the shares were acquired in the ordinary course of business as a

dealer in shares, it would be a taxable receipt. If the shares were acquired with speculative motive the profit or loss (although of a revenue nature) would have to be dealt with separately from other business.

(5) Even a single transaction may constitute a business or an adventure in the nature of trade even if it is outside the normal course of the assessee's business. Repetition of such transactions is not necessary. Thus, a bulk purchase followed by a bulk sale or a series of retail sales or bulk sale followed by a series of retail purchases would constitute an adventure in the nature of trade and consequently the income arising therefrom would be taxable. Purchase of any article with no intention to resell it, but resold under changed circumstances would be a transaction of a capital nature and capital gains arise. However, where an asset is purchased with the intention to resell it, the question whether the profit on sale is capital or revenue in nature depends upon (i) the conduct of the assessee, (ii) the nature and quantity of the article purchased, (iii) the nature of the operations involved, (iv) whether the venture is on capital or revenue account, and (v) other related circumstances of the case.

(6) In the case of annuities which are payable in specified sums at periodic intervals of time the receipt would be of a revenue nature even though it involves the conversion of capital into income for an annuity means the purchase of an income. An annuity received from an employer is taxable as "Income from salaries" whereas all other annuities are chargeable under the head "Income from other sources".

Annual payments, as distinguished from annuities, are in fact annual installments of capital. The purchase price of a business or property may be agreed to be paid in installments annually or otherwise. In such cases, the amount of installment received would be of capital nature not liable to tax. Thus, on the sale of property or business in consideration of annual payment:

- (i) if the sale is for a price which is to be paid in installments, the installments would be capital receipts;
- (ii) if the property is sold for an annuity payable regularly, the property disappears and the annuity which takes its place would be chargeable to tax;
- (iii) if the property is sold for what looks like an annuity but actually there is no transmutation of the principal sum into income and the annual payments are merely installments of the principal sum with interest only so much of the amount of installments as representing the interest payable would be income chargeable to tax, the balance being capital receipt; and
- (iv) if the property is sold for a consideration which is share of the profits or gross receipt of a business, the receipt of the share of profits would be the sale price but still chargeable to tax as income provided that the true bargain was to secure an income and not a fixed capital sum. However, if the circumstances of the case show that the receipts were only installments of a capital nature, though fluctuating in amount and measurable with reference to profits, they would not be taxable.

(7) A receipt in substitution of a source of income is capital receipt not chargeable to tax. Thus compensation received for restraint of trade or profession is a capital receipt. Where an assessee receives compensation of termination of the agency business being the only source

of income the receipt is a capital nature but taxable under section 28(ii). But where the assessee has a number of agencies and one of them is terminated and compensation received therefore, the receipt would be of a revenue nature since taking agencies and exploiting the same for earning income is the ordinary course of business and the loss of one agency would be made good by taking another. Compensation received from the employer for premature termination of the service contract is a revenue receipt taxable under section 15. In case where the compensation received is partly of a capital and partly of a revenue nature, the two will have to be segregated and treated accordingly for tax purposes.

Awards in the case of a sportsman, who is not a professional, will not be liable to tax in his hands as it would not be in the nature of income.

A lump sum payment made gratuitously (i.e. gratuity, leave encashment) or by way of compensation or otherwise to the widow or other legal heirs of an employee, who dies while still in active service, is not taxable as income under the Act.

(8) A lumpsum paid in commutation of salaries, pension, royalties or other periodic payments would be income taxable under the respective heads. Amount received under a policy of insurance would be a capital or revenue receipt depending upon the fact whether the policy was held by the assessee as a capital asset or as a trading asset. Likewise, subsidies or grants received from the Government would be generally of a revenue nature since they would be to supplement the income from business. But where a grant is received for specific purpose but not as a supplementary trading receipt (e.g., to enable the company to relieve unemployment or promote family planning) the receipt would be of a capital nature not chargeable to tax. Premium or discount received by a debenture holder, being a capital receipt, would not be chargeable to tax

Mining royalties are revenue receipts taxable as income from other sources irrespective of the fact whether they are received in lump sum or by way of a fixed annual sum or a tonnage royalty or the minimum royalty. Similarly, royalties paid for use of whether paid in lump sum or in installments of fixed or varying amounts would be taxable as income whereas the payment received in lieu of total or partial assignment of patent under which the owner ceases to own the patent as a capital asset would constitute a capital receipt.

Premium on issue of shares or debentures, profit on forfeiture of shares and the fee charged on fresh issue of shares are capital receipts not chargeable to tax. The amount received by a shareholder on the winding up is a capital receipt (except where the receipt is a dividend under section 2(22)). But in case of a partnership, the amount receivable by an outgoing partner in respect of his share of the firm's profit whether, before or after its dissolution would be a revenue receipt chargeable to tax. Compensation received by a partner for relinquishing all his interests in the firm and amounts received in settlement of claim to an interest in the capital of a firm are capital receipts.

It is necessary to note that the capital or revenue nature of a receipt would have to be determined on the basis of the particular facts and circumstances of each case and the question whether a certain item is capital or revenue would be a mixed question of law and fact.

(9) Normally, gifts constitute capital receipts in the hands of the recipient. However, it is possible that gifts may partake the character of income under certain circumstances.

Example: (i) Gifts received by doctors from their patients is taxable under the head Profits and Gains from Business or Profession.

(ii) Any sum of money or value of property received without consideration or for inadequate consideration by an individual or a HUF from any person, other than a relative, is chargeable under the head "Income from Other Sources" *[For details, refer to Chapter 8 on "Income from Other Sources"]*.

(5) Dividend [Section 2(22)]

The term 'dividend' as used in the Act has a wider scope and meaning than under the general law. According to section 2(22), the following receipts are deemed to be dividend:

(a) **Distribution of accumulated profits, entailing the release of company's assets** - Any distribution of accumulated profits, whether capitalised or not, by a company to its shareholders is dividend if it entails the release of all or any part of its assets. For example, if accumulated profits are distributed in cash it is dividend in the hands of the shareholders. Where accumulated profits are distributed in kind, for example by delivery of shares etc. entailing the release of company's assets, the market value of such shares on the date of such distribution is deemed dividend in the hands of the shareholder.

(b) **Distribution of debentures, deposit certificates and bonus shares to preference shareholders** - Any distribution to its shareholders by a company of debenture stock or deposit certificate in any form, whether with or without interest, and any distribution of bonus shares to preference shareholders to the extent to which the company possesses accumulated profits, whether capitalised or not, will be deemed as dividend. The market value of such bonus shares is taxable in the hands of the preference shareholder. In the case of debentures, debenture stock etc., their value is to be taken at the market rate and if there is no market rate they should be valued according to accepted principles of valuation.

Note: Bonus shares given to equity shareholders are not treated as dividend.

(c) **Distribution on liquidation** - Any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not, is deemed to be dividend income.

Note: Any distribution made out of the profits of the company after the date of the liquidation cannot amount to dividend. It is a repayment towards capital.

Accumulated profits include all profits of the company up to the date of liquidation whether capitalised or not. But where liquidation is consequent to the compulsory acquisition of an undertaking by the Government or by any corporation owned or controlled by the Government, the accumulated profits do not include any profits of the company prior to the 3 successive previous years immediately preceding the previous year in which such acquisition took place subject to certain exceptions.

(d) **Distribution on reduction of capital** - Any distribution to its shareholders by a company on the reduction of its capital to the extent to which the company possessed accumulated

profits, whether capitalised or not, shall be deemed to be dividend.

Exception - The same exceptions as given in case (c) above shall also apply in this case.

(e) **Advance or loan by a closely held company to its shareholder** - Any payment by a company in which the public are not substantially interested of any sum by way of advance or loan to any shareholder who is the beneficial owner of 10% or more of the equity capital of the company will be deemed to be dividend to the extent of the accumulated profits. If the loan is not covered by the accumulated profits, it is not deemed to be dividend.

There are two exceptions to this rule:

- (i) If the loan is granted in the ordinary course of its business and lending of money is a substantial part of the company's business, the loan or advance to a shareholder is not deemed to be dividend.
- (ii) Where a loan had been treated as dividend and subsequently the company declares and distributes dividend to all its shareholders including the borrowing shareholder, and the dividend so paid is set off by the company against the previous borrowing, the adjusted amount will not be again be treated as a dividend.

Advance or loan by a closely held company to a specified concern - Any payment by a company in which the public are not substantially interested to any concern (i.e. HUF / Firm / AOP / BOI / Company) in which a shareholder, having the beneficial ownership of atleast 10% of the equity shares is a member or a partner and in which he has a substantial interest (i.e. atleast 20% share of the income of the concern). The dividend income shall be taxable in the hands of the concern. Also, any payments by such a closely held company on behalf of, or for the individual benefit of any such shareholder will also deemed to be dividend. However, in both cases the ceiling limit of dividend is the extent of accumulated profits.

Illustration : Suppose Mr. X is a shareholder in a Company A as well as Company B. He has 10% shareholding in Company A and 20% shareholding in Company B. The accumulated profits of Company A = ₹ 10 lakh. A loan of ₹ 12 lakh is given by Company A to Company B. This loan up to the extent of accumulated profits of ₹ 10 lakh is treated as dividend and is taxable in the hands of Company B.

Other exceptions

Apart from the exceptions cited above, the following also do not constitute "dividend" -

- (i) Any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 77A of the Companies Act, 1956³;
- (ii) any distribution of shares on demerger by the resulting companies to the shareholders of the demerged company (whether or not there is a reduction of capital in the demerged company).

Basis of charge of dividend: Any income by way of dividends, referred to under section 115-O, is excluded from the total income of the shareholder [Section 10(34)]. Under section 115-O,

³ Section 68 of the Companies Act, 2013

any dividend declared, distributed or paid by a domestic company, whether out of current or accumulated profits, shall be charged to additional income-tax at a flat rate of 15% in addition to normal income-tax chargeable on the income of the company. This is known as corporate dividend tax. Corporate dividend tax is not leviable on deemed dividend under section 2(22)(e). Hence, the same will be taxed in the hands of the shareholder.

Dividends received from a company, other than a domestic company, are still liable to tax in the hands of the shareholder. For example, dividend received from a foreign company is liable to tax in the hands of the shareholder.

Year of accrual of dividend : Section 8 provides that deemed dividend under section 2(22) declared by a company or distributed or paid by it shall be deemed to be the income of the previous year in which it is declared, distributed or paid, as the case may be. Any interim dividend shall be deemed to be the income of the previous year in which the amount is unconditionally made available to the member who is entitled to it.

(6) India [Section 2(25A)]

The term 'India' means –

- (i) the territory of India as per article 1 of the Constitution,
- (ii) its territorial waters, seabed and subsoil underlying such waters,
- (iii) continental shelf,
- (iv) exclusive economic zone or
- (v) any other specified maritime zone and the air space above its territory and territorial waters.

Specified maritime zone means the maritime zone as referred to in the Territorial Waters, Continental Shelf, Exclusive Economic Zone and other Maritime Zones Act, 1976.

(7) Infrastructure Capital Company [Section 2(26A)]

"Infrastructure capital company" means such company which makes investments by way of acquiring shares or providing long-term finance to -

- (1) any enterprise or undertaking wholly engaged -
 - (a) in the business referred to in section 80-IA(4) i.e. business of
 - (i) developing/operating and maintaining/developing, operating and maintaining any infrastructure facility fulfilling the specified conditions
 - (ii) providing telecom services, whether basic or cellular
 - (iii) developing, developing and operating or maintaining and operating an industrial park or special economic zone notified by the Central Government
 - (iv) generating, transmitting or distributing power or undertaking substantial renovation and modernization of the existing network of transmission or distribution lines.
 - (b) in the business referred to in section 80-IAB(1) i.e. any business of developing a SEZ.

- (2) an undertaking developing and building a housing project referred to in section 80-IB(10) i.e. approved before 31.3.2007 by a local authority and commences or commenced development and construction on or after 1.10.98 and completes or completed development and construction within the time specified.
- (3) a project for constructing a hotel of not less than three-star category as classified by the Central Government or
- (4) a project for constructing a hospital with at least 100 beds for patients.

(8) Infrastructure Capital Fund [Section 2(26B)]

Infrastructure capital fund means such fund operating under a trust deed registered under the provisions of the Registration Act, 1908 established to raise monies by the trustees for investment by way of acquiring shares or providing long-term finance to -

- (1) any enterprise or undertaking wholly engaged in the business referred to in section 80-IA(4) or section 80-IAB(1); or
- (2) an undertaking developing and building a housing project referred to in section 80-IB(10); or
- (3) a project for constructing a hotel of not less than three star category as classified by the Central Government; or
- (4) a project for constructing a hospital with at least 100 beds for patients.

(9) Manufacture [Section 2(29BA)]

'Manufacture', with its grammatical variations, shall mean a change in a non-living physical object or article or thing,—

- (a) resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use; or
- (b) bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure.

1.7 Other Basic Concepts

(1) Meaning of Assessment Year and Previous Year

(i) **Assessment year** - The term has been defined under section 2(9). This means a period of 12 months commencing on 1st April every year. the year in which tax is paid is called the assessment year while the year in respect of the income of which the tax is levied is called the previous year. *For example, for the assessment year 2014-15, the relevant previous year is 2013-14 (1.4.2013 to 31.3.2014).*

(ii) **Previous year [Section 3]** – It means the financial year immediately preceding the assessment year. The income earned during the previous year is taxed in the assessment year.

Business or profession newly set up during the financial year - In such a case, the previous year shall be the period beginning on the date of setting up of the business or profession and ending with 31st March of the said financial year.

If a source of income comes into existence in the said financial year, then the previous year

will commence from the date on which the source of income newly comes into existence and will end with 31st March of the financial year.

Illustration:

1. A is running a business from 1992 onwards. Determine the previous year for the assessment year 2014-15.

Ans. The previous year will be 1.4.2013 to 31.3.2014.

2. A chartered accountant sets up his profession on 1st July, 2013. Determine the previous year for the assessment year 2014-15.

Ans. The previous year will be from 1.7.2013 to 31.3.2014.

(2) Previous year for undisclosed sources of income

There are many occasions when the Assessing Officer detects cash credits, unexplained investments, unexplained expenditure etc, the source for which is not satisfactorily explained by the assessee to the Assessing Officer. The Act contains a series of provisions to provide for these contingencies:

(i) **Cash Credits [Section 68]:** Where any sum is found credited in the books of the assessee and the assessee offers no explanation about the nature and source or the explanation offered is not satisfactory in the opinion of the Assessing Officer, the sum so credited may be charged as income of the assessee of that previous year.

Further, any explanation offered by a closely held company in respect of any sum credited as share application money, share capital, share premium or such amount, by whatever name called, in the accounts of such company shall be deemed to be not satisfactory unless the person, being a resident, in whose name such credit is recorded in the books of such company also explains, to the satisfaction of the Assessing Officer, the source of sum so credited as share application money, share capital, etc. in his hands. Otherwise, the explanation offered by the assessee-company shall be deemed as not satisfactory, consequent to which the sum shall be treated as income of the company. However, this deeming provision would not apply if the person in whose name such sum is recorded in the books of the closely held company is a Venture Capital Fund (VCF) or a Venture Capital Company (VCC) registered with SEBI.

(ii) **Unexplained Investments [Section 69]:** Where in the financial year immediately preceding the assessment year, the assessee has made investments which are not recorded in the books of account and the assessee offers no explanation about the nature and the source of investments or the explanation offered is not satisfactory, the value of the investments are taxed as income of the assessee of such financial year.

(iii) **Unexplained money etc. [Section 69A]:** Where in any financial year the assessee is found to be the owner of any money, bullion, jewellery or other valuable article and the same is not recorded in the books of account and the assessee offers no explanation about the nature and source of acquisition of such money, bullion etc. or the explanation offered is not satisfactory, the money and the value of bullion etc. may be deemed to be the income of the assessee for such financial year. Ownership is important and mere possession is not enough.

(iv) **Amount of investments etc., not fully disclosed in the books of account [Section 69B]:** Where in any financial year the assessee has made investments or is found to be the owner of any bullion, jewellery or other valuable article and the Assessing Officer finds that the amount spent on making such investments or in acquiring such articles exceeds the amount recorded in the books of account maintained by the assessee and he offers no explanation for the difference or the explanation offered is unsatisfactory, such excess may be deemed to be the income of the assessee for such financial year.

For example, if the assessee is found to be the owner of say 300 gms of gold (market value of which is ₹ 25,000) during the financial year ending 31.3.2014 but he has recorded to have spent ₹ 15,000 in acquiring it, the Assessing Officer can add ₹ 10,000 (i.e. the difference of the market value of such gold and ₹ 15,000) as the income of the assessee, if the assessee offers no satisfactory explanation thereof.

(v) **Unexplained expenditure [Section 69C]:** Where in any financial year an assessee has incurred any expenditure and he offers no explanation about the source of such expenditure or the explanation is unsatisfactory the Assessing Officer can treat such unexplained expenditure as the income of the assessee for such financial year. Such unexplained expenditure which is deemed to be the income of the assessee shall not be allowed as deduction under any head of income.

(vi) **Amount borrowed or repaid on hundi [Section 69D]:** Where any amount is borrowed on a hundi or any amount due thereon is repaid other than through an account-payee cheque drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying for the previous year in which the amount was borrowed or repaid, as the case may be.

However, where any amount borrowed on a hundi has been deemed to be the income of any person, he will not be again liable to be assessed in respect of such amount on repayment of such amount. The amount repaid shall include interest paid on the amount borrowed.

Unexplained money, investments etc. to attract maximum marginal rate of tax @30% [Section 115BBE]

(i) In order to control laundering of unaccounted money by availing the benefit of basic exemption limit, the unexplained money, investment, expenditure, etc. deemed as income under section 68 or section 69 or section 69A or section 69B or section 69C or section 69D would be taxed at the maximum marginal rate of 30% (plus surcharge and cesses).

(ii) No basic exemption or allowance or expenditure shall be allowed to the assessee under any provision of the Income-tax Act, 1961 in computing such deemed income.

(3) Certain cases when income of a previous year will be assessed in the previous year itself

The income of an assessee for a previous year is charged to income-tax in the assessment year following the previous year. However, in a few cases, this rule does not apply and the income is taxed in the previous year in which it is earned. These exceptions have been made to protect the interests of revenue. The exceptions are as follows:

(i) **Shipping business of non-resident [Section 172]** - Where a ship, belonging to or chartered by a non-resident, carries passengers, livestock, mail or goods shipped at a port in India, the ship is allowed to leave the port only when the tax has been paid or satisfactory arrangement has been made for payment thereof. 7.5% of the freight paid or payable to the owner or the charterer or to any person on his behalf, whether in India or outside India on account of such carriage is deemed to be his income which is charged to tax in the same year in which it is earned.

(ii) **Persons leaving India [Section 174]** - Where it appears to the Assessing Officer that any individual may leave India during the current assessment year or shortly after its expiry and he has no present intention of returning to India, the total income of such individual for the period from the expiry of the respective previous year up to the probable date of his departure from India is chargeable to tax in that assessment year.

Example: Suppose Mr. X is leaving India for USA on 10.6.2014 and it appears to the Assessing Officer that he has no intention to return. Before leaving India, Mr. X will be required to pay income tax on the income earned during the P.Y. 2013-14 as well as the total income earned during the period 1.4.2014 to 10.06.2014.

(iii) **AOP / BOI / Artificial Juridical Person formed for a particular event or purpose [Section 174A]** - If an AOP/BOI etc. is formed or established for a particular event or purpose and the Assessing Officer apprehends that the AOP/BOI is likely to be dissolved in the same year or in the next year, he can make assessment of the income up to the date of dissolution as income of the relevant assessment year.

(iv) **Persons likely to transfer property to avoid tax [Section 175]** - During the current assessment year, if it appears to the Assessing Officer that a person is likely to charge, sell, transfer, dispose of or otherwise part with any of his assets to avoid payment of any liability under this Act, the total income of such person for the period from the expiry of the previous year to the date, when the Assessing Officer commences proceedings under this section is chargeable to tax in that assessment year.

(v) **Discontinued business [Section 176]** - Where any business or profession is discontinued in any assessment year, the income of the period from the expiry of the previous year up to the date of such discontinuance may, at the discretion of the Assessing Officer, be charged to tax in that assessment year.

Residence and Scope of Total Income

2.1 Residential Status [Section 6]

The incidence of tax on any assessee depends upon his residential status under the Act. Therefore, after determining whether a particular amount is capital or revenue in nature, if the receipt is of a revenue nature and chargeable to tax, it has to be seen whether the assessee is liable to tax in respect of that income. The taxability of a particular receipt would thus depend upon not only the nature of the income and the place of its accrual or receipt but also upon the assessee's residential status.

For all purposes of income-tax, taxpayers are classified into three broad categories on the basis of their residential status. viz

- (1) Resident and ordinarily resident
- (2) Resident but not ordinarily resident
- (3) Non-resident

The residential status of an assessee must be ascertained with reference to each previous year. A person who is resident and ordinarily resident in one year may become non-resident or resident but not ordinarily resident in another year or *vice versa*. The provisions for determining the residential status of assessee are:

- (1) **Residential status of Individuals:** Under section 6(1), an individual is said to be resident in India in any previous year, if he satisfies any one of the following conditions:
 - (i) He has been in India during the previous year for a total period of 182 days or more, or
 - (ii) He has been in India during the 4 years immediately preceding the previous year for a total period of 365 days or more and has been in India for at least 60 days in the previous year.

If the individual satisfies any one of the conditions mentioned above, he is a resident. If both the above conditions are not satisfied, the individual is a non-resident.

Note:

- (a) The term "stay in India" includes stay in the territorial waters of India (i.e. 12 nautical miles into the sea from the Indian coastline). Even the stay in a ship or boat moored in the territorial waters of India would be sufficient to make the individual resident in India.
- (b) It is not necessary that the period of stay must be continuous or active nor is it essential

that the stay should be at the usual place of residence, business or employment of the individual.

- (c) For the purpose of counting the number of days stayed in India, both the date of departure as well as the date of arrival are considered to be in India.
- (d) The residence of an individual for income-tax purpose has nothing to do with citizenship, place of birth or domicile. An individual can, therefore, be resident in more countries than one even though he can have only one domicile.

Exceptions:

The following categories of individuals will be treated as residents only if the period of their stay during the relevant previous year amounts to 182 days. In other words even if such persons were in India for 365 days during the 4 preceding years and 60 days in the relevant previous year, they will not be treated as resident.

- (1) Indian citizens, who leave India in any previous year as a member of the crew of an Indian ship or for purposes of employment outside India, or
- (2) Indian citizen or person of Indian origin* engaged outside India in an employment or a business or profession or in any other vocation, who comes on a visit to India in any previous year

* A person is said to be of Indian origin if he or either of his parents or either of his grandparents were born in undivided India.

Not-ordinarily resident - Only individuals and HUF can be resident but not ordinarily resident in India. All other classes of assesseees can be either a resident or non-resident. A not-ordinarily resident person is one who satisfies any one of the conditions specified under section 6(6).

- (i) If such individual has been non-resident in India in any 9 out of the 10 previous years preceding the relevant previous year, or
- (ii) If such individual has during the 7 previous years preceding the relevant previous year been in India for a period of 729 days or less.

Note: In simpler terms, an individual is said to be a resident and ordinarily resident if he satisfies both the following conditions:

- (i) He is a resident in any 2 out of the last 10 years preceding the relevant previous year, and
- (iii) His total stay in India in the last 7 years preceding the relevant previous year is 730 days or more.

If the individual satisfies both the conditions mentioned above, he is a resident and ordinarily resident but if only one or none of the conditions are satisfied, the individual is a resident but not ordinarily resident.

Illustration 1

Steve Waugh, the Australian cricketer comes to India for 100 days every year. Find out his residential status for the A.Y. 2014-15.

Solution

For the purpose of his residential status in India for A.Y. 2014-15, the relevant previous year is 2013-14.

Step 1: The total stay of Steve Waugh in the last 4 years preceding the previous year is 400 days (i.e. 100×4) and his stay in the previous year is 100 days. Therefore, since he has satisfied the second condition in section 6(1), he is a resident.

Step 2: Since his total stay in India in the last 7 years preceding the previous year is 700 days (i.e. 100×7), he does not satisfy the minimum requirement of 730 days in 7 years. Any one of the conditions not being satisfied, the individual is resident but not ordinarily resident.

Therefore, the residential status of Steve Waugh for the assessment year 2014-15 is resident but not ordinarily resident.

Illustration 2

Mr. B, a Canadian citizen, comes to India for the first time during the P.Y. 2009-10. During the financial years 2009-10, 2010-11, 2011-12, 2012-13 and 2013-14, he was in India for 55 days, 60 days, 90 days, 150 days and 70 days, respectively. Determine his residential status for the A.Y. 2014-15.

Solution

During the previous year 2013-14, Mr. B was in India for 70 days and during the 4 years preceding the previous year 2013-14, he was in India for 355 days (i.e. $55 + 60 + 90 + 150$ days).

Thus, he does not satisfy section 6(1). Therefore, he is a non-resident for the previous year 2013-14.

Illustration 3

Mr. C, a Japanese citizen left India after a stay of 10 years on 1.06.2011. During the financial year 2012-13, he comes to India for 46 days. Later, he returns to India for 1 year on 10.10.2013. Determine his residential status for the A.Y. 2014-15.

Solution

During the previous year 2013-14, Mr. C was in India for 173 days (i.e. $22 + 30 + 31 + 31 + 28 + 31$ days). His stay in the last 4 years is:

2012-13	-	46	
2011-12	-	62	(i.e. $30 + 31 + 1$)
2010-11	-	365	(since he left India on 1.6.2011 after 10 years)
2009-10	-	<u>365</u>	(since he left India on 1.6.2011 after 10 years)
		<u>838</u>	

Mr. C is a resident since his stay in the previous year 2013-14 is 173 days and in the last 4 years is more than 365 days.

For the purpose of being ordinarily resident, it is evident from the above calculations, that

- (i) his stay in the last 7 years is more than 730 days and
- (ii) since he was in India for 10 years prior to 1.6.2011, he was a resident in at least 2 out of the last 10 years preceding the relevant previous year.

Therefore, Mr.C is a resident and ordinarily resident for the A.Y.2014-15.

Illustration 4

Mr. D, an Indian citizen, leaves India on 22.9.2013 for the first time, to work as an officer of a company in France. Determine his residential status for the A.Y. 2014-15.

Solution

During the previous year 2013-14, Mr. D, an Indian citizen, was in India for 175 days (i.e. 30+31+30+31+31+22 days). He does not satisfy the minimum criteria of 182 days. Also, since he is an Indian citizen leaving India for the purposes of employment, the second condition under section 6(1) is not applicable to him.

Therefore, Mr. D is a non-resident for the A.Y.2014-15.

(2) **Residential status of HUF:** A HUF would be resident in India if the control and management of its affairs is situated wholly or partly in India. If the control and management of the affairs is situated wholly outside India it would become a non-resident.

The expression 'control and management' referred to under section 6 refers to the central control and management and not to the carrying on of day-to-day business by servants, employees or agents. The business may be done from outside India and yet its control and management may be wholly within India. Therefore, control and management of a business is said to be situated at a place where the head and brain of the adventure is situated. The place of control may be different from the usual place of running the business and sometimes even the registered office of the assessee. This is because the control and management of a business need not necessarily be done from the place of business or from the registered office of the assessee. But control and management do imply the functioning of the controlling and directing power at a particular place with some degree of permanence.

If the HUF is resident, then the status of the Karta determines whether it is resident and ordinarily resident or resident but not ordinarily resident. If the karta is resident and ordinarily resident, then the HUF is resident and ordinarily resident and if the karta is resident but not ordinarily resident, then HUF is resident but not ordinarily resident.

Illustration 5

The business of a HUF is transacted from Australia and all the policy decisions are taken there. Mr. E, the karta of the HUF, who was born in Kolkata, visits India during the P.Y.2013-14 after 15 years. He comes to India on 1.4.2013 and leaves for Australia on 1.12.2013. Determine the residential status of Mr.E and the HUF for A.Y. 2014-15.

Solution

- (a) During the P.Y.2013-14, Mr. E has stayed in India for 245 days (i.e. 30+31+30+31+31+30+31+30+1 days). Therefore, he is a resident. However, since he has come to India after 15 years, he cannot satisfy any of the conditions for being ordinarily resident.

Therefore, the residential status of Mr. E for the P.Y.2013-14 is resident but not ordinarily resident.

- (b) Since the business of the HUF is transacted from Australia and nothing is mentioned regarding its control and management, it is assumed that the control and management is also wholly outside India. Therefore, the HUF is a non-resident for the P.Y.2013-14.

(3) **Residential status of firms and association of persons:** A firm and an AOP would be resident in India if the control and management of its affairs is situated wholly or partly in India. Where the control and management of the affairs is situated wholly outside India, the firm would become a non-resident.

(4) **Residential status of companies:** A company is said to be resident in India if -

- (i) it is an Indian company as defined under section 2(26), or
- (ii) its control and management is situated wholly in India during the accounting year.

Thus, every Indian company is resident in India irrespective of the fact whether the control and management of its affairs is exercised from India or outside. But a company, other than an Indian company, would become resident in India only if the entire control and management of its affairs is in India.

The control and management of the affairs of company are said to be exercised from the place where the director's meetings (not shareholders' meetings) are held, decisions taken and directions issued.

(5) **Residential status of local authorities and artificial juridical persons:** Local authorities and artificial juridical persons would be resident in India if the control and management of its affairs is situated wholly or partly in India. Where the control and management of the affairs is situated wholly outside India, they would become non-residents.

Note: In simpler terms, an individual is said to be a resident and ordinarily resident if he satisfies both the following conditions:

- (i) He is a resident in any 2 out of the last 10 years preceding the relevant previous year, and
- (iv) His total stay in India in the last 7 years preceding the relevant previous year is 730 days or more.

If the individual satisfies both the conditions mentioned above, he is a resident and ordinarily resident but if only one or none of the conditions are satisfied, the individual is a resident but not ordinarily resident.

2.2 Scope of Total Income

Section 5 provides the scope of total income in terms of the residential status of the assessee because the incidence of tax on any person depends upon his residential status. The scope of total income of an assessee depends upon the following three important considerations:

- (i) the residential status of the assessee (as discussed earlier);
- (ii) the place of accrual or receipt of income, whether actual or deemed; and
- (iii) the point of time at which the income had accrued to or was received by or on behalf of the assessee.

The ambit of total income of the three classes of assessee would be as follows:

(1) Resident and ordinarily resident - The total income of a resident assessee would, under section 5(1), consist of:

- (i) income received or deemed to be received in India during the previous year;
- (ii) income which accrues or arises or is deemed to accrue or arise in India during the previous year; and
- (iii) income which accrues or arises outside India even if it is not received or brought into India during the previous year.

In simpler terms, a resident and ordinarily resident has to pay tax on the total income accrued or deemed to accrue, received or deemed to be received in or outside India.

(2) Resident but not ordinarily resident – Under section 5(1), the computation of total income of resident but not ordinarily resident is the same as in the case of resident and ordinarily resident stated above except for the fact that the income accruing or arising to him outside India is not to be included in his total income. However, where such income is derived from a business controlled from or profession set up in India, then it must be included in his total income even though it accrues or arises outside India.

(3) Non-resident - A non-resident's total income under section 5(2) includes:

- (i) income received or deemed to be received in India in the previous year; and
- (ii) income which accrues or arises or is deemed to accrue or arise in India during the previous year.

Note: All assessee, whether resident or not, are chargeable to tax in respect of their income accrued, arisen, received or deemed to accrue, arise or to be received in India whereas residents alone are chargeable to tax in respect of income which accrues or arises outside India.

Resident And Ordinarily Resident	Resident But Not Ordinarily Resident	Non-Resident
Income received/ deemed to be received/ accrued or arisen/deemed to accrue or arise in or outside India.	Income which is received/deemed to be received/accrued or arisen/deemed to accrue or arise in India. and Income which accrues or arises outside India being derived from a business controlled from or profession set up in India.	Income received/ deemed to be received/ accrued or arisen/deemed to accrue or arise in India.

2.3 Deemed receipt and accrual of income in India

The taxability of a certain item as income would depend upon the method of accounting followed by the assessee. This is because under the cash system of accounting an income would be taxable only when it is received by the assessee himself or on his behalf. But under the mercantile system it would be taxable once the assessee gets the legal right to claim the amount. However, it has been specifically provided that in the case of income from salaries, the liability to tax arises immediately when the income is due to the assessee irrespective of the method of accounting followed. Likewise, in the case of dividends, the income would be included in total income of the shareholder under section 8 in the year in which the final dividend is declared and, in the case of interim dividend, in the year in which they are made unconditionally available to the shareholders.

2.4 Meaning of “Income received or deemed to be received”

All assesseees are liable to tax in respect of the income received or deemed to be received by them in India during the previous year irrespective of -

- (i) their residential status, and
- (ii) the place of its accrual.

Income is to be included in the total income of the assessee immediately on its actual or deemed receipt. The receipt of income refers to only the first occasion when the recipient gets the money under his control. Therefore, when once an amount is received as income, remittance or transmission of that amount from one place or person to another does not constitute receipt of income in the hands of the subsequent recipient or at the place of subsequent receipt.

Income deemed to be received – Under section 7, the following shall be deemed to be received by the assessee during the previous year irrespective of whether he had actually received the same or not -

- (i) The annual accretion in the previous year to the balance to the credit of an employee participating in a recognised provident fund (RPF). Thus, the contribution of the employer in excess of 12% of salary or interest credited in excess of 9.5% p.a. is deemed to be received by the assessee.
- (ii) The taxable transferred balance from unrecognized to recognized provident fund (being the employer's contribution and interest thereon).
- (iii) The contribution made by the Central Government or any other employer in the previous year to the account of an employee under a pension scheme referred to under section 80CCD.

2.5 Meaning of income ‘accruing’ and ‘arising’

Accrue refers to the right to receive income, whereas due refers to the right to enforce payment of the same. For e.g. salary for work done in December will accrue throughout the month, day to day, but will become due on the salary bill being passed on 31st December or 1st January. Similarly, on Government securities, interest payable on specified dates arise

during the period of holding, day to day, but will become due for payment on the specified dates. Example: Interest on Government securities is usually payable on specified dates, say on 1st January and 1st July. In all such cases, the interest would be said to accrue from 1st July to 31st December and on 1st January, it will fall due for payment.

It must be noted that income which has been taxed on accrual basis cannot be assessed again on receipt basis, as it will amount to double taxation. For example, when a loan to a director has already been treated as dividend under section 2(22)(e) and later dividend is declared, distributed and adjusted against the loan, the same cannot be treated as dividend income again.

With a view to removing difficulties and clarifying doubts in the taxation of income, *Explanation 1* to Section 5 specifically provides that an item of income accruing or arising outside India shall not be deemed to be received in India merely because it is taken into account in a balance sheet prepared in India.

Further, *Explanation 2* to Section 5 makes it clear that once an item of income is included in the assessee's total income and subjected to tax on the ground of its accrual/deemed accrual or receipt, it cannot again be included in the person's total income and subjected to tax either in the same or in a subsequent year on the ground of its receipt - whether actual or deemed.

2.6 Income deemed to accrue or arise in India [Section 9]

Certain types of income are deemed to accrue or arise in India even though they may actually accrue or arise outside India. The categories of income which are deemed to accrue or arise in India are:

- (i) Any income accruing or arising to an assessee in any place outside India whether directly or indirectly (a) through or from any business connection in India, (b) through or from any property in India, (c) through or from any asset or source of income in India or (d) through the transfer of a capital asset situated in India.

The legislative intent of this clause is to cover incomes, which are accruing or arising, directly or indirectly from a source in India. The section codifies the source rule of taxation, which signifies that where a corporate structure is created to route funds, the actual gain or income arises only in consequence of the investment made in the activity to which such gains are attributable and not the mode through which such gains are realized. This principle which supports the source country's right to tax the gains derived from offshore transactions where the value is attributable to the underlying assets, is recognized internationally by several countries.

Accordingly, *Explanation 4* clarifies that the expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of".

Further, *Explanation 5* clarifies that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.

- (ii) Income, which falls under the head "Salaries", if it is earned in India. Any income under the head "Salaries" payable for rest period or leave period which is preceded and succeeded by services rendered in India, and forms part of the service contract of employment, shall be regarded as income earned in India.
- (iii) Income from 'Salaries' which is payable by the Government to a citizen of India for services rendered outside India (However, allowances and perquisites paid outside India by the Government is exempt).
- (iv) Dividend paid by a Indian company outside India.
- (v) Interest (discussed in para 5 below)
- (vi) Royalty (discussed in para 6 below)
- (vii) Fees for technical services (discussed in para 7 below)
- (1) (a) **Income from business connection:** The expression "business connection" has been explained in *Explanation 2* to section 9(1)(i).
 - (i) 'Business connection' shall include any business activity carried out through a person acting on behalf of the non-resident.
 - (ii) He must have an authority which is habitually exercised to conclude contracts on behalf of the non-resident. However, if his activities are limited to the purchase of goods or merchandise for the non-resident, this provision will not apply.
 - (iii) Where he has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident, a business connection is established.
 - (iv) Business connection is also established where he habitually secures orders in India, mainly or wholly for the non-resident. Further, there may be situations when other non-residents control the above-mentioned non-resident. Secondly, this non-resident may also control other non-residents. Thirdly, all other non-residents may be subject to the same common control, as that of the non-resident. In all the three situations, business connection is established, where a person habitually secures orders in India, mainly or wholly for such non-residents.

Exception:

"Business connection", however, shall not be held to be established in cases where the non-resident carries on business through a broker, general commission agent or any other agent of an independent status, if such a person is acting in the ordinary course of his business.

A broker, general commission agent or any other agent shall be deemed to have an independent status where he does not work mainly or wholly for the non-resident. He will however, not be considered to have an independent status in the three situations explained in (iv) above, where he is employed by such a non-resident.

Where a business is carried on in India through a person referred to in (ii), (iii) or (iv)

mentioned above, only so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India.

(1) (b) &(c) Income from property, asset or source of income

Any income which arises from any property (movable, immovable, tangible and intangible property) would be deemed to accrue or arise in India eg. hire charges or rent paid outside India for the use of the machinery or buildings situated in India, deposits with an Indian company for which interest is received outside India etc.

(1)(d) Income through the transfer of a capital asset situated in India

Capital gains arising from the transfer of a capital asset situated in India would be deemed to accrue or arise in India in all cases irrespective of the fact whether (i) the capital asset is movable or immovable, tangible or intangible; (ii) the place of registration of the document of transfer etc., is in India or outside; and (iii) the place of payment of the consideration for the transfer is within India or outside.

Explanation 1 to section 9(1)(i) lists out income which shall not be deemed to accrue or arise in India. They are given below:

- (i) In the case of a business, in respect of which all the operations are not carried out in India [Explanation 1(a) to section 9(1)(i)] :In the case of a business of which all the operations are not carried out in India, the income of the business deemed to accrue or arise in India shall be only such part of income as is reasonably attributable to the operations carried out in India. Therefore, it follows that such part of income which cannot be reasonably attributed to the operations in India, is not deemed to accrue or arise in India.
- (ii) Purchase of goods in India for export [Explanation 1(b) to section 9(1)(i)]: In the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export.
- (iii) Collection of news and views in India for transmission out of India [Explanation 1(c) to section 9(1)(i)]: In the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India for transmission out of India.
- (iv) Shooting of cinematograph films in India [Explanation 1(d) to section 9(1)(i)]: In the case of a non-resident, no income shall be deemed to accrue or arise in India through or from operations which are confined to the shooting of any cinematograph film in India, if such non-resident is :
 - (i) an individual, who is not a citizen of India or
 - (ii) a firm which does not have any partner who is a citizen of India or who is resident in India ; or

- (iii) a company which does not have any shareholder who is a citizen of India or who is resident in India.

(2) & (3) **Income from salaries:** Under section 9(1)(ii) income which falls under the head 'salaries', would be deemed to accrue or arise in India, if it is in respect of services rendered in India.

Exception under section 9(2): Pension payable outside India by the Government to its officials and judges who permanently reside outside India shall not be deemed to accrue or arise in India. It may however, be noted here that the salary of an employee in the United Nations Organisation (UNO) or in its constituent bodies is exempt under United Nations (Privilege and Immunity) Act.

(4) **Income from dividends:** All dividends paid by an Indian company must be deemed to accrue or arise in India. Under section 10(34), income from dividends referred to in section 115-O are exempt from tax in the hands of the shareholder. It may be noted that dividend distribution tax under section 115-O does not apply to deemed dividend under section 2(22)(e), which is chargeable in the previous year in which such dividend is distributed or paid.

(5) **Interest:** Under section 9(1)(v), an interest is deemed to accrue or arise in India if it is payable by -

- (i) the Central Government or any State Government.
- (ii) a person resident in India (except where it is payable in respect of any money borrowed and used for the purposes of a business or profession carried on by him outside India or for the purposes of making or earning any income from any source outside India)
- (iii) a non-resident when it is payable in respect of any debt incurred or moneys borrowed and used for the purpose of a business or profession carried on in India by him. Interest on money borrowed by the non-resident for any purpose other than a business or profession, will not be deemed to accrue or arise in India. Thus, if a non-resident 'A' borrows money from a non-resident 'B' and invests the same in shares of an Indian company, interest payable by 'A' to 'B' will not be deemed to accrue or arise in India.

(6) **Royalty:** Royalty will be deemed to accrue or arise in India when it is payable by -

- (i) the Government; or
- (ii) a person who is a resident in India except in cases where it is payable for the transfer of any right or the use of any property or information or for the utilization of services for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India; or
- (iii) a non-resident only when the royalty is payable in respect of any right, property or information used or services utilised for purposes of a business or profession carried on in India or for the purposes of making or earning any income from any source in India.

Lumpsum royalty payments made by a resident for the transfer of all or any rights (including the granting of a licence) in respect of computer software supplied by a non-resident manufacturer along with computer hardware under any scheme approved by the Government

under the Policy on Computer Software Export, Software Development and Training, 1986 shall not be deemed to accrue or arise in India.

“Computer software” means any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customised electronic data.

The term ‘royalty’ means consideration (including any lumpsum consideration but excluding any consideration which would be the income of the recipient chargeable under the head ‘Capital gains’) for:

- (i) the transfer of all or any rights (including the granting of licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;
- (ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property;
- (iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property;
- (iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;
- (v) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB;
- (vi) the transfer of all or any rights (including the granting of licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films;
- (vii) the rendering of any service in connection with the activities listed above.

The definition of ‘royalty’ for this purpose is wide enough to cover both industrial royalties as well as copyright royalties. The deduction specially excludes income which should be chargeable to tax under the head ‘capital gains’.

Consideration for use or right to use of computer software is royalty within the meaning of section 9(1)(vi)

As per section 9(1)(vi), any income payable by way of royalty in respect of any right, property or information is deemed to accrue or arise in India. The term “royalty” means consideration for transfer of all or any right in respect of certain rights, property or information. There have been conflicting court rulings on the interpretation of the definition of royalty, on account of which there was a need to resolve the following issues –

- (i) Does consideration for use of computer software constitute royalty?
- (ii) Is it necessary that the right, property or information has to be used directly by the payer?
- (iii) Is it necessary that the right, property or information has to be located in India or control or possession of it has to be with the payer?

(iv) What is the meaning of the term “process”?

In order to resolve the above issues arising on account of conflicting judicial decisions and to clarify the true legislative intent, Explanations 4, 5 & 6 have been inserted with retrospective effect from 1st June, 1976.

Explanation 4 clarifies that the consideration for use or right to use of computer software is royalty by clarifying that, transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

Consequently, the provisions of tax deduction at source under section 194J and section 195 would be attracted in respect of consideration for use or right to use computer software since the same falls within the definition of royalty.

Note - The Central Government has, vide Notification No.21/2012 dated 13.6.2012 to be effective from 1st July, 2012, exempted certain software payments from the applicability of tax deduction under section 194J. Accordingly, where payment is made by the transferee for acquisition of software from a resident-transferor, the provisions of section 194J would not be attracted if -

- (1) the software is acquired in a subsequent transfer without any modification by the transferor;
- (2) tax has been deducted either under section 194J or under section 195 on payment for any previous transfer of such software; and
- (3) the transferee obtains a declaration from the transferor that tax has been so deducted along with the PAN of the transferor.

Explanation 5 clarifies that royalty includes and has always included consideration in respect of any right, property or information, whether or not,

- (a) the possession or control of such right, property or information is with the payer;
- (b) such right, property or information is used directly by the payer;
- (c) the location of such right, property or information is in India.

Explanation 6 clarifies that the term “process” includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret.

(7) **Fees for technical services:** Any fees for technical services will be deemed to accrue or arise in India if they are payable by -

- (i) the Government.
- (ii) a person who is resident in India, except in cases where the fees are payable in respect of technical services utilised in a business or profession carried on by such person outside India or for the purpose of making or earning any income from any source outside India.

- (iii) a person who is a non-resident, only where the fees are payable in respect of services utilised in a business or profession carried on by the non-resident in India or where such services are utilised for the purpose of making or earning any income from any source in India.

Fees for technical services means any consideration (including any lumpsum consideration) for the rendering of any managerial, technical or consultancy services (including providing the services of technical or other personnel). However, it does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head 'Salaries'.

Income deemed to accrue or arise in India to a non-resident by way of interest, royalty and fee for technical services to be taxed irrespective of territorial nexus (*Explanation* to section 9)

Income by way of interest, royalty or fee for technical services which is deemed to accrue or arise in India by virtue of clauses (v), (vi) and (vii) of section 9(1), shall be included in the total income of the non-resident, whether or not –

- (i) the non-resident has a residence or place of business or business connection in India; or
- (ii) the non-resident has rendered services in India.

In effect, the income by way of fee for technical services, interest or royalty, from services utilized in India would be deemed to accrue or arise in India in case of a non-resident and be included in his total income, whether or not such services were rendered in India.

Illustration 6

Determine the taxability of the following incomes in the hands of a resident and ordinarily resident, resident but not ordinarily resident, and non-resident for the A.Y. 2014-15 -

Particulars	Amount (₹)
Interest on UK Development Bonds, 50% of interest received in India	10,000
Income from a business in Chennai (50% is received in India)	20,000
Profits on sale of shares of an Indian company received in London	20,000
Dividend from British company received in London	5,000
Profits on sale of plant at Germany 50% of profits are received in India	40,000
Income earned from business in Germany which is controlled from Delhi (₹ 40,000 is received in India)	70,000
Profits from a business in Delhi but managed entirely from London	15,000
Rent from property in London deposited in a Indian Bank at London, brought to India	50,000
Interest on debentures in an Indian company received in London.	12,000
Fees for technical services rendered in India but received in London	8,000
Profits from a business in Bombay managed from London	26,000
Pension for services rendered in India but received in Burma	4,000

2.15 Income Tax

<i>Income from property situated in Pakistan received there</i>	16,000
<i>Past foreign untaxed income brought to India during the previous year</i>	5,000
<i>Income from agricultural land in Nepal received there and then brought to India</i>	18,000
<i>Income from profession in Kenya which was set up in India, received there but spent in India</i>	5,000
<i>Gift received on the occasion of his wedding</i>	20,000
<i>Interest on savings bank deposit in State Bank of India</i>	12,000
<i>Income from a business in Russia, controlled from Russia</i>	20,000
<i>Dividend from Reliance Petroleum Limited, an Indian Company</i>	5,000
<i>Agricultural income from a land in Rajasthan</i>	15,000

Solution:

Computation of total income for the A.Y.2014-15

Particulars	Resident and ordinarily resident ₹	Resident but not ordinarily resident ₹	Non-resident ₹
Interest on UK Development Bonds, 50% of interest received in India	10,000	5,000	5,000
Income from a business in Chennai (50% is received in India)	20,000	20,000	20,000
Profits on sale of shares of an Indian company received in London (assuming that they are in the nature of short-term capital gains)	20,000	20,000	20,000
Dividend from British company received in London	5,000	-	-
Profits on sale of plant at Germany, 50% of profits are received in India	40,000	20,000	20,000
Income earned from business in Germany which is controlled from Delhi, out of which ₹ 40,000 is received in India	70,000	70,000	40,000
Profits from a business in Delhi but managed entirely from London	15,000	15,000	15,000
Rent from property in London deposited in a Bank at London, later on remitted to India	50,000	-	-
Interest on debentures in an Indian company received in London.	12,000	12,000	12,000
Fees for technical services rendered in India but received in London	8,000	8,000	8,000
Profits from a business in Bombay managed from London	26,000	26,000	26,000

Pension for services rendered in India but received in Burma	4,000	4,000	4,000
Income from property situated in Pakistan received there	16,000	-	-
Past foreign untaxed income brought to India during the previous year	-	-	-
Income from agricultural land in Nepal received there and then brought to India	18,000	-	-
Income from profession in Kenya which was set up in India, received there but spent in India	5,000	5,000	-
Gift received on the occasion of his wedding [not an income]	-	-	-
Interest on savings bank deposit in State Bank of India	12,000	12,000	12,000
Income from a business in Russia, controlled from Russia	20,000	-	-
Dividend from Reliance Petroleum Limited, an Indian Company [Exempt under section 10(34)]	-	-	-
Agricultural income from a land in Rajasthan [Exempt under section 10(1)]	-	-	-
Gross Total Income	3,51,000	2,17,000	1,82,000
Less: Deduction under section 80TTA [Interest on savings bank account subject to a maximum of ₹ 10,000]	10,000	10,000	10,000
Total Income	3,41,000	2,07,000	1,72,000

Incomes Which Do Not Form Part of Total Income

3.1 Introduction

In this chapter, we are going to study section 10 which enumerates the various categories of income that are exempt from tax. Thereafter, we shall consider section 11, which provides exemption in respect of income derived from property held under trust wholly for charitable or religious purposes. Section 13A exempts certain categories of income derived by a political party and section 13B exempts voluntary contributions received by electoral trusts.

3.2 Incomes not included in Total Income [Section 10]

The various items of income referred to in the different clauses of section 10 are excluded from the total income of an assessee. These incomes are known as exempted incomes. Consequently, such income shall not enter into the computation of taxable income or the rate of tax.

Restrictions on allowability of expenditure [Section 14A] – (i) As per section 14A, expenditure incurred in relation to any exempt income is not allowed as a deduction while computing income under any of the five heads of income [Sub-section (1)].

However, the Assessing Officer is not empowered to reassess under section 147 or to pass an order increasing the liability of the assessee by way of enhancing the assessment or reducing a refund already made or otherwise increase the liability of the assessee under section 154, for any assessment year beginning on or before 1.4.2001 i.e. for any assessment year prior to A.Y. 2002-03 [Proviso to sub-section (1)].

The Assessing Officer is empowered to determine the amount of expenditure incurred in relation to such income which does not form part of total income in accordance with such method as may be prescribed [Sub-section (2)].

The method for determining expenditure in relation to exempt income is to be prescribed by the CBDT for the purpose of disallowance of such expenditure under section 14A. Such method should be adopted by the Assessing Officer if he is not satisfied with the correctness of the claim of the assessee, having regard to the accounts of the assessee.

Further, the Assessing Officer is empowered to adopt such method, where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of total income [Sub-section (3)].

Rule 8D lays down the method for determining the amount of expenditure in relation to income not includible in total income.

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

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

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

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

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

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

Where,

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

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

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

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

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

Difference between Section 10 and Chapter VI-A deductions - Certain other incomes are also wholly or partly rendered tax-free by being allowed as deductions in computation of total income under Chapter VI-A. Students should note a very important difference between exemptions under section 10 and the deductions under Chapter VI-A. While the incomes which are exempt under section 10 will not be included for computing total income, incomes from which deductions are

3.3 Income Tax

allowable under Chapter VI-A will first be included in the gross total income (GTI) and then the deductions will be allowed. Let us now see the various incomes that are exempt from tax and the conditions to be satisfied in order to be eligible for exemptions.

(1) **Agricultural income [Section 10(1)]** – (i) Section 10(1) provides that agricultural income is not to be included in the total income of the assessee. The reason for totally exempting agricultural income from the scope of central income tax is that under the Constitution, the Parliament has no power to levy a tax on agricultural income.

(ii) **Indirect way of taxing agricultural income** - However, a method has been laid down to levy tax on agricultural income in an indirect way. This concept is known as partial integration of taxes. It is applicable to individuals, HUF, unregistered firms, AOP, BOI and artificial persons. Two conditions which need to be satisfied for partial integration are:

1. The net agricultural income should exceed ₹ 5,000 p.a., and
2. Non-agricultural income should exceed the maximum amount not chargeable to tax. (i.e., ₹ 5,00,000 for very senior citizens, ₹ 2,50,000 for senior citizens, ₹ 2,00,000 for all other individuals and HUFs).

It may be noted that aggregation provisions do not apply to company, firm assessed as such (FAS), co-operative society and local authority. The object of aggregating the net agricultural income with non-agricultural income is to tax the non-agricultural income at higher rates.

Tax calculation in such cases is as follows:

- Step 1:** Add non-agricultural income with net agricultural income. Compute tax on the aggregate amount.
- Step 2:** Add net agricultural income and the maximum exemption limit available to the assessee (i.e. ₹ 2,00,000 / ₹ 2,50,000/ ₹ 5,00,000). Compute tax on the aggregate amount.
- Step 3:** Deduct the amount of income tax calculated in step 2 from the income tax calculated in step 1 i.e. Step 1 – Step 2.
- Step 4:** The sum so arrived at shall be increased by education cess @2% and secondary and higher education cess @1%.

The above concept can be clearly understood with the help of the following illustrations:

Illustration 1

Mr. X, a resident, has provided the following particulars of his income for the P.Y.2013-14.

i. Income from salary (computed)	- ₹ 2,40,000
ii. Income from house property (computed)	- ₹ 2,00,000
iii. Agricultural income from a land in Jaipur	- ₹ 1,80,000
iv. Expenses incurred for earning agricultural income	- ₹ 1,20,000

Compute his tax liability assuming his age is -

(a) 45 years

(b) 70 years

Solution

Computation of total income of Mr. X for the A.Y.2014-15

(a) Computation of tax liability (age 45 years)

For the purpose of partial integration of taxes, Mr. X has satisfied both the conditions i.e.

1. Net agricultural income exceeds ₹ 5,000 p.a., and
2. Non-agricultural income exceeds the basic exemption limit of ₹ 2,00,000.

Particulars	₹	₹
Income from salary		2,40,000
Income from house property		2,00,000
Net agricultural income [₹ 1,80,000 – ₹ 1,20,000]	60,000	
Less: Exempt under section 10(1)	(60,000)	-
Gross Total Income		4,40,000
Less: Deductions under Chapter VI-A		-
Total Income		4,40,000

His tax liability is computed in the following manner:

Step 1: ₹ 4,40,000 + ₹ 60,000 = ₹ 5,00,000.

Tax on ₹ 5,00,000 = ₹ 30,000

Step 2: ₹ 60,000 + ₹ 2,00,000 = ₹ 2,60,000.

Tax on ₹ 2,60,000 = ₹ 6,000 (i.e. 10% of ₹ 60,000)

Step 3: ₹ 30,000 – ₹ 6,000 = ₹ 24,000.

Step 4 : Total tax payable = ₹ 24,000 - ₹ 2,000 (Rebate u/s 87A) = ₹ 22,000

= ₹ 22,000 + 2% of ₹ 22,000 + 1% of ₹ 22,000 = ₹ 22,660.

(b) Computation of tax liability (age 70 years)

For the purpose of partial integration of taxes, Mr. X has satisfied both the conditions i.e.

1. Net agricultural income exceeds ₹ 5,000 p.a., and
2. Non-agricultural income exceeds the basic exemption limit of ₹ 2,50,000.

His tax liability is computed in the following manner:

Step 1: ₹ 4,40,000 + ₹ 60,000	= ₹ 5,00,000.
Tax on ₹ 5,00,000	= ₹ 25,000 (i.e. 10% of ₹ 2,50,000)
Step 2: ₹ 60,000 + ₹ 2,50,000	= ₹ 3,10,000.
Tax on ₹ 3,10,000	= ₹ 6,000 (i.e. 10% of ₹ 60,000)
Step 3: ₹ 25,000 – ₹ 6,000	= ₹ 19,000.
Step 4: Total tax payable	= ₹ 19,000 - ₹ 2,000 (Rebate u/s 87A)
	= ₹ 17,000 + 2% of ₹ 17,000 + 1% of ₹ 17,000 = ₹ 17,510.

(iii) Definition of agricultural income [Section 2(1A)]: This definition is very wide and covers the income of not only the cultivators but also the land holders who might have rented out the lands. Agricultural income may be received in cash or in kind.

Three ways: Agricultural income may arise in any one of the following three ways:-

- (1) It may be rent or revenue derived from land situated in India and used for agricultural purposes.
- (2) It may be income derived from such land through agriculture or the performance of a process ordinarily employed by a cultivator or receiver of rent in kind to render the produce fit to be taken to the market or through the sale of such agricultural produce in the market.
- (3) Lastly, agricultural income may be derived from any farm building required for agricultural operations.

Now let us take a critical look at the following aspects:

- (1) Land has to be situated in India - If agricultural lands are situated in a foreign State, the entire income would be taxable.
- (2) "Agriculture" and "agricultural purposes" - These terms have not been defined in the Act. However, cultivation of a field involving expenditure of human skill and labour on the land can be broadly termed as agriculture.
 - (a) "Agriculture" means tilling of the land, sowing of the seeds and similar operations. These are basic operations and require the expenditure of human skill and labour on land itself. Those operations which the agriculturists have to resort to and which are absolutely necessary for the purpose of effectively raising produce from the land are the basic operations.
 - (b) Operations to be performed after the produce sprouts from the land (e.g., weeding, digging etc.) are subsequent operations. These subsequent operations would be agricultural operations only when taken in conjunction with and as a continuation of the basic operations. Simply performing these subsequent operations without raising such products is not characterized as agriculture.
 - (c) "Agriculture" comprises within its scope the basic as well as the subsidiary operations regardless of the nature of the produce raised on the land. These produce may be grain, fruits or vegetables necessary for *sustenance* of human beings including plantation and

groves or grass or pasture for consumption of beasts or articles of luxury such as betel, coffee, tea, spices, tobacco or commercial crops like cotton flax, jute hemp and indigo. The term comprises of products of land having some utility either for consumption or for trade and commerce and would include forest products such as sal, tendu leaves etc.

- (d) However, the term 'agriculture' cannot be extended to all activities which have some distant relation to land like dairy farming, breeding and rearing of live stock, butter and cheese making and poultry farming. This aspect is discussed in detail later on.

(3) **Income from nursery** - In the past, there have been court rulings that only if a nursery is maintained by carrying out the basic operations on land and subsequent operations in continuation thereof, income from such nursery would be treated as agricultural income and would qualify for exemption under section 10(1). The Supreme Court has, in *CIT v. Raja Benoy Kumar Sahas Roy (1957) 32 ITR 466*, held that the basic operations must be performed before any income can be called agricultural income. The basic operations involve cultivation of the ground, in the sense of tilling of the land, sowing of the seeds, planting and other similar operations on the land. Such basic operations demand the expenditure of human labour and skill upon the land itself and further, they are directed to make the crop sprout from the land. Therefore, income derived from sale of plants grown directly in pots would not be treated as agricultural income.

However, the Madras High Court, in *CIT v. Soundarya Nursery (2000) 241 ITR 530*, observed that nursing activity involves carrying out of several operations on land before the saplings were transplanted in suitable containers including pots and thereafter kept in shade or green house for further operation and growth. Therefore, income arising from nursery should be considered as agricultural income.

Explanation 3 to section 2(1A) provides that the income derived from saplings or seedlings grown in a nursery would be deemed to be agricultural income, whether or not the basic operations were carried out on land. This Explanation ratifies the view taken by the Madras High Court in favour of the taxpayer.

(4) **Process ordinarily employed** - The process to which the agricultural produce is subject should be a process which is ordinarily employed by a cultivator. It may be manual or mechanical. However, it must be employed to render the produce fit to be taken to the market. For example, before making rice fit to be taken to the market we have to remove the basic grain from the hay, we have to remove the chaff from the grain, we have to properly filter them, we have to remove stones etc. and we have to pack the grain in gunny bags. In that condition alone the rice can be taken to the market and sold. This process of making the rice ready for the market may involve manual operations or mechanical operations. All these operations constitute the process ordinarily employed to make the product fit for the market. The produce must retain its original character in spite of the processing unless there is no market for selling it in that condition.

Explanation regarding gains arising on the transfer of urban agricultural land - the capital gains arising from the transfer of such urban agricultural land would not be treated as agricultural income under section 10 but will be taxable under section 45.

3.7 Income Tax

Example: Suppose A sells agricultural land situated in New Delhi for ₹ 10 lakh and makes a surplus of ₹ 8 lakh over its cost of acquisition. This surplus will not constitute agricultural income exempt under section 10(1) and will be taxable under section 45.

(5) **Income from farm building** - Income from any farm building which satisfies the following conditions would be agricultural income and would consequently be exempt from tax. Income derived from any such building arising from any other use (other than those discussed below) shall not be agricultural income.

- (a) The building should be on or in the immediate vicinity of the agricultural land;
- (b) It should be owned and occupied by the receiver of the rent or revenue of any such land or occupied by the cultivator or the receiver of rent in kind of any land with respect to which land or the produce of which land the process discussed above is carried on;
- (c) The receiver of the rent or revenue or the cultivator or the receiver of rent in kind should, by reason of his connection with such land require it as a dwelling house or other out building.

In addition to the above three conditions any one of the following two conditions should also be satisfied:

- (i) The land should either be assessed to land revenue in India or be subject to a local rate assessed and collected by the officers of the Government as such or;
- (ii) Where the land is not so assessed to land revenue in India or is not subject to local rate:-
 - (a) It should not be situated in any area as comprised within the jurisdiction of a municipality or a cantonment board and which has a population not less than 10,000.
 - (b) *It should not be situated in any area within such distance, measured aurally, in relation to the range of population according to the last preceding census as shown hereunder -*

	<i>Shortest aerial distance from the local limits of a municipality or cantonment board referred to in item (a)</i>	<i>Population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.</i>
(i)	2 kilometers	$> 10,000 \leq 1,00,000$
(ii)	6 kilometers	$> 1,00,000 \leq 10,00,000$
(iii)	8 kilometers	$> 10,00,000$

Example

	Area	<i>Shortest aerial distance from the local limits of a municipality or cantonment board referred to in item (a)</i>	<i>Population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.</i>	<i>Is the land situated in this area an agricultural land?</i>
(i)	A	1 km	9,000	Yes

(ii)	B	1.5 kms	12,000	No
(iii)	C	2 kms	11,00,000	No
(iv)	D	3 kms	80,000	Yes
(v)	E	4 kms	3,00,000	No
(v)	F	5 kms	12,00,000	No
(vi)	G	6 kms	8,000	Yes
(vii)	H	7 kms	4,00,000	Yes
(viii)	I	8 kms	10,50,000	No
(ix)	J	9 kms	15,00,000	Yes

- (iv) Indirect connection with the land - We have seen above that agricultural income is exempt, whether it is received by the tiller or the landlord. However, non-agricultural income does not become agricultural merely on account of its indirect connection with the land. The following examples will illustrate the above point.
1. A rural society had as its principal business the selling on behalf of its member societies, butter made by these societies from cream sold to them by farmers. The making of butter was a factory process separated from the farm. It was held that the butter resulting from the factory operations separated from the farm was not an agricultural product and the society was, therefore, not entitled to exemption from income tax.
 2. X was the managing agent of a company. He was entitled for a commission at the rate of 10% p.a. on the annual net profits of the company. A part of the company's income was agricultural income. X claimed that since his remuneration was calculated with reference to income of the company, part of which was agricultural income, such part of the commission as was proportionate to the agricultural income was exempt from income tax. It was held that X received remuneration under a contract for personal service calculated on the amount of profits earned by the company and that remuneration was not an agricultural income.
 3. Y owned 100 acres of agricultural land, a part of which was used as pasture for cows. The lands were purely maintained for manuring and other purposes connected with agriculture and only the surplus milk after satisfying the assessee's needs was sold. The question arose whether income from such sale of milk was agricultural income. It was held that the regularity with which the sales of milk were effected and quantity of milk sold showed that the assessee carried on regular business of producing milk and selling it as a commercial proposition. Hence, it was not agricultural income.
 4. B was a shareholder in certain tea companies, 60% of whose income was exempt from tax as agricultural income. She claimed that 60% of the dividend received by her on her shares in those companies was also exempt from tax as agricultural income. It was held that dividend is derived from the investment made in the shares of the company and is not an agricultural income.
 5. In regard to forest trees of spontaneous growth which grow on the soil unaided by any human skill and labour there is no cultivation of the soil at all. Even though operations in

3.9 Income Tax

the nature of forestry operations performed by the assessee may have the effect of nursing and fostering the growth of such forest trees, it cannot constitute agricultural operations. Income from the sale of such forest trees of spontaneous growth do not, therefore, constitute agricultural income.

- (v) For better understanding of the concept, certain examples of agricultural income and non-agricultural income are given below:

Agricultural income

1. Income derived from the sale of seeds.
2. Income from growing of flowers and creepers.
3. Rent received from land used for grazing of cattle required for agricultural activities.
4. Income from growing of bamboo.

Non-agricultural income

1. Income from breeding of livestock.
2. Income from poultry farming.
3. Income from fisheries.
4. Income from dairy farming.

(vi) **Apportionment in certain cases** - Where the agricultural produce like tea, cotton, tobacco, sugarcane etc. are subjected to a manufacturing process and the manufactured product is sold, the profit on such sales will consist of agricultural income as well as business income. That portion of the profit representing agricultural income will be exempted. For this purpose, Rules 7, 7A, 7B & 8 of Income-tax Rules, 1962 provides the basis of apportionment.

(a) **Rule 7 - Income from growing and manufacturing of any product other than tea** - Where income is partially agricultural income and partially income chargeable to income-tax under the head 'profits and gains of business', the market value of any agricultural produce which has been raised by the assessee or received by him as rent in kind and which has been utilised as raw material in such business or the sale receipts of which are included in the accounts of the business shall be deducted. No further deduction shall be made in respect of any expenditure incurred by the assessee as a cultivator or receiver of rent in kind.

Determination of market value - There are two possibilities here :

- (a) The agricultural produce is capable of being sold in the market either in its raw stage or after application of any ordinary process to make it fit to be taken to the market. In such a case, the value calculated at the average price at which it has been so sold during the relevant previous year will be the market value.
- (b) It is possible that the agricultural produce is not capable of being ordinarily sold in the market in its raw form or after application of any ordinary process. In such case the market value will be the total of the following:—
 - (i) The expenses of cultivation;
 - (ii) The land revenue or rent paid for the area in which it was grown; and

- (iii) Such amount as the Assessing Officer finds having regard to the circumstances in each case to represent at reasonable profit.

Illustration 2

Mr. B grows sugarcane and uses the same for the purpose of manufacturing sugar in his factory. 30% of sugarcane produce is sold for ₹ 10 lacs, and the cost of cultivation of such sugarcane is ₹ 5 lacs. The cost of cultivation of the balance sugarcane (70%) is ₹ 14 lacs and the market value of the same is ₹ 22 lacs. After incurring ₹ 1.5 lacs in the manufacturing process on the balance sugarcane, the sugar was sold for ₹ 25 lacs. Compute B's business income and agricultural income.

Solution

Income from sale of sugarcane gives rise to agricultural income and from sale of sugar gives rise to business income.

$$\begin{aligned}\text{Business income} &= \text{Sales} - \text{Market value of 70\% of sugarcane produce} - \\ &\quad \text{Manufacturing expenses} \\ &= ₹ 25 \text{ lacs} - ₹ 22 \text{ lacs} - ₹ 1.5 \text{ lacs} = ₹ 1.5 \text{ lacs.}\end{aligned}$$

$$\begin{aligned}\text{Agricultural income} &= \text{Market value of sugarcane produce} - \text{Cost of cultivation} \\ &= [₹ 10 \text{ lacs} + ₹ 22 \text{ lacs}] - [₹ 5 \text{ lacs} + ₹ 14 \text{ lacs}] \\ &= ₹ 32 \text{ lacs} - ₹ 19 \text{ lacs} \\ &= ₹ 13 \text{ lacs.}\end{aligned}$$

(b) Rule 7A – Income from growing and manufacturing of rubber – This rule is applicable when income derived from the sale of latex or cenex or latex based crepes or brown crepes manufactured from field latex or coagulum obtained from rubber plants grown by the seller in India. In such cases 35% profits on sale is taxable as business income under the head profits and gains from business or profession, and the balance 65% is agricultural income and is exempt.

Illustration 3

Mr. C manufactures latex from the rubber plants grown by him in India. These are then sold in the market for ₹ 30 lacs. The cost of growing rubber plants is ₹ 10 lacs and that of manufacturing latex is ₹ 8 lacs. Compute his total income.

Solution

The total income of Mr. C comprises of agricultural income and business income.

$$\text{Total profits from the sale of latex} = ₹ 30 \text{ lacs} - ₹ 10 \text{ lacs} - ₹ 8 \text{ lacs} = ₹ 12 \text{ lacs.}$$

$$\text{Agricultural income} = 65\% \text{ of } ₹ 12 \text{ lacs.} = ₹ 7.8 \text{ lacs}$$

$$\text{Business income} = 35\% \text{ of } ₹ 12 \text{ lacs.} = ₹ 4.2 \text{ lacs}$$

(c) Rule 7B – Income from growing and manufacturing of coffee – (a) In case of income derived from the sale of coffee grown and cured by the seller in India, 25% profits on sale is taxable as business income under the head “Profits and gains from business or profession”, and the balance 75% is agricultural income and is exempt. (b) In case of 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, 40% profits on sale is taxable as business income under the head "Profits and gains from business or profession", and the balance 60% is agricultural income and is exempt.

(d) **Rule 8 - Income from growing and manufacturing of tea** - This rule applies only in cases where the assessee himself grows tea leaves and manufactures tea in India. In such cases 40% profits on sale is taxable as business income under the head "Profits and gains from business or profession", and the balance 60% is agricultural income and is exempt.

(2) Amounts received by a member from the income of the HUF [Section 10(2)]

(i) As seen in the first Chapter, a HUF is a 'person' and hence a unit of assessment under the Act. Income earned by the HUF is assessable in its own hands.

(ii) In order to prevent double taxation of one and the same income, once in the hands of the HUF which earns it and again in the hands of a member when it is paid out to him, section 10(2) provides that members of a HUF do not have to pay tax in respect of any amounts received by them from the family.

(iii) The exemption applies only in respect of a payment made by the HUF to its member

(1) out of the income of the family or

(2) out of the income of the impartible estate belonging to the family.

(3) **Share income of a partner [Section 10(2A)]** - This clause exempts from tax a partner's share in the total income of the firm. In other words, the partner's share in the total income of the firm determined in accordance with the profit-sharing ratio will be exempt from tax.

(4) Exemption to non-residents and person resident outside India [Section 10(4)]

(i) This clause provides that in the case of a non-resident, any income by way of interest on Central Government securities as may be prescribed will be exempt. Even income by way of premium on the redemption of such bonds is exempt.

(ii) However, the Central Government shall not notify any such bonds or securities after 1.6.2002. Hence, this exemption will no more be available in respect of any further issue of bonds or securities on or after the 1.6.2002.

(iii) In the case of an individual who is a person resident outside India, as defined in *Foreign Exchange Management Act, 1999 (FEMA, 1999)*, any income by way of interest on moneys standing to his credit in a Non-resident (External) Account (NRE A/c) in any bank in India will be exempt, subject to fulfillment of certain conditions.

(iv) In this context, it may be noted that the joint holders of the NRE Accounts do not constitute an AOP by merely having these accounts in joint names. The benefit of exemption under section 10(4)(ii) will be available to such joint account holders, subject to fulfillment of other conditions contained in that section by each of the individual joint account holders.

(5) Interest on savings certificates [Section 10(4B)]

(i) An individual, being a citizen of India or a person of Indian origin, who is non-resident shall be entitled for exemption in respect of interest on such saving certificates issued before

1.6.2002 by the Central Government and notified by it in the Official Gazette in this behalf.

(ii) However, to claim such exemption, the individual should have subscribed to such certificates in convertible foreign exchange remitted from a country outside India in accordance with the provisions of the *FEMA, 1999*.

(6) Leave travel concession [Section 10(5)]

(i) This clause exempts the leave travel concession (LTC) received by employees from their employers for proceeding to any place in India,

- (a) either on leave or
- (b) after retirement from service or
- (c) after termination of his service.

(ii) The benefit is available to individuals - citizens as well as non-citizens - in respect of travel concession or assistance for himself or herself and for his/her family- i.e., spouse and children of the individual and parents, brothers and sisters of the individual or any of them wholly or mainly dependent on the individual.

(iii) **Limit of exemption** - The exemption in all cases will be limited to the amount actually spent subject to such conditions as specified in Rule 2B regarding the ceiling on the number of journeys for the place of destination.

Under Rule 2B, exemption will be available in respect of 2 journeys performed in a block of 4 calendar years commencing from the calendar year 1986. Where such travel concession or assistance is not availed by the individual during any block of 4 calendar years, one such unavailed LTC will be carried forward to the immediately succeeding block of 4 calendar years and will be eligible for exemption.

Example: An employee does not avail any LTC for the block 2006-09. He avails it during 2010. He is allowed to carry forward maximum one such holiday to be used in the succeeding block. Therefore, he will be eligible for exemption and two more journeys can be further availed.

(iv) **Monetary limits** - Where the journey is performed on or after the 1.10.1997, the amount exempted under section 10(5) in respect of the value of LTC shall be the amount actually incurred on such travel subject to the following conditions:

- (1) where it is performed by air, an amount not exceeding the air economy fare of the National Carrier by the shortest route to the place of destination;
- (2) where places of origin of journey and destination are connected by rail and the journey is performed by any mode of transport other than by air an amount not exceeding the air-conditioned first class rail fare by the shortest route to the place of destination; and
- (3) where the places of origin of journey and destination or part thereof are not connected by rail, the amount eligible for exemption shall be,—
 - (A) where a recognised public transport system exists, an amount not exceeding the 1st class or deluxe class fare, as the case may be, on such transport by the shortest route to the place of destination ; and

- (B) where no recognised public transport system exists, an amount equivalent to the air-conditioned first class rail fare, for the distance of the journey by the shortest route, as if the journey had been performed by rail.

Note: The exemption referred to shall not be available to more than two surviving children of an individual after 1.10.1998. This restrictive sub-rule shall not apply in respect of children born before 1.10.1998 and also in case of multiple births after one child.

Illustration 4

Mr. D went on a holiday on 25.12.2013 to Delhi with his wife and three children (one son – age 5 years; twin daughters – age 2 years). They went by flight (economy class) and the total cost of tickets reimbursed by his employer was ₹ 60,000 (₹ 45,000 for adults and ₹ 15,000 for the three minor children). Compute the amount of LTC exempt.

Solution

Since the son's age is more than the twin daughters, Mr. D can avail exemption for all his three children. The restriction of two children is not applicable to multiple births after one child. The holiday being in India and the journey being performed by air (economy class), the entire reimbursement met by the employer is fully exempt.

Illustration 5

In the above illustration 4, will there be any difference if among his three children the twins were 5 years old and the son 3 years old? Discuss.

Solution

Since the twins' age is more than the son, Mr. D cannot avail for exemption for all his three children. LTC exemption can be availed in respect of only two children. Taxable LTC =

$$15,000 \times \frac{1}{3} = ₹ 5,000 .$$

LTC exempt is only ₹ 55,000 (i.e. ₹ 60,000 – ₹ 5,000)

(7) Exemption in the case of individuals, who are not citizens of India [Section 10(6)]- Individual assessee who are not citizens of India are entitled to certain exemptions:

- (i) Section 10(6)(ii) grants exemption to a person in respect of the remuneration received by him for services as an official of an embassy, high commission, legation, consulate or the trade representation of a foreign State or as a member of the staff of any of these officials.

Conditions

- (a) The remuneration received by our corresponding Government officers resident in such foreign countries should be exempt.

- (b) The above-mentioned officers should be the subjects of the respective countries and should not be engaged in any other business or profession or employment in India.

- (ii) Section 10(6)(vi) provides that remuneration received by a foreign national as an employee of a foreign enterprise for service rendered by him during his stay in India is also exempt from tax.

Conditions

- (1) The foreign enterprise is not engaged in a business activity in India;
- (2) The employee's stay in India does not exceed a total of 90 days in the previous year;
- (3) The remuneration is not liable to be deducted from the employer's income chargeable to tax under the Act.

(iii) Section 10(6)(viii) provides that salary income received by or due to a non-citizen of India who is also non-resident for services rendered in connection with his employment on a foreign ship where his total stay in India does not exceed a total of 90 days in the previous year.

(iv) Section 10(6)(xi) provides that any remuneration received by employees of foreign Government from their respective Government during their stay in India in connection with their training in any establishment or office of the Government or any public sector undertaking is exempt from tax. For this purpose, the expression 'public sector undertaking' will cover Statutory Corporations; companies wholly owned by the Central Government or State Government or jointly by the Central and State Government and subsidiaries of such companies, societies registered under the Societies Registration Act, 1860 or any other similar law, which are wholly financed by the Central Government or State Government or jointly by the Central or State Government.

(8) Tax on royalty or fees for technical services derived by foreign companies [Section 10(6A)] - The benefit of exemption under this section is available to foreign companies only. As per this clause, tax paid by the Government or by an Indian concern on behalf of a foreign company is exempt in the hands of such foreign company provided all the following conditions are satisfied:

- (i) Such tax must have been payable by the foreign company in respect of income received from the Government or the Indian concern by way of royalty or fees for technical services.
- (ii) Such income by way of royalty or fees for technical services must have been received in pursuance of an agreement made by the foreign company with the Government or the Indian concern on or after 1.4.1976 but before 1.6.2002 and such agreement must have been approved by the Central Government. However, where the agreement relates to a subject matter which is included in the industrial policy of the Government and such agreement is in accordance with that policy, no approval of the Central Government is necessary.

(9) Tax paid on behalf of non-resident [Section 10(6B)] – This clause provides that the amount of tax paid by Government or an Indian concern on behalf of a non-resident or a foreign company in respect of its income will not be included in computing the total income of such non-resident or foreign company in pursuance of an agreement entered before 1.6.2002 between the Central Government and the Government of foreign State or an international organisation under the terms of that agreement or of any related agreement which has been approved before 1.6.2002 by the Central Government.

(10) Tax paid on behalf of foreign state or foreign enterprise on amount paid as consideration of acquiring aircraft, etc. on lease [Section 10(6BB)] - Under this section, exemption is provided in respect of tax paid by an Indian company engaged in the business of

operation of an aircraft, on income derived by the Government of a foreign State or a foreign enterprise as a consideration of acquiring an aircraft or aircraft engine on lease under an agreement entered into after 31.3.1997 but before 1.4.1999 or entered into after 31.3.2007 and approved by the Central Government.

However, payment for providing spares, facilities or services in connection with the operation of leased aircraft is not covered under this clause.

(11) Income from projects connected with the security of India [Section 10(6C)] - Any income arising to such foreign company as the Central Government may notify, by way of fees for technical services received in pursuance of an agreement entered into with that Government for providing services in or outside India in projects connected with security of India will be exempt. Such exemption is also available in respect of royalty for technical services arising to the foreign company.

(12) Allowances payable outside India [Section 10(7)] - Allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for services rendered outside India are exempt from tax. Students may remember that in such cases under section 9(1)(iii), the income chargeable under the head 'Salaries' is deemed to accrue in India. The residential status of the recipient will, however, not affect this exemption.

(13) Co-operative technical assistance programmes [Sections 10(8) and (9)] - Individuals who are assigned duties in India in connection with any co-operative technical assistance programmes and projects would be exempt from tax on their receipts by way of:

- (a) remuneration received directly or indirectly from the Government of a foreign State for rendering such services; and
- (b) any other income accruing or arising outside India (but is not deemed to accrue or arise in India) in respect of which the individual is required to pay income-tax or other social security tax to the Government of that foreign State.

A similar exemption would be available under section 10(9) in respect of the income of any member of the family of any such individual referred to above provided that the income:

- (i) actually accrues outside India;
- (ii) cannot be deemed to accrue or arise in India; and
- (iii) in respect of which such member is required to pay income or social security tax to the Government of that foreign State.

(14) Consultant remuneration [Sections 10(8A) and (8B)] - Under clause (8A), any remuneration or fee received by a consultant, directly or indirectly, out of the funds made available to an international organisation (agency) under a technical assistance grant agreement with the agency and Government of a foreign State is exempted from income-tax. The expression "Consultant" means any individual who is either not a citizen of India or, being a citizen of India, is resident but not ordinarily resident, or any other person who is a non-resident and is engaged by the agency for rendering technical services in India in accordance with an agreement entered into by the Central Government and the State agency and the agreement relating to the engagements of the consultant is approved by the prescribed authority.

Under clause (8B), the remuneration received by an employee of the consultant is exempted from income-tax provided such employee is either not a citizen of India or, being a citizen of India, is resident but not ordinarily resident and the contract of his service is approved by the prescribed authority before the commencement of his service.

Section 10(9) discussed above exempts the income of any member of the family of any such individual as is referred to in clauses (8A) and (8B) accompanying him to India, which accrues or arises outside India, and in respect of which such member is required to pay any income or social security tax to the country of his origin.

(15) Gratuity [Section 10(10)]

1. Retirement gratuity received under the Pension Code Regulations applicable to members of the Defence Service is fully exempt from tax.

2. Central / State Government Employees: Any death cum retirement gratuity is fully exempt from tax.

3. Non-government employees covered by the Payment of Gratuity Act, 1972

Any death cum retirement gratuity is exempt from tax to the extent of least of the following:

- (i) ₹ 10,00,000
- (ii) Gratuity actually received
- (iii) 15 days' salary based on last drawn salary for each completed year of service or part thereof in excess of 6 months

Note: Salary for this purpose means basic salary and dearness allowance. No. of days in a month for this purpose, shall be taken as 26.

4. Non-government employees not covered by the Payment of Gratuity Act, 1972

Any death cum retirement gratuity is exempt from tax to the extent of least of the following:

- (i) ₹ 10,00,000
- (ii) Gratuity actually received
- (iii) Half month's salary (based on last 10 months' average salary immediately preceding the month of retirement or death) for each completed year of service (fraction to be ignored)

Note: Salary for this purpose means basic salary and dearness allowance, if provided in the terms of employment for retirement benefits, forming part of salary and commission which is expressed as a fixed percentage of turnover.

Students must also note the following points:

- (1) Gratuity received during the period of service is fully taxable.
- (2) Where gratuity is received from 2 or more employers in the same year then aggregate amount of gratuity exempt from tax cannot exceed ₹ 10,00,000.
- (3) Where gratuity is received in any earlier year from former employer and again received from another employer in a later year, the limit of ₹ 10,00,000 will be reduced by the amount of gratuity exempt earlier.

(4) The exemption in respect of gratuities would be available even if the gratuity is received by the widow, children or dependents of a deceased employee.

Illustration 6

Mr. Ravi retired on 15.6.2013 after completion of 26 years 8 months of service and received gratuity of ₹ 6,00,000. At the time of retirement his salary was:

Basic Salary	:	₹ 5,000 p.m.
Dearness Allowance	:	₹ 3,000 p.m. (60% of which is for retirement benefits)
Commission	:	1% of turnover (turnover in the last 12 months was ₹ 12,00,000)
Bonus	:	₹ 12,000 p.a.

Compute his taxable gratuity assuming:

- (a) *He is non-government employee and covered by the Payment of Gratuity Act 1972.*
- (b) *He is non-government employee and not covered by Payment of Gratuity Act 1972.*
- (c) *He is a Government employee.*

Solution

- (a) He is covered by the Payment of Gratuity Act 1972.

Gratuity received at the time of retirement		₹ 6,00,000
Less: Exemption under section 10(10)		
Least of the following:		
i. Gratuity received	₹ 6,00,000	
ii. Statutory limit	₹ 10,00,000	
iii. 15 days salary based on last drawn salary for each completed year of service or part thereof in excess of 6 months		
$\frac{15}{26} \times \text{last drawn salary} \times \text{years of service}$		
$\frac{15}{26} \times (\text{₹ } 5,000 + \text{₹ } 3,000) \times 27 =$	<u>₹ 1,24,615</u>	<u>₹ 1,24,615</u>
Taxable Gratuity		<u>₹ 4,75,385</u>

- (b) He is not covered by the Payment of Gratuity Act 1972.

Gratuity received at the time of retirement	₹ 6,00,000
Less: Exemption under section 10(10) (Note 1)	<u>₹ 1,01,400</u>
Taxable Gratuity	<u>₹ 4,98,600</u>

Note 1: Exemption under section 10(10) is least of the following:

- i. Gratuity received ₹ 6,00,000
- ii. Statutory limit ₹ 10,00,000
- iii. Half month's salary based on average salary of last 10 months preceding the month of retirement for each completed year of service.

i.e. $\frac{1}{2} \times \text{Average salary} \times \text{years of service}$

$$= \frac{1}{2} \times \left[\frac{(5,000 \times 10) + (3,000 \times 60\% \times 10) + \left(1\% \times 12,00,000 \times \frac{10}{12}\right)}{10} \right] \times 26$$

$$= ₹ 1,01,400$$

- (c) He is a government employee

Gratuity received at the time of retirement	₹ 6,00,000
Less : Exemption under section 10(10)	<u>₹ 6,00,000</u>
Taxable gratuity	<u>Nil</u>

(16) Payment in commutation of pension [Section 10(10A)]

Pension is of two types: commuted and uncommuted.

Uncommuted Pension: Uncommuted pension refers to pension received periodically. It is fully taxable in the hands of both government and non-government employees.

Commuted Pension: Commuted pension means lump sum amount taken by commuting the whole or part of the pension. Its treatment is discussed below:

- (a) **Employees of the Central Government/local authorities/Statutory Corporation/ members of the Defence Services:** Any commuted pension received is fully exempt from tax.
- (b) **Non-Government Employee:** Any commuted pension received is exempt from tax in the following manner:

If the employee is in receipt of gratuity,

Exemption = $\frac{1}{3}$ rd of the amount of pension which he would have received had he commuted the whole of the pension.

$$= \left[\frac{1}{3} \times \frac{\text{commuted pension received}}{\text{commutation \%}} \times 100\% \right]$$

If the employee does not receive any gratuity

Exemption = $\frac{1}{2}$ of the amount of pension which he would have received had he commuted the whole of the pension.

$$= \left[\frac{1}{2} \times \frac{\text{commuted pension received}}{\text{commutation \%}} \times 100\% \right]$$

Note: 1. Judges of the Supreme Court and High Court will be entitled to exemption of the commuted portion not exceeding $\frac{1}{2}$ of the pension.

2. Any commuted pension received by an individual out of annuity plan of the Life Insurance Corporation of India (LIC) from a fund set up by that Corporation will be exempted.

Illustration 7

Mr. Sagar retired on 1.10.2013 receiving ₹ 5,000 p.m. as pension. On 1.2.2014, he commuted 60% of his pension and received ₹ 3,00,000 as commuted pension. You are required to compute his taxable pension assuming:

- He is a government employee.
- He is a non-government employee, receiving gratuity of ₹ 5,00,000 at the time of retirement.
- He is a non-government employee and is in receipt of no gratuity at the time of retirement.

Solution

(a) He is a government employee.

Uncommuted pension received (October – March)		₹ 24,000
[(₹ 5,000 × 4 months) + (40% of ₹ 5,000 × 2 months)]		
Commuted pension received	₹ 3,00,000	
Less : Exempt u/s 10(10A)	<u>₹ 3,00,000</u>	<u>NIL</u>
Taxable pension		<u>₹ 24,000</u>

(b) He is a non-government employee, receiving gratuity ₹ 5,00,000 at the time of retirement.

Uncommuted pension received (October – March)		₹ 24,000
[(₹ 5,000 × 4 months) + (40% of ₹ 5,000 × 2 months)]		
Commuted pension received	₹ 3,00,000	
Less : Exempt u/s 10(10A)		
$\left(\frac{1}{3} \times \frac{₹ 3,00,000}{60\%} \times 100\% \right)$	<u>₹ 1,66,667</u>	<u>₹ 1,33,333</u>
Taxable pension		<u>₹ 1,57,333</u>

(c) He is a non-government employee and is not in receipt of gratuity at the time of retirement.

Uncommuted pension received (October – March)		₹ 24,000
[(₹ 5,000 × 4 months) + (40% of ₹ 5,000 × 2 months)]		
Commuted pension received	₹ 3,00,000	

$$\left(\frac{1}{2} \times \frac{\text{₹ } 3,00,000}{60\%} \times 100\% \right)$$

₹ 50,000

₹ 74,000

(a) Government employees: Leave salary received at the time of retirement is fully exempt from tax.

(i) ₹ 3,00,000

(ii) Leave salary actually received

(iii) 10 months' salary (on the basis of average salary of last 10 months)

(iv) Cash equivalent of leave (based on last 10 months' average salary immediately preceding the date of retirement) to the credit of the employee at the time of retirement or death. Earned leave entitlement cannot exceed 30 days for every year of actual service rendered for the employer from whose service he has retired.

1. Leave salary received during the period of service is fully taxable.

2. Where leave salary is received from two or more employers in the same year, then the aggregate amount of leave salary exempt from tax cannot exceed ₹ 3,00,000.

3. Where leave salary is received in any earlier year from a former employer and again received from another employer in a later year, the limit of ₹ 3,00,000 will be reduced by the amount of leave salary exempt earlier.

4. "Salary" for this purpose means basic salary and dearness allowance, if provided in the terms of employment for retirement benefits and commission which is expressed as a fixed percentage of turnover.

5. 'Average salary' will be determined on the basis of the salary drawn during the period of ten months immediately preceding the date of his retirement whether on superannuation or otherwise.

Mr. Gupta retired on 1.12.2013 after 20 years 10 months of service, receiving leave salary of ₹ 5,00,000. Other details of his salary income are:

Basic Salary : ₹ 5,000 p.m. (₹ 1,000 was increased w.e.f. 1.4.2013)

3.21 Income Tax

Dearness Allowance : ₹ 3,000 p.m. (60% of which is for retirement benefits)
 Commission : ₹ 500 p.m.
 Bonus : ₹ 1,000 p.m.
 Leave availed during service : 480 days

He was entitled to 30 days leave every year.

You are required to compute his taxable leave salary assuming:

- (a) He is a government employee.
 (b) He is a non government employee.

Solution

- (a) He is a government employee.

Leave Salary received at the time of retirement	₹ 5,00,000
Less : Exemption under section 10(10AA)	₹ 5,00,000
Taxable Leave salary	<u>Nil</u>

- (b) He is a non-government employee

Leave Salary received at the time of retirement	₹ 5,00,000
Less : Exempt under section 10(10AA) [Note 1]	₹ 26,400
Taxable Leave Salary	<u>₹ 4,73,600</u>

Note 1 : Exemption under section 10(10AA) is least of the following:

- (i) Leave salary received ₹ 5,00,000
 (ii) Statutory limit ₹ 3,00,000
 (iii) 10 months salary based on average salary of last 10 months

$$\begin{aligned}
 &\text{i.e. } \left[10 \times \frac{\text{Salary of last 10 months i.e. Feb - Nov}}{10 \text{ months}} \right] \\
 &= \left[10 \times \frac{(5000 \times 8) + (4000 \times 2) + (60\% \times 3000 \times 10)}{10 \text{ months}} \right] \quad \text{₹ 66,000}
 \end{aligned}$$

- (iv) Cash equivalent of leave standing at the credit of the employee based on the average salary of last 10 months (max. 30 days per year of service)

$$\begin{aligned}
 \text{Leave Due} &= \text{Leave allowed} - \text{Leave taken} \\
 &= (30 \text{ days per year} \times 20 \text{ years}) - 480 \text{ days} \\
 &= 120 \text{ days}
 \end{aligned}$$

$$\begin{aligned} & \text{i.e. } \left[\frac{\text{Leave due (in days)}}{30 \text{ days}} \times \text{Average salary p.m.} \right] \\ & = \left[\frac{120 \text{ days}}{30 \text{ days}} \times \frac{\text{₹ } 66,000}{10} \right] \qquad \qquad \qquad \text{₹ } 26,400 \end{aligned}$$

(18) **Retrenchment compensation [Section 10(10B)]** - Retrenchment compensation will be exempt from tax subject to the following limits:

(a) Amount calculated in accordance with the provisions of section 25F of the Industrial Disputes Act, 1947

$$\text{i.e. } \frac{15}{26} \times \text{Avg salary of last 3 mths} \times \text{Completed yrs of service and part thereof in excess of 6 mths}$$

or

(b) An amount, not less than ₹ 5,00,000 as may be notified by the Central Government in this behalf,

whichever is lower.

The retrenchment compensation for this purpose means the compensation paid under Industrial Disputes Act, 1947 or under any Act, Rule, Order or Notification issued under any law. It also includes compensation paid on transfer of employment under section 25F or closing down of an undertaking under section 25FF of the Industrial Disputes Act, 1947.

The above limits will not be applicable to cases where the compensation is paid under any scheme approved by the Central Government for giving special protection to workmen under certain circumstances.

Illustration 9

Mr. Garg received retrenchment compensation of ₹ 10,00,000 after 30 years 4 months of service. At the time of retrenchment, he was drawing basic salary ₹ 20,000 p.m.; dearness allowance ₹ 5,000 p.m. Compute his taxable retrenchment compensation.

Solution

Retrenchment compensation received	₹ 10,00,000
Less : Exemption under section 10(10B) [Note 1]	<u>₹ 4,32,692</u>
Taxable retrenchment compensation	<u>₹ 5,67,308</u>

Note 1 : Exemption is to the extent of least of the following :

(i) Compensation actually received	= ₹ 10,00,000
(ii) Statutory Limit	= ₹ 5,00,000
(iii) Amount calculated in accordance with provisions of the Industrial Disputes Act, 1947	

$$= \left[\frac{15}{26} \times \frac{(20,000 \times 3) + (5,000 \times 3)}{3} \times 30 \text{ years} \right] = ₹ 4,32,692$$

(19) **Payments to Bhopal Gas Victims [Section 10(10BB)]** - Any payment made to a person under Bhopal Gas Leak Disaster (Processing of Claims) Act, 1985 and any scheme framed thereunder will be fully exempt. However, payments made to any assessee in connection with Bhopal Gas Leak Disaster to the extent he has been allowed a deduction under the Act on account of any loss or damage caused to him by such disaster will not be exempted.

(20) **Exemption of compensation received on account of disaster [Section 10(10BC)]**

(i) This clause exempts any amount received or receivable as compensation by an individual or his legal heir on account of any disaster.

(ii) Such compensation should be granted by the Central Government or a State Government or a local authority.

(iii) However, exemption would not be available in respect of compensation for alleviating any damage or loss, which has already been allowed as deduction under the Act.

(iv) "Disaster" means a catastrophe, mishap, calamity or grave occurrence in any area, arising from natural or manmade causes, or by accident or negligence. It should have the effect of causing -

- (1) substantial loss of life or human suffering; or
- (2) damage to, and destruction of, property; or
- (3) damage to, or degradation of, environment.

It should be of such a nature or magnitude as to be beyond the coping capacity of the community of the affected area.

(21) **Voluntary Retirement Receipts [Section 10(10C)]** - Compensation received by an employee at the time of voluntary retirement is exempt from tax subject to the following conditions:

Eligible Undertakings - The employee of the following undertakings are eligible for exemption under this clause:

- (i) Public sector company
- (ii) Any other company
- (iii) An authority established under a Central/State or Provincial Act
- (iv) A local authority
- (v) A co-operative society
- (vi) An University established or incorporated under a Central/State or Provincial Act and an Institution declared to be an University by the University Grants Commission.
- (vii) An Indian Institute of Technology
- (viii) Such Institute of Management as the Central Government may, by notification in the Official Gazette, specify in this behalf

- (ix) Any State Government
- (x) The Central Government
- (xi) An institution, having importance throughout India or in any state or states, as the Central Government may specify by notification in the Official Gazette.

Limit : The maximum limit of exemption should not exceed ₹ 5 lakh.

Such compensation should be at the time of his voluntary retirement or termination of his service, in accordance with any scheme or schemes of voluntary retirement or, in the case of public sector company, a scheme of voluntary separation. The exemption will be available even if such compensation is received in installments.

The schemes should be framed in accordance with such guidelines, as may be prescribed and should include the criteria of economic viability.

Guidelines: Rule 2BA prescribes the following guidelines for the purposes of the above clause:

1. It applies to an employee of the company or the authority, as the case may be, who has completed 10 years of service or completed 40 years of age.
However, this requirement is not applicable in case of an employee of a public sector company under the scheme of voluntary separation framed by the company.
2. It applies to all employees by whatever name called, including workers and executives of the company or the authority except directors of a company or a cooperative society.
3. The scheme of voluntary retirement or separation must have been drawn to result in overall reduction in the existing strength of the employees of a company or the authority or a cooperative society.
4. The vacancy caused by the voluntary retirement or separation must not be filled up.
5. The retiring employee of a company shall not be employed in another company or concern belonging to the same management.
6. The amount receivable on account of voluntary retirement or separation of the employee must not exceed the amount equivalent to three months' salary for each completed year of service or salary at the time of retirement multiplied by the balance months of service left before the date of his retirement or superannuation.

Note - Where any relief has been allowed to any assessee under section 89 for any assessment year in respect of any amount received or receivable on his voluntary retirement or termination of service or voluntary separation, no exemption under section 10(10C) shall be allowed to him in relation to that assessment year or any other assessment year.

Illustration 10

Mr. Dutta received voluntary retirement compensation of ₹ 7,00,000 after 30 years 4 months of service. He still has 6 years of service left. At the time of voluntary retirement, he was drawing basic salary ₹ 20,000 p.m.; Dearness allowance (which forms part of pay) ₹ 5,000 p.m. Compute his taxable voluntary retirement compensation, assuming that he does not claim any relief under section 89.

Solution

Voluntary retirement compensation received	₹ 7,00,000
Less: Exemption under section 10(10C) [Note 1]	<u>₹ 5,00,000</u>
Taxable voluntary retirement compensation	<u>₹ 2,00,000</u>

Note 1: Exemption is to the extent of least of the following:

(i) Compensation actually received	= ₹ 7,00,000
(ii) Statutory limit	= ₹ 5,00,000
(iii) Last drawn salary × 3 × completed years of service	
= (20,000 + 5,000) × 3 × 30 years	= ₹ 22,50,000
(iv) Last drawn salary × remaining months of service	
= (20,000 + 5,000) × 6 × 12 months	= ₹ 18,00,000

(22) Income-tax paid by employer [Section 10(10CC)] – This clause provides for exemption in the hands of an employee, being an individual deriving income by way of perquisites, not provided by way of monetary payment within the meaning of section 17(2). This applies where the tax on such income is actually paid by the employer, at the option of the employer, on behalf of such employee, notwithstanding anything contained in section 200 of the Companies Act, 1956.

This provision will provide relief to the employee if the employer is willing to bear the tax burden in respect of non-monetary perquisites provided by it to the employee as otherwise the tax so paid by employer would have been treated as income of the employee.

(23) Receipts from LIC [Section 10(10D)] - This clause clarifies that any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy shall not be included in the total income of a person.

Recently, policies were introduced in respect of which the premium payable was very high. Sometimes, such premium was payable on a one-time basis. They are similar to deposits or bonds. With a view to ensure that such insurance policies are treated at par with other investment schemes, clause (10D) has been rationalised as follows –

In respect of policies issued between 1.4.2003 and 31.3.2012

- (i) Any sum received, under an insurance policy issued on or after 1.4.03 in respect of which the premium payable/paid during any of the years during the term of the policy exceeds 20% of the actual capital sum assured, shall not be exempt. Therefore, sum received in respect of such policies issued prior to 1.4.03 will continue to enjoy exemption.
- (ii) However, such sum received under such policy on the death of a person shall continue to be exempt.
- (iii) For the purpose of calculating the actual capital sum assured under this clause,
 - (a) the value of any premiums agreed to be returned or

- (b) the value of any benefit by way of bonus or otherwise, over and above the sum actually assured,
shall not be taken into account. Such premium or bonus may be received either by the policy holder or by any other person.
- (iv) Any sum received under section 80DD(3) shall not be exempt under this clause in addition to sum received under 80DDA(3) or under a Keyman insurance policy.

In respect of policies issued on or after 1.4.2012

- (i) Any sum received, under an insurance policy issued on or after 1.4.2012 in respect of which the premium payable/paid during any of the years during the term of the policy exceeds 10% of the actual capital sum assured, shall not be exempt.
- (ii) However, such sum received under such policy on the death of a person shall continue to be exempt.
- (iii) In respect of policies issued on or after 1st April, 2012, the actual capital sum assured shall mean the minimum amount assured under the policy on happening of the insured event at any time during the term of the policy, not taking into account -

- (a) the value of any premiums agreed to be returned or
- (b) the value of any benefit by way of bonus or otherwise, over and above the sum actually assured which is to be or may be received under the policy by any person,

In effect, in case the insurance policy has varied sum assured during the term of policy then the minimum of the sum assured during the life time of the policy shall be taken into consideration for calculation of the “actual capital sum assured” for the purpose of section 80C and section 10(10D), in respect of life insurance policies to be issued on or after 1st April, 2012.

- (iv) Any sum received under section 80DD(3) or section 80DDA(3) shall not be exempt. Further, any sum received under a Keyman insurance policy shall also not be exempt.

Explanation 1 to section 10(10D) defines “Keyman insurance policy” as a life insurance policy taken by one person on the life of another person who is or was the employee of the first-mentioned person or is or was connected in any manner whatsoever with the business of the first-mentioned person. The scope of the term “keyman insurance policy” has now been amplified to include a keyman insurance policy which has been assigned to any person during its term, with or without consideration. Therefore, such policies shall continue to be treated as a keyman insurance policy even after the same is assigned to the keyman. Consequently, the sum received by the keyman on such policies, being “keyman insurance policies”, would not be exempt under section 10(10D).

In respect of policies issued on or after 1.4.2013

Any sum received under a life insurance policy including the sum allocated by way of bonus on such policy would be exempt, where the policy is issued on or after 1st April, 2013 and is for insurance on life of any person, who is –

- (1) *a person with disability or person with severe disability as referred to in section 80U; or*

(2) *suffering from disease or ailment as specified in the rules made under section 80DDB,*

and the premium payable for any of the years does not exceed 15% of minimum capital sum assured.

Where the insurance is on the life of any person, other than the persons mentioned above, exemption would be available only if the premium payable for any of the years during the term of the policy does not exceed 10% of "minimum capital sum assured" under the policy on the happening of the insured event at any time during the term of the policy.

(24) Payment from provident funds [Sections 10(11) and (12)] - The following payments received by an assessee will be fully exempt from tax:

- (a) Provident Fund (PF) to which Provident Fund Act, 1925, applies; or
- (b) Public Provident Fund.
- (c) Accumulated balance payable to an employee participating in a RPF (subject to certain conditions).

The conditions for the purpose of RPF above are as follows:

- (i) The employee should have rendered continuous service with the employer from whom the amount is received for a period of at least five years; or
- (ii) Where the employee had not rendered such continuous service the reason for the termination of his service should have been his ill-health or contraction or discontinuance of employer's business or any other cause beyond the control of the employee.

If such conditions are not satisfied the payments become taxable in the hands of the employee.

(25) Payment from superannuation funds [Section 10(13)] - Any payment received by any employee from an approved superannuation fund shall be entirely excluded from his total income if the payment is made

- (a) on the death of a beneficiary;
- (b) to an employee in lieu or in commutation of an annuity on his retirement at or after a specified age or on his becoming incapacitated prior to such retirement; or
- (c) by way of refund of contribution on the death of a beneficiary; or
- (d) by way of contribution to an employee on his leaving the service in connection with which the fund is established otherwise than by retirement at or after a specified age or his becoming incapacitated prior to such retirement.

In the case of (d) above the amount of exemption will be to the extent the payment made does not exceed the contribution made prior to 1-4-1962 and the interest thereon.

(26) House rent allowance (HRA) [Section 10(13A)] – HRA is a special allowance specifically granted to an employee by his employer towards payment of rent for residence of the employee. HRA granted to an employee is exempt to the extent of least of the following :

Metro Cities (i.e. Delhi, Kolkata, Mumbai, Chennai)	Other Cities
1) HRA actually received.	1) HRA actually received
2) Rent paid-10% of salary for the relevant period	2) Rent paid - 10% of salary for the relevant period
3) 50% of salary for the relevant period	3) 40% of salary for the relevant period

Note: 1. Exemption is not available to an assessee who lives in his own house, or in a house for which he has not incurred the expenditure of rent.

2. Salary for this purpose means basic salary, dearness allowance, if provided in terms of employment and commission as a fixed percentage of turnover.

3. Relevant period means the period during which the said accommodation was occupied by the assessee during the previous year.

Illustration 11

Mr. Raj Kumar has the following receipts from his employer:

(1) Basic pay	₹ 3,000 p.m.
(2) Dearness allowance (D.A.)	₹ 600 p.m.
(3) Commission	₹ 6,000 p.a.
(4) Motor car for personal use (expenditure met by the employer)	₹ 500 p.m.
(5) House rent allowance	₹ 900 p.m.

Find out the amount of HRA eligible for exemption to Mr. Raj Kumar assuming that he paid a rent of ₹ 1,000 p.m. for his accommodation at Kanpur. DA forms part of salary for retirement benefits.

Solution:

HRA received	₹ 10,800
Less: Exempt under section 10(13A) [Note 1]	₹ 7,680
Taxable HRA	₹ 3,120

Note 1: Exemption shall be least of the following three limits:

(a) the actual amount received (₹ 900 × 12)	= ₹ 10,800
(b) excess of the actual rent paid by the assessee over 10% of his salary	
= Rent Paid - 10% of salary for the relevant period	
= (₹ 1,000 × 12) - 10% of [(₹ 3,000 + ₹ 600) × 12]	
= (₹ 12,000 - ₹ 4,320)	= ₹ 7,680
(c) 40% salary as his accommodation is situated at Kanpur	
= 40% of [(₹ 3,000 + ₹ 600) × 12]	= ₹ 17,280

Note: For the purpose of exemption under section 10(13A), salary includes dearness allowance only when the terms of employment so provide, but excludes all other allowances and perquisites.

(27) Special allowances to meet expenses relating to duties or personal expenses [Section 10(14)] - This clause provides for exemption (as per Rule 2BB) in respect of the following:

- (i) Special allowances or benefit not being in the nature of a perquisite, specifically granted to meet expenses incurred wholly, necessarily and exclusively in the performance of the duties of an office or employment of profit. For the allowances under this category, there is no limit on the amount which the employee can receive from the employer, but whatever amount is received should be fully utilized for the purpose for which it was given to him.
- (ii) Special allowances granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at the place where he ordinarily resides or to compensate him for the increased cost of living. For the allowances under this category, there is a limit on the amount which the employee can receive from the employer. Any amount received by the employee in excess of these specified limits will be taxable in his hands as income from salary for the year. It does not matter whether the amount which is received is actually spent or not by the employee for the purpose for which it was given to him.

Rule 2BB

The following allowances have been prescribed in Rule 2BB:

Allowances prescribed for the purposes of section 10(14)(i)

- (a) any allowance granted to meet the cost of travel on tour or on transfer (Travelling Allowance);
- (b) any allowance, whether granted on tour or for the period of journey in connection with transfer, to meet the ordinary daily charges incurred by an employee on account of absence from his normal place of duty;
- (c) any allowance granted to meet the expenditure incurred on conveyance in performance of duties of an office or employment of profit (Conveyance Allowance);
- (d) any allowance granted to meet the expenditure incurred on a helper where such helper is engaged in the performance of the duties of an office or employment of profit (Helper Allowance);
- (e) any allowance granted for encouraging the academic research and training pursuits in educational and research institutions;
- (f) any allowance granted to meet the expenditure on the purchase or maintenance of uniform for wear during the performance of the duties of an office or employment of profit (Uniform Allowance).

Explanation - For the purpose of clause (a) "allowance granted to meet the cost of travel on transfer" includes any sum paid in connection with the transfer, packing and transportation of personal effects on such transfer.

Allowances prescribed for the purposes of section 10(14)(ii)

1. Any Special Compensatory Allowance in the nature of Special Compensatory (Hilly Areas) Allowance or High Altitude Allowance or Uncongenial Climate Allowance or Snow Bound Area Allowance or Avalanche Allowance - ₹ 800 or ₹ 7,000 or ₹ 300 per month depending upon the specified locations.
2. Any Special Compensatory Allowance in the nature of border area allowance or remote locality allowance or difficult area allowance or disturbed area allowance - ₹ 1,300 or ₹ 1,100 or ₹ 1,050 or ₹ 750 or ₹ 300 or ₹ 200 per month depending upon the specified locations.
3. Special Compensatory (Tribal Areas / Schedule Areas / Agency Areas) Allowance - ₹ 200 per month.
4. Any allowance granted to an employee working in any transport system to meet his personal expenditure during his duty performed in the course of running such transport from one place to another, provided that such employee is not in receipt of daily allowance – 70% of such allowance upto a maximum of ₹ 10,000 per month.
5. Children Education Allowance - ₹ 100 per month per child upto a maximum of two children.
6. Any allowance granted to an employee to meet the hostel expenditure on his child ₹ 300 per month per child upto a maximum of two children.
7. Compensatory Field Area Allowance - ₹ 1,300 per month in specified areas.
8. Compensatory Modified Field Area Allowance - ₹ 500 per month in specified areas.
9. Any special allowance in the nature of counter insurgency allowance granted to the members of the armed forces operating in areas away from their permanent locations for a period of more than 30 days - ₹ 1,300 per month.
Any assessee claiming exemption in respect of allowances mentioned at serial numbers 7, 8 and 9 shall not be entitled to exemption in respect of the allowance referred to at serial number 2.
10. Any transport allowance granted to an employee (other than those referred to in Sl. No. 11 below) to meet his expenditure for the purpose of commuting between the place of his residence and the place of his duty - ₹ 800 per month.
11. Any transport allowance granted to an employee who is blind or orthopaedically handicapped with disability of the lower extremities of the body, to meet his expenditure for commuting between his residence and place of duty - ₹ 1,600 per month.
12. Underground Allowance of ₹ 800 per month would be granted to an employee who is working in uncongenial, unnatural climate in underground coal mines. This is applicable to whole of India.

Illustration 12

Mr. Srikant has two sons. He is in receipt of children education allowance of ₹ 150 p.m. for his elder son and ₹ 70 p.m. for his younger son. Both his sons are going to school. He also receives the following allowances:

3.31 Income Tax

Transport allowance : ₹ 1,000 p.m. (amount spent ₹ 600 p.m.)

Tribal area allowance : ₹ 500 p.m.

Compute his taxable allowances.

Solution

Taxable allowance in the hands of Mr. Srikant is computed as under -

Children Education Allowance:

Elder son	[(₹ 150 – ₹ 100) p.m. × 12 months]	= ₹ 600	
Younger son	[(₹ 70 – ₹ 70) p.m. × 12 months]	= Nil	₹ 600
Transport allowance	[(₹ 1,000 – ₹ 800) p.m. × 12 months]		₹ 2,400
Tribal area allowance	[(₹ 500 – ₹ 200)p.m. × 12 months]		<u>₹ 3,600</u>
∴ Taxable allowances			<u>₹ 6,600</u>

(28) Interest income arising to certain persons [Section 10(15)]

- (i) Income by way of interest, premium on redemption or other payment on notified securities, bonds, annuity certificates or other savings certificates is exempt subject to such conditions and limits as may be specified in the notification. It may be noted that interest on Post Office Savings Bank Account which was so far fully exempt would henceforth be exempt from tax for any assessment year only to the extent of:
 - (1) ₹ 3,500 in case of an individual account.
 - (2) ₹ 7,000 in case of a joint account.
- (ii) Interest on 7% Capital Investment Bonds and 10.1% Relief Bonds, 1993 notified by the Central Government This exemption is available to Individuals and HUFs. Such capital Investment Bonds are not specified on or after 1.6.2002.
- (iii) Interest on NRI bonds, 1988 and NRI Bonds (Second Series), and Resurgent India Bonds, 1998 issued by the SBI arising to (i) Non Resident Indians who own such bonds, (ii) their nominees or survivors, (iii) donees who have received such bonds by way of gift from such non-residents. The interest and principal received in respect of such bonds whether on maturity or otherwise should not be taken out of India. The exemption will continue to apply even after the non-resident, after purchase of such bonds, becomes a resident in any subsequent year. However, the exemption will not apply in the previous year in which such bonds are encashed prior to their maturity. Such bonds shall not be specified on or after 1.06.2002.
- (iv) Interest on securities held by the Issue Department of Central Bank of Ceylon constituted under the Ceylon Monetary Law Act, 1949.
- (v) Interest payable to any bank incorporated in a country outside India and authorised to perform central banking functions in that country on any deposits made by it, with the approval of the RBI, with any scheduled bank.
- (vi) Interest payable to the Nordic Investment Bank, on a loan advanced by it to a project

approved by the Central Government in terms of the Memorandum of Understanding entered into by the Central Government with that Bank on 25.11.86.

(vii) Interest payable to the European Investment Bank, on a loan granted by it in pursuance of the framework agreement for financial co-operation entered into by the Central Government with the Bank on 25.11.1993.

(viii) Interest payable —

- (a) by the Government or a local authority on moneys borrowed by it before 1.6.2001 or debts owed by it before 1.6.2001 to sources outside India;
- (b) by an industrial undertaking in India on moneys borrowed by it before 1.6.2001 under a loan agreement entered into with any such financial institution in a foreign country as may be approved by the Central Government;
- (c) by an industrial undertaking in India on moneys borrowed or debt incurred by it before 1.6.2001 in a foreign country for the purchase outside India of raw material or capital equipment or components provided that the loan or the debt is approved by the Central Government, to the extent to which such interest does not exceed the amount of the interest calculated at the rate approved by the Government;

“Purchase of capital plant and machinery” includes the purchase of such capital plant and machinery under hire-purchase agreement or a lease agreement with an option to purchase such plant and machinery.

Exemption has also been given for payment of usance interest payable outside India by an undertaking engaged in ship-breaking business, in respect of purchase of a ship from outside India.

- (d) by IFCI, IDBI, the Export-Import Bank of India and the Industrial Credit and Investment Corporation of India, NHB, SIDBI, on moneys borrowed from sources outside India before 1.6.2001 to the extent to which the interest does not exceed the amount of interest calculated at the rate approved by the Central Government having regard to the terms of the loan and its repayment;
- (e) by any other financial institution or a banking company established in India on loans raised in foreign countries before 1.6.2001 under approved agreements for the purpose of advancing loans to industrial undertakings in India for importing raw materials or capital plant and machinery or other goods which the Central Government may consider necessary to import in the public interest;
- (f) by an industrial undertaking in India on moneys borrowed by it in foreign currency from foreign sources under a loan agreement approved by the Central Government before 1.6.2001 having regard to the need for industrial development in India will be exempt from income-tax, to the extent to which such interest does not exceed the amount of interest calculated at the rates approved by the Central Government in this behalf, having regard to the terms of the loan and its repayment.
- (g) by a scheduled bank on deposits in foreign currency held by a non-resident or a person who is not ordinarily resident, where the acceptance of such deposits by the

bank is approved by the RBI. It may be noted that for the purpose of exemption under this clause, a scheduled bank does not include a co-operative bank.

- (h) by an Indian public limited company, being a company eligible for deduction under section 36(1)(viii), mainly engaged in providing long-term finance for construction or purchase of residential houses in India on loans raised in foreign countries under a loan agreement approved by the Central Government before 1.6.2003
- (i) by public sector companies on certain specified bonds and debentures subject to the conditions which the Central Government may specify by notification, including the condition that the holder of such bonds or debentures registers his name and holding with that company;

Accordingly, the Central Government has specified tax free bonds issued by India Infrastructure Company Ltd. and tax free, secured, redeemable, non-convertible Bonds of the Indian Railway Finance Corporation Ltd. (IRFCL), National Highways Authority of India (NHAI), Rural Electrification Corporation Ltd. (RECL), Housing and Urban Development Corporation Ltd. (HUDCL), Power Finance Corporation (PFC), *Jawaharlal Nehru Port Trust, Dredging Corporation of India Limited, Ennore Port Limited and The Indian Renewable Energy Development Agency Limited*, the interest from which would be exempt under this section.

- (j) by Government of India on deposit made by an employee of the Central or State Government or a public sector company in accordance with the scheme as may be notified of the moneys due to him on account of his retirement while on superannuation or otherwise. It is significant that this scheme is not applicable to non-Government employees.

The term 'industrial undertaking' means any undertaking which is engaged in:

- (i) the manufacture or processing of goods; or
- (ii) the manufacture of computer software or recording of programmes on any disc, tape, perforated media or other information device; or
- (iii) the business of generation or generation and distribution of electricity or any other form of power; or
- (iv) the business of providing telecommunication services; or
- (v) mining; or
- (vi) construction of ships, or
- (vii) the business of ship-breaking; or
- (viii) the operation of ships or aircrafts or construction or operation of rail systems.

For the purposes of the clause, "interest" shall not include interest paid on delayed payment of loan or default if which is more than 2% p.a. over the rate of interest payable in terms of such loan. Interest would include hedging transaction charges on account of currency fluctuation.

- (ix) Bhopal Gas Victims - Section 10(15)(v) provides exemption in respect of interest on securities held by the Welfare Commissioner, Bhopal Gas Victims, Bhopal, in the Reserve Bank's Account No. SL/DH 048. Recently, in terms of an order of the Supreme Court to finance the construction of a hospital at Bhopal to serve the victims of the gas leak, the shares of the Union Carbide Indian Ltd., have been sold. The sale consideration reserved for construction has been deposited with SBI, New Delhi. The interest on the aforesaid deposit and similar deposits which may be made in future needs to be provided income tax exemption. The scope of the above exemption has been extended to interest on deposits for the benefit of the victims of the Bhopal Gas Leak disaster. Such deposits can be held in such account with the RBI or with a public sector bank as the Central Government may notify in the Official Gazette. Such notification may have prospective or retrospective effect. However, in no case it can be effective from a period earlier than 1-4-1994.
- (x) Interest on Gold Deposit Bond issued under the Gold Deposit Scheme, 1999 notified by the Central Government.
- (xi) Interest on bonds, issued by –
 - (a) a local authority; or
 - (b) a State Pooled Finance Entity
 and specified by the Central Government by notification in the Official Gazette.
 “State Pooled Finance Entity” means such entity which is set up in accordance with the guidelines for the Pooled Finance Development Scheme notified by the Central Government in the Ministry of Urban Development.
 Accordingly, the Central Government has specified the “Tax-free Pooled Finance Development Bonds” under Pooled Finance Development Fund Scheme of Government of India, interest from which would be exempt under section 10(15).
- (xii) interest income received by a non-resident/not-ordinarily resident in India from a deposit made on or after 1.4.2005 in an Offshore Banking Unit referred to in section 2(u) of the SEZ Act, 2005 i.e. a branch of a bank located in a SEZ and which has obtained permission under section 23(1)(a) of the Banking Regulation Act, 1949.

(29) Payments for acquisition of aircraft [Section 10(15A)] – Any payment made by an Indian company engaged in the business of operation of aircraft to acquire an aircraft on lease from the government of a foreign State or a foreign enterprise under an agreement not being an agreement entered into between 1-4-1997 and 31-3-1999, and approved by the Central Government in this behalf will be exempt. For the purpose of this clause ‘foreign enterprise’ means a person who is a non-resident.

This exemption has been withdrawn in respect of all such agreements entered into on or after 1st April, 2007.

The exemption for lease payments shall continue with regard to agreements entered into before 1.4.2007. Consequently, the benefit of exemption from tax, on the tax paid will be available in respect of lease payments made in pursuance of agreements entered into on or after 1.4.2007. The effect of these amendments is that up to 31.3.2007, the consideration for

lease itself is exempt from tax. With effect from 1.4.2007, the consideration for lease is taxable and if the Indian company who makes payment of such consideration undertakes to bear the tax on behalf of the lessor, then such tax shall not be considered as income and further taxed. Such tax paid by the Indian company would be exempt from further tax. This is provided in clause (6BB) of section 10.

(30) Educational scholarships [Section 10(16)] - The value of scholarship granted to meet the cost of education would be exempt from tax in the hands of the recipient irrespective of the amount or source of scholarship.

(31) Payments to MPs & MLAs [Section 10(17)] – The following incomes of Members of Parliament or State Legislatures will be exempt:

- (i) Daily allowance received by any Member of Parliament or of State Legislatures or any Committee thereof.
- (ii) In the case of a Member of Parliament or of any Committee thereof, any allowance received under Members of Parliament (Constituency Allowance) Rules, 1986; and
- (iii) Any constituency allowance received by any person by reason of his membership of any State Legislature under any Act or rules made by that State Legislature.

(32) Awards for literary, scientific and artistic works and other awards by the Government [Section 10(17A)] - Any award instituted in the public interest by the Central/State Government or any body approved by the Central Government and a reward by Central/State Government for such purposes as may be approved by the Central Government in public interest, will enjoy exemption under this clause.

(33) Pension received by recipient of gallantry awards [Section 10(18)] - Any income by way of pension received by an individual who has been awarded "Param Vir Chakra" or "Maha Vir Chakra" or "Vir Chakra" or such other gallantry award as the Central Government may, by notification in the Official Gazette, specify in this behalf.

In case of the death of the awardee, any income by way of family pension received by any member of the family of the individual shall also be exempt under this clause. The expression "family" shall have the meaning assigned to it in the Explanation to clause (5) of the said section.

(34) Family pension received by widow/children/nominated heirs of members of armed forces [Section 10(19)] – Exemption is available in respect of family pension received by the widow or children or nominated heirs, of a member of the armed forces (including para-military forces) of the Union, where the death of such member has occurred in the course of operational duties, in specified circumstances and circumstances.

(35) Annual value of palaces of former rulers [Section 10(19A)] - The annual value of any one palace in the occupation of former Rulers would be excluded from their total income provided such annual value was exempt from income-tax before the de-recognition of Rulers of Indian States and abolition of their privy purses.

(36) Income of local authorities [Section 10(20)] – (i) All income arising to a local authority, other than from trade or business carried on by it which accrues or arises from the supply of commodity or service under its jurisdictional area is excludible from its total income.

(ii) Exemption is available to income derived by a local authority from the supply of water or

electricity even outside its juridical area.

(iii) For the purposes of this clause, "local authority" means the following:

- (1) Panchayat
- (2) Municipality
- (3) Municipal Committee and District Board legally entitled to, or entrusted by the Government with the control or management of a Municipal or local Fund
- (4) Cantonment Board

(37) Income of research associations approved under section 35(1)(ii) [Section 10(21)] - This clause also provides for exemption in respect of any income of research associations which are approved under section 35(1)(ii)/(iii). This exemption has however, been made subject to the following conditions:

- (i) It should apply its income or accumulate for application wholly and exclusively to its objects and provisions of section 11(2) and (3) would also apply in relation to such accumulation.
- (ii) The association should invest or deposit its funds in the forms or modes specified in section 11(5). This condition would however not apply to -
 - (1) any assets held by the research association where such assets form part of the corpus of the fund of the association as on 1-6-1993;
 - (2) any debentures of a company acquired by the association before 1-3-1983;
 - (3) any bonus shares coming as an accretion to the corpus mentioned above;
 - (4) voluntary contributions in the form of jewellery, furniture or any article notified.
- (iii) The exemption will not apply to income of such association which are in the nature of profits and gains of business unless the business is incidental to the attainment of its objectives and separate books of account are maintained in respect of such business.
- (iv) However, approval once granted may be withdrawn if at any time the Government is satisfied that -
 - (1) the research association has not applied its income in accordance with sections 11(2) and (3);
 - (2) the research association has not invested or deposited its funds in accordance with section 11(5).

Such withdrawal shall be made after giving reasonable opportunity to the assessee. A copy of the order shall be sent to the Assessing Officer as well as the assessee.

(38) Income of news agency [Section 10(22B)] – (i) This clause provides income-tax exemption on any income of such news agency set up in India solely for collection and distribution of news as specified by the Central Government.

(ii) However, in order to get this exemption, the news agency should:

- (a) apply its income or accumulate it for application solely for collection and distribution of news.

- (b) It should not also distribute its income in any manner to its members.
- (iii) Any notification issued by the Central Government under this clause will have effect for 3 assessment years. It may include an assessment year or years commencing before the date of notification.
- (iv) However, once the notification has been issued, the notification may be rescinded approval if at any time the Government is satisfied that the news agency has not applied or accumulated or distributed its income in accordance with the provisions of this section.
- (v) The notification may be rescinded after giving reasonable opportunity to the assessee. A copy of the order shall be sent to the Assessing Officer as well as the assessee.

(39) Income of professional associations [Section 10(23A)] – (i) Associations or institutions of the following classes approved by the Government and applying their income or accumulating it solely to their objects shall be exempt from tax on certain items of their income. The association or institution must:

- (a) be established in India;
- (b) have as its object the control, supervision, regulation or encouragement of the profession of law, medicine, accountancy, engineering or architecture, or any other profession specified by the Central Government.
- (ii) All income arising to such an association, except the following categories of income, are exempt from inclusion in income:
 - (a) income under the head 'interest on securities';
 - (b) income under the head 'income from house property';
 - (c) income received for rendering any specific service; and
 - (d) income by way of interest or dividends derived from its investments.
- (iii) However, approval once granted may be withdrawn if at any time the Government is satisfied that –

- (1) the association or institution has not applied or accumulated its income in accordance with the provisions of the section;
- (2) the activities of the association or institution are not being carried out in accordance with the conditions imposed on the basis of which the approval was granted.
- (iv) Such withdrawal shall be made after giving reasonable opportunity to the assessee. A copy of the order shall be sent to the Assessing Officer as well as the assessee.

(40) Income of institutions established by armed forces [Section 10(23AA)] - Any income received by any person on behalf of any regimental fund or non-public fund established by the armed forces of the Union for the welfare of the past and present members of such forces or their dependents is exempt from tax.

Students may note that donations to such institutions will qualify for deduction under section 80G.

(41) Income of Funds established for welfare of employees of which such employees are members [Section 10(23AAA)] - A number of funds have been established for the welfare of employees or their dependents in which such employees themselves are members.

These funds are utilised to provide cash benefits to a member on his superannuation, or in the event of his illness or illness of any member of his family, or to the dependents of a member on his death.

Example : XYZ Ltd. has an employee welfare fund. Employees, who are members of the fund, contribute a portion of their salary to the fund. The company makes an annual contribution equal to the employees' contribution. The funds thus made available are utilised by the fund to provide benefits to the members or their dependents in case of illness etc. The surplus fund may be invested in bonds, Government securities or deposited with banks. Essentially, these funds are in the nature of mutual benefit funds. Hence, their income does not qualify for exemption under section 10(23C)(iv). Since they are not charitable institutions they cannot also claim exemption under section 11 in respect of their income. They are now entitled for exemption under section 10(23AAA).

Accordingly, in exercise of the powers conferred by section 10(23AAA), the CBDT has notified the following purposes –

- (1) cash benefits to a member of the fund -
 - (a) on superannuation, or
 - (b) in the event of his illness or illness of his spouse or dependent children, or
 - (c) to meet the cost of education of his dependent children or
- (2) cash benefits to the dependents of a member of the fund in the event of the death of such member.
- (3) cash benefits to a member of the fund to meet the cost of annual medical tests or medical checkups of a member, his spouse and dependent children as one of the purposes of the fund.

The exemption will be available only if the following conditions are fulfilled:

- (i) the fund should have been established for the welfare of employees or their dependents and for such purposes as may be notified by the Board;
- (ii) such employees should be the members of the fund;
- (iii) the fund should apply its income, or accumulate it for application, wholly and exclusively to the objects for which it is established;
- (iv) the fund shall invest its fund and contributions made by the employees and other sums received by it in any one mode specified under section 11(5);
- (v) the fund should be approved by the Commissioner in accordance with the prescribed rules. The approval shall have effect for such assessment year or years not exceeding three assessment years as may be specified in the order of approval.

Note:

1. There are no conditions regarding accumulation towards the object of the fund.
2. There is no requirement of application of any minimum percentage of the income towards the object of the fund.

3. No time limit has been prescribed within which the fund must exercise the option of accumulation.
4. Any contribution made by an employer to this approved welfare fund would also not be allowed as a deduction.

(42) **Income of Fund set up by Life Insurance Corporation under pension scheme [Section 10(23AAB)]** - Any income of a fund set up by the LIC of India or any other insurer under a pension scheme to which contribution is made by any person for receiving pensions from such fund. Such scheme should be approved by the Controller of Insurance or the IRDA.

(43) **Income of institution established for development of Khadi and Village Industries [Section 10(23B)]** – (i) The exemption will be available to institutions constituted as public charitable trusts or registered under the Societies Registration Act, 1860 or under any law corresponding to that Act in force in any part of India existing solely for development of khadi and village industries.

(ii) Income derived by such institutions from the production, sale or marketing of Khadi products or village industries would be exempt from income-tax.

(iii) The conditions for availing exemption are:

- (1) The institution has to apply its income or accumulate it for application, solely for the development of village industries.
- (2) They should be approved by the Khadi and Village Industries Commission.
- (3) Such approval is granted for a period of 3 years at a time.
- (iv) However, approval once granted may be withdrawn if at any time the Government is satisfied that –

- (1) the institution has not applied or accumulated its income in accordance with the provisions of the section;
- (2) the activities of the institution are not being carried out in accordance with the conditions imposed on the basis of which the approval was granted.

(v) Such withdrawal shall be made after giving reasonable opportunity to the assessee. A copy of the order shall be sent to the Assessing Officer as well as the assessee.

(44) **Income of authorities set up under State or Provincial Act for promotion of Khadi and Village Industries [Section 10(23BB)]** - Income derived by authorities similar to Khadi and Village Industries Commission, set up under any State or Provincial Act, for the development of Khadi or Village industries in the state is exempt from tax.

(45) **Income of authorities set up to administer religious or charitable trusts [Section 10(23BBA)]** – (i) Income of bodies or authorities established, constituted or appointed under any enactment for the administration of public, religious or charitable trust or endowments (including temples, gurudwaras, wakfs, churches, synagogues, or other places of public religious worship) or societies for religious or charitable purpose is exempt from tax.

(ii) However, exemption will apply to the income of the administrative bodies or authorities but shall not apply to the income of any such trust, endowment or society mentioned above.

(46) Income of European Economic Community (EEC) [Section 10(23BBB)] - This clause provides exemption on any income of the EEC derived in India by way of interest, dividends or capital gains from investments made out of its funds under a scheme notified by the Government.

(47) Income derived by the SAARC Fund for Regional Projects [Section 10(23BBC)] - Any income derived by the SAARC Fund for Regional Projects which was set up by Colombo Declaration shall be exempt.

(48) Income of the IRDA [Section 10(23BBE)] - Any income of the IRDA established under section 3(1) of the IRDA Act, 1999 will be exempt.

(49) Exemption of income of Central Electricity Regulatory Commission [Section 10(23BBG)] - This section provides exemption to any income of Central Electricity Regulatory Commission constituted under sub-section (1) of Section 76 of the Electricity Act, 2003.

(50) Exemption of income of Prasar Bharati (Broadcasting Corporation of India) [Section 10(23BBH)] - Any income of the Prasar Bharati (Broadcasting Corporation of India) established under section 3(1) of the Prasar Bharati (Broadcasting Corporation of India) Act, 1990 is exempt under this section.

(51) Income of certain funds or institutions [Section 10(23C)] - An exemption is available in respect of any income received by any person on behalf of the following entities:

- (i) the Prime Minister's National Relief Fund [Sub-clause (i)];
- (ii) the Prime Minister's Fund (Promotion of Folk Art) [Sub-clause (ii)];
- (iii) the Prime Minister's Aid to Students Fund [Sub-clause (iii)];
- (iv) the National Foundation for Communal Harmony [Sub-clause (iiia)];
- (v) any other Fund or Institution for charitable purposes approved by the prescribed authority having regard to the objects of the fund or institution and its importance throughout India or throughout any State or States [Sub-clause (iv)];
- (vi) any trust (including any other legal obligation) or institution wholly for public religious or public religious and charitable purposes approved by the prescribed authority [Sub-clause (v)];
- (vii) any university or other educational institution wholly or substantially financed by the Government which exists solely for educational purposes and not for profit [Sub-clause (iiiab)];
- (viii) any university or other educational institution existing solely for educational purposes and not for profit and its aggregate annual receipts do not exceed ₹ 1 crore [Sub-clause (iiiad)];
- (ix) any hospital or other institution wholly or substantially financed by the Government, which exists solely for philanthropic purposes and not for profit and which exists for the reception and treatment of persons suffering from illness or mental defectiveness or treatment of convalescing persons or persons requiring medical attention [Sub-clause (iiiac)];
- (x) any hospital or other institution as described in (ix) above if its aggregate annual receipts do not exceed the prescribed limit of ₹ 1 crore [Sub-clause (iiiae)];

- (xi) any other university or educational institutions approved by prescribed authority [Sub-clause (vi)];
- (xii) any other hospital, etc. approved by prescribed authority [Sub-clause (via)].

Note:

1. The application form for such exemption will have to be made in the prescribed form and manner.
2. The prescribed authority, is empowered to call for such documents or information as it considers necessary in order to satisfy itself about the genuineness of the activities of the fund or trust or institution or any university or other educational institution or any hospital or other medical institution, before approving the same under section 10(23C)(iv), (v), (vi) or (via). Such documents may include audited annual accounts. The prescribed authority may also make such inquiries as it may deem necessary for this purpose.
3. Exemption under section 10(23C)(iv)/(v) would apply only if the funds are invested or deposited for any period during the relevant previous year otherwise in the modes specified in section 11(5). This requirement will not however apply where the investment is maintained in the form of jewellery, furniture or any other article notified by the Board. For this purpose, the fund or trust or institution must fulfill the following conditions:
 - (a) It should apply its income or accumulate it for application wholly and exclusively to the objects for which it is established,
 - (b) In case where more than 15% of its income is accumulated on or after 1.4.2002, the period of accumulation of the amount exceeding 15% of its income shall be maximum 5 years.
 - (c) It should invest or deposit the following kinds of funds:
 - any assets which form part of the corpus of the fund, trust or institution as on 1.6.1973;
 - any equity shares of a public company held by any University or other educational institution or any hospital or other medical institution where such assets form part of its corpus as on 1.6.1998;
 - any debentures, issued by or on behalf of any company or corporation, acquired by the fund, trust or institution, etc. before 1.3.1983;
 - any bonus shares allotted to the fund, trust or institution, etc. in respect of the shares mentioned above forming part of the corpus of such fund, etc.
 - any voluntary contributions received and maintained in the form of jewellery, furniture or other article as the Board may specify for any period during the previous year. However, such assets should not be in the forms or modes of investment laid down in section 11(5).
4. Investments or deposits made before 1.4.1989 in any mode or form not specified in Section 11(5) should be liquidated and invested in such modes, by 30.3.1993.
5. In case of (xi) and (xii) above, if any funds of such institution or hospital are invested before 1.6.1998 in any mode other than that specified in section 11(5), the exemption to

such an institution shall not be denied if such funds do not continue to be so invested or deposited after 30.3.2001.

6. Exemption under sub-clause (iv) or (v) (vi) or (via) would be available only if the funds are invested in mode specified in section 11(5), within 1 year from the end of the previous year in which the asset is acquired or 31.3.1992, whichever is earlier.
7. Exemption under section 10(23C)(iv) or (v) or (vi) or (via) would not apply to profits and gains of business in all cases. However, where the business is incidental to the attainment of its objectives and separate books of account are maintained in respect of the business, the exemption would apply to such business profits also.
8. Notification issued under sub-clauses (iv) and (v) before 13.7.2006, being the date on which the Taxation Laws (Amendment) Act, 2006 received the assent of the President, shall have effect for a maximum 3 assessment years at any one time. Any notification issued by the Central Government [under sub-clauses (iv) or (v)] on or after 13.7.2006 will be valid until withdrawn and there will be no requirement on the part of the assessee to seek renewal of the same after 3 years.
9. In order to expedite disposal of such applications, it has now been provided that where such an application is made on or after 13.7.2006, every notification under sub-clause (iv) or sub-clause (v) shall be issued or approval under sub-clause (vi) or sub-clause (via) shall be granted or an order rejecting the application shall be passed within the period of 12 months from the end of the month in which such application was received.
10. If the total income of any entity referred to in sub-clauses (iv), (v), (vi) and (via) of section 10(23C), without giving effect to the provisions of the said sub-clauses, exceeds the basic exemption limit in any previous year, it shall –
 - (1) get its accounts audited in respect of that year by a chartered accountant; and
 - (2) furnish such audit report along with the return of income for the relevant assessment year. The report must be in the prescribed form, duly signed and verified by the accountant, and must contain such particulars as may be prescribed.
11. In case of donations received between 26.1.2001 and 30.9.2001 for the purpose of providing relief to victims of the Gujarat earthquake, any amount unutilized or mis-utilized and not transferred to the Prime Minister's National Relief Fund on or before 31.3.2004 shall be deemed to be the income of the previous year, chargeable to tax. Further, exemption will not be available if such fund/institution does not render accounts of income and expenditure to authority prescribed under section 80G(5C)(v) as prescribed.
12. Where the fund / trust / institution / university / hospital etc. does not apply its income during the year of receipt and accumulates it, and subsequently makes a payment or credit out of such accumulated income, to any institution or trust registered u/s 12AA or to any fund / trust / institution / university / hospital, such payment or credit shall not be considered to be an application of income for its specified objectives.
13. The Central Government, or prescribed authority shall have the power to withdraw the approval or rescind the notification if:
 - (i) such fund/institution/university/hospital etc. has not applied its income or

invested/deposited its funds in accordance with the provisions. or

- (ii) the activities of such fund, etc are not genuine; or
- (iii) such activities are not being carried out in accordance with the conditions based upon which it was notified or approved.

However, the approval or notification can be withdrawn or rescinded only after issuing a show cause notice and giving reasonable opportunity to such fund, etc. of being heard. After withdrawing the approval or rescinding the notification, a copy of the order is to be forwarded to the concerned fund/institution, etc. as well as to the Assessing Officer.

14. The time limit for making an application for grant of exemption or continuation thereof under section 10(23C) by a fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in sub-clauses (iv)/(v)/(vi)/(via) of section 10(23C) has been specified in respect of such applications made on or after 1.6.2006. Such applications have to be filed on or before 30th September of the succeeding financial year.

For example, if an educational institution seeks exemption under clause (vi) for P.Y.2013-14 (i.e. A.Y.2014-15), it has to make an application for grant of exemption by 30.9.2014.

15. However, any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of the said section shall be included in the total income.

16. It has also been provided that all pending applications in respect of which no notification has been issued under the said sub-clause (iv) or (v) before 1st June, 2007, shall stand transferred on that day to the prescribed authority and the prescribed authority may proceed with such applications from the stage at which they were on that day.

17. If the purpose of a trust or institution referred to in sub clauses (iv)/(v) of section 10(23C) does not remain charitable in a previous year on account of the commercial receipts exceeding the specified threshold of ₹ 25 lakhs, then, such trust or institution would not be entitled to get benefit of exemption in respect of its income for that previous year in which the commercial receipts exceed the specified threshold. The denial of exemption would be compulsory by operation of law and would not be dependent on any approval being withdrawn or registration being cancelled or a notification being rescinded.

Such trust and institution cannot get benefit of tax exemption in the year in which its receipts from commercial activities exceed the specified threshold of ₹ 25 lakhs, whether or not the registration or approval granted or notification issued is cancelled, withdrawn or rescinded in respect of such trust or institution.

(52) Income of Mutual Fund [Section 10(23D)] – (i) The income of a Mutual Fund set up by a public sector bank / public financial institution / SEBI / RBI subject to certain conditions is exempt.

(ii) “Public sector bank” means SBI or any nationalised bank or a bank included in the category “other public sector banks” by the RBI, for example, IDBI Bank.

Note: 1. The income of a mutual fund registered under the SEBI will be exempt without any conditions laid down by the Central Government

3. In the case of other mutual funds, the conditions will be applicable.

(53) Exemption of any income of a securitization trust from the activity of securitization [Section 10(23DA)]

Section 10(35A)	Exemption of the distributed income referred to in section 115TA (received from a securitization trust) in the hands of the recipient-investor consequent to levy of additional income-tax on such distributed income in the hands of the securitization trust.

(i) *Securitization trusts are special purpose entities set up in the form of trust to undertake securitization activities.*

(ii) *For the purpose of the exemption and taxability provisions under the Income-tax Act, 1961, a “securitization trust” means a trust which is a special purpose distinct entity or special purpose vehicle, the details of which are tabulated hereunder, which fulfills the prescribed conditions –*

	Form of trust	Regulation/ Guidelines	Definition under the respective Regulation/Guidelines
(1)	Special purpose distinct entity	SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008.	Special purpose distinct entity means a trust which acquires debt or receivables out of funds mobilized by it by issuance of securitised debt instruments through one or more schemes, and includes any trust set up by the National Housing Bank or by the NABARD. <i>For this purpose, “securitised debt instrument” means any certificate or instrument, by whatever name called, issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable including mortgage debt, as the case may be;</i>
(2)	Special purpose vehicle (SPV)	The guidelines on securitization of standard assets issued by RBI.	SPV means any company, trust, or other entity constituted or established for a specific purpose – (a) <i>activities of which are limited to those for accomplishing the purpose of the company, trust or other entity as the case may be; and</i> (b) <i>which is structured in a manner intended to isolate the corporation, trust or entity as the case may be, from the credit risk of an originator to make it bankruptcy remote.</i>

(iv) *A special taxation regime has been introduced in respect of taxation of income of*

securitisation entities, set up as a trust, from the activity of securitisation.

The significant provisions of the special regime are :-

(1) In case of securitisation vehicles which are set up as a trust and the activities of which are regulated by either SEBI or RBI, the income from the activity of securitisation of such trusts will be exempt from taxation. New clause (23DA) has been inserted in section 10 to exempt any income of a securitization trust from the activity of securitization with effect from A.Y.2014-15.

(2) New Chapter XII-EA, comprising of sections 115TA, 115TB and 115TC, has been inserted in the Income-tax Act, 1961, with effect from 1st June, 2013 to levy additional income-tax on securitization trusts in respect of income distributed to its investors.

(3) Consequent to the levy of distribution tax, the distributed income referred to in section 115TA received from a securitization trust will be exempt from tax in the hands of the recipient-investor with effect from A.Y.2014-15 [Section 10(35A)].

(54) Income of Investor Protection Funds [Section 10(23EA)] – (i) Clause (23EA) excludes any income by way of contributions received from recognized stock exchanges and the members thereof, from the total income of an Investor Protection Fund set up by recognised stock exchanges in India, either jointly or separately, and notified by the Central Government in this behalf.

(ii) Where any amount standing to the credit of the Fund and not charged to income-tax during any previous year is shared, either wholly or in part, with a recognised stock exchange, the whole of the amount so shared shall be deemed to be the income of the previous year in which such amount is so shared and shall accordingly be chargeable to income-tax.

(55) Exemption of specified income of Investor Protection Fund set up by commodity exchanges [Section 10(23EC)] - (i) This clause exempts income, by way of contributions received from commodity exchanges and the members thereof, of such Investor Protection Fund set up by commodity exchanges in India, either jointly or separately, as the Central Government may, by notification in the Official Gazette, specify in this behalf.

(ii) Where any amount standing to the credit of the said Fund and not charged to income-tax during any previous year is shared, either wholly or in part, with a commodity exchange, the entire amount so shared shall be deemed to be the income of the previous year in which the amount is so shared and shall accordingly be chargeable to income-tax.

(iii) A “commodity exchange” means a “registered association” as defined in clause section 2(ji) of the Forward Contracts (Regulation) Act, 1952. i.e. an association to which for the time being a certificate of registration has been granted by the Forward Markets Commission under section 14B.

(56) Exemption of income of Investor Protection Fund set up by depositories [Section 10(23ED)]

(i) Consequent to amendment in the SEBI (Depositories and Participants) Regulations, 1996, in the year 2012, there is a compulsory requirement for depositories to set up an Investor Protection Fund.

(ii) “Depository” means a company formed and registered under the Companies Act, 1956

and which has been granted a certificate of registration under section 12(1A) of the SEBI Act, 1992

(iii) Under section 10(23EA), income by way of contributions from a recognised stock exchange received by a Investor Protection Fund set up by the recognised stock exchange is exempt from taxation.

(iv) In line with section 10(23EA), the Finance Act, 2013 has inserted section 10(23ED) to provide that any income, by way of contribution from a depository, of such Investor Protection Fund set up by a depository in accordance with the regulations made under the SEBI Act, 1992 and the Depositories Act, 1996, will not be included while computing the total income of such investor protection fund. The Central Government, would, by way of notification in the Official Gazette, specify such investor protection funds set up by depositories in accordance with the SEBI and depositories regulations.

(v) However, where any amount standing to the credit of the fund and not charged to income-tax during any previous year is shared wholly or partly with a depository, the amount so shared shall be deemed to be the income of the previous year in which such amount is shared. Accordingly, such amount would be chargeable to income-tax.

(57) Income of Venture Capital Company / Fund [Section 10(23FB)] - This clause exempts any income of a venture capital company (VCC) or venture capital fund (VCF) set up to raise funds for investment in a venture capital undertaking (VCU). Further, as per section 115U, income accruing or arising or received by a person out of investment made in a VCC or VCF shall be taxable in the like manner as if the person had made direct investment in the VCU.

In effect, under sections 10(23FB) and 115U, a tax pass through status (i.e. income is taxable in the hands of investors instead of VCF/VCC) is available to such funds which satisfy the investment and other conditions as are provided in SEBI (Venture Capital Funds) Regulations, 1996. Further, these sections provide a "pass through status" only in respect of income which arises to the fund from investment in VCU, being a company which satisfies the conditions provided in SEBI (Venture Capital Fund) Regulations, 1996.

The SEBI (Alternative Investment Funds) Regulations, 2012 (AIF regulations) have replaced the SEBI (Venture Capital Fund) Regulations, 1996 (VCF regulations) from 21st May, 2012. The AIF Regulations now regulate all privately pooled investment vehicles which collect funds from investors for investments in accordance with a predefined investment policy for the benefit of its investors. AIF can be a fund established or incorporated in the form of a trust, company, LLP or body corporate. The AIF Regulations cover a much wider ambit of funds and categorize them into broadly three categories:

Category I AIF comprises of funds which invest in start-up or early stage ventures or social ventures or SMEs or infrastructure or other sectors or areas which the government or regulators consider as socially or economically desirable.

Category I AIF presently has 4 sub-categories, namely, venture capital funds, SME Funds, social venture funds and infrastructure funds. Investment norms have been prescribed for each of the sub-categories to ensure that the fund allocates substantial majority of its capital to the target focus. The stated intent of Category I AIF is to cover AIFs that are generally perceived to have positive spillover effects on economy and for which the SEBI/

Government/ other regulators might consider providing incentives or concessions. The Explanation to Regulation 3(4)(a) of AIF Regulations which clarified this aspect also clarified that such funds which are formed as trusts or companies shall be construed as VCF/VCC as specified under section 10(23FB) of the Income-tax Act, 1961.

Category II AIF is a residual category and covers AIFs for which no specific incentives or concessions are given by the Government/other regulators. Category II AIF will cover classic private equity funds and debt funds. Such funds do not undertake leverage or borrowing other than to meet day-to-day operational requirements.

Category III AIFs are AIFs which employ diverse or complex trading strategies and may employ leverage including through investment in listed or unlisted derivatives. Category III AIF will cover hedge funds or funds which trade with a view to make short term returns or such other funds which are open ended. As in the case of Category II AIFs, no specific incentives or concessions are given by the Government/other regulators.

The Finance Act, 2013 has granted “pass through status” to only the Venture Capital Fund, being a sub-category of Category I AIFs, with a corresponding direct tax charge on the investors. The benefit is available to only such AIFs which are established as a trust or a company. Further, the Income-tax Act, 1961 requires compliance of three conditions by such AIFs, in order to be covered within the ambit of exemption under section 10(23FB), namely:

(1) The units of a trust set up as AIF and shares of a company set up as AIF should not be listed on a recognised stock exchange.

(2) The AIF (established as a company) should not have invested in a VCU, in which its director or a substantial shareholder (being a beneficial owner of equity shares exceeding 10% of its equity share capital) holds, either individually or collectively, equity shares in excess of 15% of the paid-up equity share capital of such venture capital undertaking.

The AIF (established as a trust) should not have invested in any VCU in which its trustee or the settlor holds, either individually or collectively, equity shares in excess of 15% of the paid-up equity share capital of such VCU.

(3) The AIF should have invested not less than two-thirds of its investible funds in unlisted equity shares/ equity linked instruments of VCU.

The tax implications on account of the amendment by the Finance Act, 2013 are as follows -

(i) VCCs/VCFs registered prior to 21st May 2012 under SEBI (VCF) Regulations, 1996 (VCF regulations), will continue to be eligible for “pass through status” under section 10(23FB) read with section 115U.

(ii) The impact on AIFs registered on or after 21st May, 2012 under AIF Regulations are summarized as follows :-

Category	Sub-categories	Tax status in the event AIF is registered on or after 21 May 2012
I	VCF, being trust & VCC	Would qualify as VCC/VCF under section 10(23FB) but, subject to compliance of three conditions viz., (1) Shares of company/units of trust set up as an AIF are not listed on a recognized stock exchange. (2) Has invested not less than 2/3rd of its investible funds in unlisted equity shares/equity linked instruments of VCUs (3) Has not invested in associate VCUs.
I	SME Fund Social Venture Fund Infrastructure Fund	Will not qualify as VCC/VCF under section 10(23FB) and consequently will not be eligible for "pass through status" despite being identified as socially desirable having positive spillover effects on the economy and eligible for other concessions from Government/SEBI. Will be governed by normal provisions of taxation as applicable to relevant nature of entity.
II	Generally includes private equity and debt funds	Will not qualify as VCC/VCF under section 10(23FB)
III	Generally includes hedge funds	

Note - Venture Capital Undertaking (VCU), for the purpose of this section, would include –

VCU as defined in clause (n) of Regulation 2 of VCF Regulations	VCU as defined in clause (aa) of Regulation 2(1) of the AIF Regulations
A domestic company— (i) whose shares are not listed on a recognized stock exchange in India; (ii) which is engaged in the business for providing services, production or manufacture of article or things or does not include such activities or sectors which are specified in the negative list by the Board with the approval of the Central Government	A domestic company - (i) which is not listed on a recognised stock exchange in India at the time of making investment; and (ii) which is engaged in the business for providing services, production or manufacture of article or things and does not include following activities or sectors: (1) NBFCs i.e., non-banking financial companies;

<i>by notification in the Official Gazette in this behalf.</i>	(2) <i>gold financing;</i> (3) <i>activities not permitted under industrial policy of Government of India;</i> (4) <i>any other activity which may be specified by the Board in consultation with Government of India from time to time;</i>

(58) Income of trade unions [Section 10(24)] - Any income under the heads "income from house property" and "income from other sources" of a registered trade union, within the meaning of the Trade Unions Act, 1926, formed primarily for the purpose of regulating the relations between workmen and the employers or between workmen and workmen will be exempt. Further, this exemption is also available in respect of an association of such registered unions.

(59) Income of provident funds, superannuation funds, gratuity funds [Section 10(25)] - Income of a recognized provident fund (RPF) and of an approved superannuation fund or gratuity fund is exempt from tax and the trustees of these funds would not be liable to tax thereon.

The exemption also applies to -

- (i) the interest on securities which are held by or are the property of statutory provident fund (SPF) governed by the Provident Funds Act, 1925;
- (ii) the capital gains, if any arising to it from the sale, exchange or transfer of such securities;
- (iii) any income received by the Board of Trustees constituted under Coal Mines Provident Fund and Miscellaneous Provisions Act, 1984 and under the Employees Provident Funds and Miscellaneous Provisions Act, 1952, on behalf of the Deposit Linked Insurance Funds established under these respective Acts.

(60) Income tax exemption to Employees State Insurance (ESI) Fund [Section 10(25A)] - The contributions paid under ESI Act, 1948 and all other moneys received on behalf of the ESI Corporation are paid into a Fund called the ESI Fund. This Fund is held and administered by the ESI Corporation. The amounts lying in the Fund are to be expended for payment of cash benefits and provision of medical treatment and attendance to insured persons and their families, establishment and maintenance of hospitals and dispensaries, etc. Any income of the ESI Fund is exempted.

(61) Income of member of a scheduled tribe [Section 10(26)] - A member of a Scheduled Tribe residing in -

- (i) any area (specified in the Constitution) or
- (ii) in the States of Manipur, Tripura, Arunachal Pradesh, Mizoram and Nagaland, or
- (iii) in the Ladakh region of the state of Jammu and Kashmir

is exempt from tax on his income arising or accruing -

- (a) from any source in the areas or States aforesaid.
- (b) by way of dividend or interest on securities.

(62) Exemption of income of a Sikkimese Individual [Section 10(26AAA)]

(i) The following income, which accrues or arises to a Sikkimese individual, would be exempt from income-tax –

- (a) income from any source in the State of Sikkim; or
- (b) income by way of dividend or interest on securities.

(ii) However, this exemption will not be available to a Sikkimese woman who, on or after 1st April, 2008, marries a non-Sikkimese individual.

(63) Exemption of income of an Agricultural Produce Market Committee or Board [Section 10(26AAB)] - Any income of an Agricultural Produce Market Committee or Board constituted under any law for the time being in force for the purpose of regulating the marketing of agricultural produce would be exempt.

(64) Income of a corporation etc. for the promotion of interests of members of scheduled castes or tribes or both [Section 10(26B)] - Any income of a corporation (established by a Central, State or Provincial Act) or other body, institution or association (wholly financed by Government) formed for promotion of the interests of the members of scheduled castes or tribes or backward classes or of any two or all of them is exempt from tax.

(65) Exemption of income of corporations established to protect interests of minority community [Section 10(26BB)] - Any income of a corporation established by the Central Government or any State Government for promoting the interests of the members of a minority community will be exempt from income tax. Section 80G also provides tax relief in respect of donations made to these corporations.

(66) Exemption of income of corporation established by a Central, State or Provincial Act for welfare of ex-servicemen [Section 10(26BBB)] - This clause exempts any income of a corporation established by a Central, State or Provincial Act for the welfare and economic upliftment of ex-servicemen, being citizens of India.

(67) Co-operatives for scheduled castes [Section 10(27)] - Any income of a co-operative society formed for promoting the interests of the members of either the scheduled castes or scheduled tribes will be exempted from being included in the total income of the society.

Conditions: (a) The membership of the co-operative society should consist of only other co-operative societies formed for similar purposes, and

(b) The finances of the society shall be provided by the Government and such other societies.

(68) Incomes of certain bodies like Coffee Board, etc. [Section 10(29A)] - Under this clause, any income accruing or arising to the following bodies is exempt from tax:

- (a) the Coffee Board constituted under section 4 of the Coffee Act, 1942,
- (b) the Rubber Board constituted under section 4(1) of the Rubber Board Act, 1947,
- (c) the Tea Board established under section 4 of the Tea Act, 1953,
- (d) the Tobacco Board constituted under the Tobacco Board Act, 1975,
- (e) the Marine Products Export Development Authority established under section 4 of the Marine Products Export Development Authority Act, 1972,

(f) the Agricultural and Processed Food Products Export Development Authority established under section 4 of the Agricultural and Processed Food Products Export Development Act, 1985,

(g) the Spices Board constituted under section 3(1) of the Spices Board Act, 1986,

(h) the Coir Board established under the Coir Industry Act, 1953.

(69) Tea board subsidy [Section 10(30)] - The amount of any subsidy received by any assessee engaged in the business of growing and manufacturing tea in India through or from the Tea Board will be wholly exempt from tax.

Conditions: (a) The subsidy should have been received under any scheme for replantation or replacement of the bushes or for rejuvenation or consolidation of areas used for cultivation of tea.

(b) The assessee should furnish a certificate from the Tea Board as to the subsidy received by him during the previous year to the Assessing Officer along with his return of the relevant assessment year or within the time extended by the Assessing Officer for the purpose.

(70) Other subsidies [Section 10(31)] - Amount of any subsidy received by an assessee engaged in the business of growing and manufacturing rubber, coffee, cardamom or other specified commodity in India from or through the Rubber Board, Coffee Board, Spices Board or any other Board in respect of any other commodity under any scheme for replantation or replacement of rubber, coffee, cardamom or other plants or for rejuvenation or consolidation of areas used for cultivation of all such commodities will be exempt from income-tax. Condition for submission of certificate is applicable.

(71) Exemption in respect of clubbed income of minor [Section 10(32)] - In case the income of an individual (i.e. the parent) includes the income of his minor child in terms of section 64(1A), such parent shall be entitled to exemption of ₹ 1,500 in respect of each minor child. However, if income of any minor so includible is less than ₹ 1,500, then the entire income shall be exempt.

Illustration 13

Mr. Khanna has an income from salary of ₹ 3,00,000. Details of income of his minor children are:

Minor daughter has earned an interest income from bank FD : ₹ 5,000

His minor son has also earned an interest income on NSC : ₹ 1,000.

Compute his gross total income for the P.Y. 2013-14.

Solution

Computation of Gross Total income of Mr. Khanna for the P.Y.2013-14

Income from Salary	₹ 3,00,000
Income from other sources	
Minor daughter's interest income from bank FD	5,000
Less: Exempt under section 10(32)	<u>(1,500)</u>
	₹ 3,500

Minor son's interest income on NSC	1,000		
Less: Exempt under section 10(32)	(1,000)	Nil	₹ 3,500
Gross Total Income			₹ 3,03,500

(72) Exemption of capital gain on transfer of a unit of Unit Scheme, 1964 (US 64) [Section 10(33)] - This clause provides that any income arising from the transfer of specified units, shall be exempt from tax. Such transfer should take place on or after 1.4.2002.

(73) Exclusion of dividends referred to in section 115-O from total income [Section 10(34)] - This clause provides that any income by way of dividends referred to in section 115-O shall be exempt. Under section 115-O, any amount declared, distributed or paid by a domestic company by way of dividend shall be subject to dividend distribution tax@16.995% (i.e., 15% plus surcharge@10% plus education cess@2% plus SHEC@1%). Therefore, a domestic company is liable to pay dividend distribution tax in addition to income-tax chargeable in respect of total income. The dividend income would, however, be exempt in the hands of the shareholder.

(74) Exemption of income received by an investor on account of buy-back of unlisted shares of a domestic company [Section 10(34A)]

(i) Under section 115-O, dividend distribution tax (DDT) is levied on a company at the time when it distributes, declares or pays any dividend to its shareholders. Consequently, the amount of dividend received by the shareholders is not included in the total income of the shareholder, by virtue of exemption provided under section 10(34).

(ii) So far, the consideration received by a shareholder on buy-back of shares by a company is not treated as dividend but is taxable as capital gains under section 46A.

(iii) While payment of dividend is one option available to a company to distribute its reserves to its shareholders, another option available is to buy-back its own shares at a consideration determined by it. If the company exercises the former option, the payment of dividend would be subject to DDT under section 115-O and income in the hands of shareholders would be exempt as per section 10(34). However, if the company prefers the second option, the income would be taxed in the hands of shareholder under section 46A as capital gains.

(iv) In order to discourage the practice of domestic companies resorting to buy back of unlisted shares instead of payment of dividends in order to avoid payment of tax by way of DDT, especially if the capital gains arising to the shareholders are either not chargeable to tax or are taxable at a lower rate, a new Chapter XII-DA, comprising of sections 115QA, 115QB and 115QC, has been inserted with effect from 1st June, 2013 to levy additional income-tax on buy back of such shares by domestic companies.

(v) The income arising to the shareholders in respect of such buy back of unlisted shares by the domestic company would be exempt under section 10(34A) w.e.f. A.Y.2014-15, where the company is liable to pay the additional income-tax on the buy-back of shares.

(vi) For this purpose, buyback means purchase by a company of its own shares in accordance with the provisions of section 77A of the Companies Act, 1956¹.

¹ Section 68 of the Companies Act, 2013

(75) Exemption of income from units from the Administrator of specified undertaking / specified company / mutual fund specified in clause (23D) [Section 10(35)] - This clause provides that any income received in respect of units from the Administrator of the specified undertaking / specified company / Mutual Fund specified under clause (23D) shall be exempt. Exemption shall not apply to any income arising from transfer of such units.

(76) Exemption of long term capital gains on transfer of listed equity shares [Section 10(36)] - Any income arising from transfer of a long-term capital asset, being an eligible equity share in a company purchased on or after 1.3.2003 but before 1.3.2004, and held for a period of 12 months or more shall be exempt from tax.

"Eligible equity share" means –

- (i) any equity share in a company being a constituent of BSE-500 Index of the Stock Exchange, Mumbai as on 1.3.2003 and the transactions of purchase and sale of such equity share are entered into on a recognised stock exchange in India;
- (ii) any equity share in a company allotted through a public issue on or after 1.3.2003 and listed in a recognised stock exchange in India before 1.3.2004 and the transaction of sale of such share is entered into on a recognised stock exchange in India.

(77) Exemption of capital gains on compulsory acquisition of agricultural land situated within specified urban limits [Section 10(37)] - With a view to mitigate the hardship faced by the farmers whose agricultural land situated in specified urban limits has been compulsorily acquired, clause (37) has been inserted to exempt the capital gains arising to an individual or a HUF from transfer of agricultural land by way of compulsory acquisition.

Such exemption is available where the compensation or the enhanced compensation or consideration, as the case may be, is received on or after 1.4. 2004.

The exemption is available only when such land has been used for agricultural purposes during the preceding two years by such individual or a parent of his or by such HUF.

Illustration 14

Mr. Kumar has an agricultural land (costing ₹ 6 lakh) in Lucknow and has been using it for agricultural purposes since 1.4.1995 till 1.8.2005 when the Government took over compulsory acquisition of this land. A compensation of ₹ 10 lakh was settled. The compensation was received by Mr. Kumar on 1.7.2013. Compute the amount of capital gains taxable in the hands of Mr. Kumar.

Solution

In the given problem, compulsory acquisition of an urban agricultural land has taken place and the compensation is received after 1.4.2004. This land had also been used for at least 2 years by the assessee himself for agricultural purposes. Thus, as per section 10(37), entire capital gains arising on such compulsory acquisition will be fully exempt and nothing is taxable in the hands of Mr. Kumar in the year of receipt of compensation i.e. A.Y.2014-15.

Illustration 15

Will your answer be any different if Mr. Kumar had by his own will sold this land to his friend Mr. Sharma? Explain.

Solution

As per section 10(37), exemption is available if compulsory acquisition of urban agricultural land takes place. Since the sale is out of own will and desire, the provisions of this section are not attracted and the capital gains arising on such sale will be taxable in the hands of Mr. Kumar.

Illustration 16

Will your answer be different if Mr. Kumar had not used this land for agricultural activities? Explain.

Solution

As per section 10(37), exemption is available only when such land has been used for agricultural purposes during the preceding two years by such individual or a parent of his or by such HUF. Since the assessee has not used it for agricultural activities, the provisions of this section are not attracted and the capital gains arising on such compulsory acquisition will be taxable in the hands of Mr. Kumar.

Illustration 17

Will your answer be different if the land belonged to ABC Ltd. and not Mr. Kumar and compensation on compulsory acquisition was received by the company? Explain.

Solution

Section 10(37) exempts capital gains arising to an individual or a HUF from transfer of agricultural land by way of compulsory acquisition. Since the land belongs to ABC Ltd., a company, the provisions of this section are not attracted and the capital gains arising on such compulsory acquisition will be taxable in the hands of ABC Ltd.

(78) Exemption of long-term capital gains on sale of equity shares / units of an equity oriented fund [Section 10(38)]

- (i) This clause exempts LTCG on sale of equity shares of a company or units of an equity oriented fund on or after 1.10.2004.
- (ii) This exemption is available only if such transaction is chargeable to securities transaction tax.
- (iii) However, such long term capital gains exempt under section 10(38) shall be taken into account in computing the book profit and income tax payable under section 115JB.
- (iv) "Equity oriented fund" means a fund –
 - (1) where the investible funds are invested by way of equity shares in domestic companies to the extent of more than 65% of the total proceeds of such fund; [The percentage of equity share holding of the fund should be computed with reference to the annual average of the monthly averages of the opening and closing figures], and
 - (2) which has been set up under a scheme of a Mutual Fund specified under clause (23D)

The percentage of equity share holding of the fund should be computed with reference to the annual average of the monthly averages of the opening and closing figures.

Illustration 18

Mr. Basu purchased 2,000 equity shares of ABC Ltd. (a listed company) on 1.4.2011 at ₹ 20 per share. He sold all the shares on 1.6.2013 at ₹ 50 per share. He also had to pay securities transaction tax (STT) on the same. Explain the taxability in the hands of Mr. Basu in the year of transfer i.e. A.Y.2014-15.

Solution

In the given problem, since the listed equity shares of ABC Ltd. are being sold after 12 months, there is a long-term capital gains (LTCG) on the sale of these shares. Also, such LTCG has arisen after 1.10.2004 and STT has also been paid on these shares. Thus, as per section 10(38), the entire LTCG arising on such sale will be fully exempt and nothing is taxable in the hands of Mr. Basu in the year of sale i.e. A.Y.2014-15.

Illustration 19

Will your answer be different if these shares were preference shares and not equity shares? Explain.

Solution

As per section 10(38), LTCG on sale of eligible equity shares of a company on or after 1.10.2004 shall be exempt. Since the shares are preference shares and not equity shares, the provisions of this section are not attracted and the capital gains arising on such sale will be taxable in the hands of Mr. Basu in the A.Y. 2014-15.

Illustration 20

Will your answer be different if these shares were not listed in a recognised stock exchange? Explain.

Solution

As per section 10(38), LTCG on sale of equity shares of a company on or after 1.10.2004 shall be exempt. However, this exemption is available only if such transaction is chargeable to securities transaction tax. Since the shares are not listed in a recognised stock exchange, STT will not be chargeable, hence the provisions of this section are not attracted and the capital gains arising on such sale will be taxable in the hands of Mr. Basu in the A.Y.2014-15.

(79) Exemption of specified income arising from any international sporting event in India [Section 10(39)]

(i) This clause exempts income of the nature and to the extent, arising from any international sporting event in India, to the person or persons notified by the Central Government in the Official Gazette.

(ii) Such international sporting event should -

- (1) be approved by the international body regulating the international sport relating to such event;
- (2) have participation by more than two countries;
- (3) be notified by the Central Government in the Official Gazette for the purposes of this clause.

(iii) Accordingly, in exercise of the powers conferred by section 10(39), the Central Government has notified the following:

- (a) the Commonwealth Games Federation, London, United Kingdom as the person,
- (b) the Commonwealth Games 2010 to be held in India, as the international sporting event,
- (c) the income arising to Commonwealth Games Federation from Commonwealth Games 2010 on account of Host Fee, received or receivable from the Organising Committee Commonwealth Games 2010 Delhi, India amounting to 7.3 million GBP, as the specified income, for the purposes of exemption under section 10(39).

(80) Exemption of certain grants etc. received by a subsidiary from its Indian holding company engaged in the business of generation or transmission or distribution of power [Section 10(40)]

(i) This clause exempts income of any subsidiary company by way of grant or otherwise received from an Indian company, being its holding company engaged in the business of generation or transmission or distribution of power.

(ii) The receipt of such income should be for settlement of dues in connection with reconstruction or revival of an existing business of power generation.

(iii) The exemption under this clause is available if the reconstruction or revival of any existing business of power generation is by way of transfer of such business to the Indian company notified under section 80-IA(4)(v)(a).

(81) Exemption of any income from transfer of an asset of an undertaking engaged in the business of generation or transmission or distribution of power [Section 10(41)]

(i) This clause exempts income arising from transfer of a capital asset, being an asset of an undertaking engaged in the business of generation or transmission or distribution of power.

(ii) Such transfer should be effected on or before 31st March, 2006, to an Indian company notified under section 80-IA(4)(v)(a).

(82) Exemption of specified income of certain bodies or authorities [Section 10(42)]

(i) This clause exempts income, of the nature and to the extent, arising to a body or authority, notified by the Central Government.

(ii) Such body or authority should have been established or constituted or appointed -

- (a) under a treaty or an agreement entered into by the Central Government with two or more countries or a convention signed by the Central Government;
- (b) not for the purposes of profit.

(83) Exemption of income received in a transaction of reverse mortgage [Section 10(43)]

The Finance Minister had, in his budget speech of Union Budget 2007-08, announced that the National Housing Bank would introduce the Reverse Mortgage scheme. This scheme is for the benefit of senior citizens, who own a residential house property. In order to supplement their existing income, they can mortgage their house property with a scheduled bank or housing finance

company, in return for a lump-sum amount or for a regular monthly/quarterly/annual income. The senior citizens can continue to live in the house and receive regular income, without the botheration of having to pay back the loan.

The loan will be given up to, say, 60% of the value of residential house property mortgaged. Also, the bank/housing finance company would undertake a revaluation of the property once every 5 years. The borrower can use the loan amount for renovation and extension of residential property, family's medical and emergency expenditure etc., amongst others. However, he cannot use the amount for speculative or trading purposes.

The bank will recover the loan along with the accumulated interest by selling the house after the death of the borrower. The excess amount will be given to the legal heirs. However, before resorting to sale of the house, preference will be given to the legal heirs to repay the loan and interest and get the mortgaged property released.

Therefore, clause (xvi) of section 47 clarifies that any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government would not amount to a transfer for the purpose of capital gains. Further, section 10(43) provides that the amount received by the senior citizen as a loan, either in lump sum or in installments, in a transaction of reverse mortgage would be exempt from income-tax.

Capital gains tax liability would be attracted only at the stage of alienation of the mortgaged property by the bank/housing finance company for the purposes of recovering the loan.

(84) Exemption of income received by any person on behalf of NPS Trust [Section 10(44)] -The New Pension System (NPS), operational since 1st January, 2004, is compulsory for all new recruits to the Central Government service from 1st January, 2004. Thereafter, it has been opened up for employees of State Government and private sector.

NPS Trust has been set-up on 27th February, 2008 as per the provisions of the Indian Trust Act, 1882 to manage the assets and funds under the NPS in the interest of the beneficiaries. The NPS Trust from the applicability of –

- (i) income-tax on any income received by any person for, or on behalf of, the NPS Trust [Section 10(44)]
- (ii) dividend distribution tax in respect of dividend paid to any person for, or on behalf of, the NPS Trust; and
- (iii) securities transaction tax on all purchases and sales of equity and derivatives by the NPS Trust.

Further, the NPS Trust shall receive all income without any deduction of tax at source. [Section 197A(1E)].

Thus, the NPS Trust, which was set up to manage the assets and funds under the New Pension System in the interest of the beneficiaries, would enjoy a “pass-through status”.

(85) Exemption of specified allowances and perquisites paid to Chairman or a retired Chairman or any other member or retired member of the UPSC [Section 10(45)]

- (i) Under the Income-tax Act, 1961, perquisites and allowances received by an employee are taxable under the head “Salaries” unless they are specifically exempted.

(ii) Section 10(45) exempts specified allowances and perquisites received by Chairman or any other member, including retired Chairman/member, of the Union Public Service Commission (UPSC).

(iii) The exemption would be available in respect of such allowances and perquisites as may be notified by the Central Government in this behalf.

(iv) Accordingly, the Central Government has notified the following allowances and perquisites for serving Chairman and members of UPSC, for the purpose of exemption under section 10(45) -

- (1) the value of rent free official residence,
- (2) the value of conveyance facilities including transport allowance,
- (3) the sumptuary allowance and
- (4) the value of leave travel concession.

In case of retired Chairman and retired members of UPSC, the following have been notified for exemption under section 10(45):

- (i) a sum of maximum ₹ 14,000 per month for defraying the service of an orderly and for meeting expenses incurred towards secretarial assistance on contract basis.
- (ii) the value of a residential telephone free of cost and the number of free calls to the extent of ₹ 1,500 pm (over and above free calls per month allowed by the telephone authorities)

Note – Tax exemption is also available in respect of certain specified perquisites enjoyed by Chief Election Commissioner/Election Commissioner and judges of Supreme Court on account of the enabling provisions in the respective Acts which govern their service conditions.

(86) Exemption of specified income of notified entities not engaged in commercial activity [Section 10(46)]

(i) Section 10(46) provides for exemption of income arising to a body or authority or Board or Trust or Commission, the nature and extent of which is to be specified by the Central Government.

(ii) For availing the benefit of exemption under this clause, the body or authority or Board or Trust or Commission should be set up or constituted by or under a Central, State or Provincial Act or constituted by the Central or State Government with the object of regulating or administering an activity for the benefit of the general public.

(iii) Further, the body or authority or Board or Trust or Commission should –

- (1) not be engaged in any commercial activity;
- (2) be notified by the Central Government in this behalf.

(iv) Accordingly, the Central Government has notified that for the purposes of section 10(46), the following income arising to the National Skill Development Corporation (NSDC), a body constituted by the Central Government, for F.Y. 2011-12 to F.Y. 2015-16, shall not be chargeable to tax:

- (1) long-term or short-term capital gain out of investment in an organization for skill development;

- (2) dividend and royalty from skill development venture supported or funded by NSDC;
- (3) interest on loans to Institutions for skill development;
- (4) interest earned on fixed deposits with banks; and
- (5) amount received in the form of Government grants.

Such exemption shall apply if:

(1) the activities and the nature of the specified income of NSDC remain unchanged throughout the financial year, and

(2) NSDC files its return of income in accordance with section 139(4C)(g).

(v) Further, the Central Government has notified that for the purposes of section 10(46), the following income arising to the Competition Commission of India (CCI), a Commission established under section 7(1) of the Competition Act, 2002, for F.Y. 2011-12 to F.Y. 2015-16, shall not be chargeable to tax:

- (i) amount received in the form of Government grants;
- (ii) fee received under the Competition Act, 2002; and
- (iii) interest income accrued on Government grants and interest accrued on fee received under the Competition Act, 2002.

Such exemption shall apply if:

(i) the activities and the nature of the specified income of CCI remain unchanged throughout the financial year, and

(ii) CCI files its return of income in accordance with section 139(4C)(g)

(87) Exemption of income of notified infrastructure debt funds and concessional tax rate on interest received by non-residents from such fund [Section 10(47)]

(i) In order to give a fillip to infrastructure and encourage inflow of long-term foreign funds to this sector, the Central Government to notify infrastructure debt funds to be set up in accordance with the prescribed guidelines, the income of which would be exempt from tax.

(ii) Interest income received by a non-resident or a foreign company from such fund would be subject to tax at a concessional rate of 5% under section 115A on the gross amount of such interest income.

(88) Exemption in respect of income received by certain foreign companies in India in Indian currency from sale of crude oil to any person in India [Section 10(48)]

(i) A mechanism has been devised, in the national interest, to make payment to certain foreign companies in India in Indian currency for import of crude oil.

(ii) In order to provide exemption in respect of such income in the hands of the foreign company, especially since the payment is made in the interest of the nation, clause (48) of section 10 exempts any income of a foreign company received in India in Indian currency on account of sale of crude oil, *any other goods or rendering of services, as may be notified by the Central Government in this behalf*, to any person, in India.

(iii) The following conditions have to be fulfilled for claim of such exemption –

The money has been received under an agreement or arrangement which is either entered into, or approved by, the Central Government;

The foreign company, as well as the arrangement or agreement, are notified by the Central Government having regard to the national interest;

The foreign company is not engaged in any other activity in India, except receipt of income under such arrangement or agreement.

(89) Exemption in respect of income of National Financial Holdings Company Ltd. [Section 10(49)]

(i) The Specified Undertaking of Unit Trust of India (SUUTI) was created vide the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 as the successor of Unit Trust of India (UTI). It was eligible for exemption from income-tax in respect of its income up to 31st March, 2014.

(ii) Consequent to winding up of SUUTI and its succession by a new company wholly owned by the Central Government i.e., National Financial Holdings Company Limited (NFHCL), which has been incorporated on 7th June, 2012, a new clause (49) has been inserted in section 10 to exempt the income accruing or arising to NFHCL on or before 31.03.2014 or the income received by NFHCL on or before the said date.

Such exemption would be available for A.Y.2013-14 and A.Y.2014-15.

Students should carefully note that all the items under section 10 listed above are altogether exempt from taxation and they are not even includible in the total income of the person concerned.

3.3 Tax Holiday for Newly Established Units in Special Economic Zones [Section 10AA]

A deduction of profits and gains which are derived by an assessee being an entrepreneur from the export of articles or things or providing any service, shall be allowed from the total income of the assessee.

(1) **Assessee who is eligible for exemption:** Exemption is available to all categories of assessee who derive any profits or gains from an undertaking being a unit engaged in the export of articles or things or providing any service. Such assessee should be an entrepreneur referred to in section 2(j) of the SEZ Act, 2005 i.e., a person who has been granted a letter of approval by the Development Commissioner under section 15(9).

(2) **Essential conditions to claim exemption:** The exemption shall apply to an undertaking which fulfils the following conditions:

(i) It has begun or begins to manufacture or produce articles or things or provide any service on or after 1.4.2005 in any SEZ.

(ii) It should not be formed by splitting up or reconstruction of a business already in existence (except in circumstances provided in section 33B) or formed by transfer to a new business, of plant and machinery previously used for any purpose exceeding 20% of the total

value of machinery and plant used in the business.

(iii) For this purpose, any machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose if the following conditions are fulfilled:

- (a) such machinery or plant was not at any time used in India;
- (b) such machinery or plant is imported into India from any country outside India; and
- (c) no deduction on account of depreciation has been allowed in respect of such machinery or plant to any person earlier.

(iv) The assessee should furnish in the prescribed form [Form No. 56F], alongwith the return of income, the report of a chartered accountant certifying that the deduction has been correctly claimed.

(v) The conditions laid down in sub-section (8) (relating to inter-unit transfer) and sub-section (10) (relating to showing excess profit from such unit) of section 80-IA shall, so far as may be, apply in relation to the undertaking referred to in this section as they apply for the purposes of the undertaking referred to in section 80-IA.

(3) Period for which deduction is available : The unit of an entrepreneur, which begins to manufacture or produce any article or thing or provide any service in a SEZ on or after 1.4.2005, shall be allowed a deduction of:

(i) 100% of the profits and gains derived from the export, of such articles or things or from services for a period of 5 consecutive assessment years beginning with the assessment year relevant to the previous year in which the Unit begins to manufacture or produce such articles or things or provide services, and

(ii) 50% of such profits and gains for further 5 assessment years.

(iii) A further deduction for next 5 consecutive years shall be so much of the amount not exceeding 50% of the profit as is debited to the profit and loss account of the previous year in respect of which the deduction is to be allowed and credited to a reserve account (to be called the "Special Economic Zone Re-investment Reserve Account") to be created and utilised in the manner laid down under section 10AA(2).

Example: An undertaking is set up in a SEZ and begins manufacturing on 15.10.2005. The deduction under section 10AA shall be allowed as under:

(a) 100% of profits of such undertaking from exports from A.Y.2006-07 to A.Y.2010-11.

(b) 50% of profits of such undertaking from exports from A.Y.2011-12 to A.Y. 2015-16.

(c) 50% of profits of such undertaking from exports from A.Y.2016-17 to A.Y.2020-21 provided certain conditions are satisfied.

(4) Conditions to be satisfied for claiming deduction for further 5 years (after 10 years) [Section 10AA(2)] - Sub-section (2) provides that the deduction under (3)(iii) above shall be allowed only if the following conditions are fulfilled, namely:-

- (a) the amount credited to the Special Economic Zone Re-investment Reserve Account is utilised-
- (1) for the purposes of acquiring machinery or plant which is first put to use before the expiry of a period of three years following the previous year in which the reserve was created; and
 - (2) until the acquisition of the machinery or plant as aforesaid, for the purposes of the business of the undertaking. However, it should not be utilized for
 - (i) distribution by way of dividends or profits; or
 - (ii) for remittance outside India as profits; or
 - (iii) for the creation of any asset outside India;
- (b) the particulars, as may be specified by the CBDT in this behalf, have been furnished by the assessee in respect of machinery or plant. Such particulars include details of the new plant/machinery, name and address of the supplier of the new plant/machinery, date of acquisition and date on which new plant/machinery was first put to use. Such particulars have to be furnished along with the return of income for the assessment year relevant to the previous year in which such plant or machinery was first put to use.

(5) Consequences of mis-utilisation / non-utilisation of reserve [Section 10AA(3)]

Where any amount credited to the Special Economic Zone Re-investment Reserve Account -

- (a) has been utilised for any purpose other than those referred to in sub-section (2), the amount so utilized shall be deemed to be the profits in the year in which the amount was so utilised and charged to tax accordingly; or
 - (b) has not been utilised before the expiry of the said period of 3 years, the amount not so utilised, shall be deemed to be the profits in the year immediately following the said period of three years and be charged to tax accordingly [Sub-section (3)].
- (6) **Computation of profit and gains from exports of such undertakings:** The profits derived from export of articles or things or services (including computer software) shall be the amount which bears to the profits of the business of the undertaking, being the unit, the same proportion as the export turnover in respect of such articles or things or computer software bears to the total turnover of the business carried on by the undertaking. i.e.

Profits from business of the undertaking being the unit ×

$$\left(\frac{\text{Export turnover of the undertaking of such articles or things or computer software}}{\text{Total turnover of the business carried on by the undertaking}} \right)$$

- (7) **Conversion of EPZ / FTZ into SEZ:** Where a Unit initially located in any FTZ or EPZ is subsequently located in a SEZ by reason of conversion of such FTZ or EPZ into a SEZ, the period of 10 consecutive assessment years referred to above shall be reckoned from the assessment year relevant to the previous year in which the Unit began to manufacture, or produce or process such articles or things or services in such FTZ or EPZ.

However, where a unit initially located in any FTZ or EPZ is subsequently located in a SEZ by reason of conversion of such FTZ or EPZ into a SEZ and has already completed the period of 10 consecutive assessment years, it shall not be eligible for further deduction from income w.e.f. A.Y.2006-07.

Note - The provisions of erstwhile section 10A shall not apply to any undertaking, being a Unit referred to under section 2(zc) of the SEZ Act, 2005, which has begun or begins to manufacture or produce articles or things or computer software during the previous year relevant to the assessment year commencing on or after the 1.4.2006 in any SEZ. "Unit" as per section 2(zc) of the SEZ Act, 2005 means unit set up by an entrepreneur in a Special Economic Zone and includes an existing Unit, an Offshore Banking Unit and a Unit in an International Financial Services Centre, whether established before or after the commencement of this Act.

(8) Restriction on other tax benefits

(i) The loss referred to in section 72(1) or section 74(1)/(3), in so far as such loss relates to the business of the undertaking, being the Unit shall be allowed to be carried forward or set off.

(ii) In order to claim deduction under this section, the assessee should furnish report from a Chartered Accountant in the prescribed form along with the return of income certifying that the deduction is correct.

(iii) During the period of deduction, depreciation is deemed to have been allowed on the assets. Written down value shall accordingly be reduced.

(iv) No deduction under section 80-IA and 80-IB shall be allowed in relation to the profits and gains of the undertaking.

(v) Any unabsorbed depreciation under section 32(2) or business loss under section 72(1) or loss under the head "Capital gains" under section 74 of the undertaking, being the Unit shall be allowed to be carried forward and set off in the subsequent years.

(vi) Where any goods or services held for the purposes of eligible business are transferred to any other business carried on by the assessee, or where any goods held for any other business are transferred to the eligible business and, in either case, if the consideration for such transfer as recorded in the accounts of the eligible business does not correspond to the market value thereof, then the profits eligible for deduction shall be computed by adopting market value of such goods or services on the date of transfer. In case of exceptional difficulty in this regard, the profits shall be computed by the Assessing Officer on a reasonable basis as he may deem fit. Similarly, where due to the close connection between the assessee and the other person or for any other reason, it appears to the Assessing Officer that the profits of eligible business is increased to more than the ordinary profits, the Assessing Officer shall compute the amount of profits of such eligible business on a reasonable basis for allowing the deduction.

(9) Deduction allowable in case of amalgamation and demerger - In the event of any undertaking, being the Unit which is entitled to deduction under this section, being transferred, before the expiry of the period specified in this section, to another undertaking, being the Unit in a scheme of amalgamation or demerger, -

- (a) no deduction shall be admissible under this section to the amalgamating or the demerged Unit for the previous year in which the amalgamation or the demerger takes place; and
- (b) the provisions of this section would apply to the amalgamated or resulting Unit, as they would have applied to the amalgamating or the demerged Unit had the amalgamation or demerger had not taken place.

Clarification on issues relating to export of computer software

Section 10AA provides deduction to assessee who derive any profits and gains from export of articles or things or services (including computer software) from the year in which the Unit begins to manufacture or produce such articles or things or provide services, as the case may be, subject to fulfillment of the prescribed conditions. Explanation 2 to the said section clarifies that the profits and gains derived from on site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India.

Circular No. 1/2013, dated 17.01.2013 provides certain clarifications in respect of following issues arising out of the said provisions:

	Issue	Clarification given by the CBDT
(1)	Would "On-site" development of computer software qualify as an export activity for tax benefit under section 10AA?	The software developed abroad at a client's place would be eligible for such benefit, because these would amount to 'deemed export'. However, it is necessary that there must exist a direct and intimate nexus or connection of development of software done abroad with the eligible units set up in India and such development of software should be pursuant to a contract between the client and the eligible unit.
(2)	Would receipts from deputation of technical manpower for such "On-site" software development abroad at the client's place be eligible for deduction under section 10AA?	Explanation 2 to section 10AA clarifies that profits and gains derived from 'services for development of software' outside India would also be deemed as profits derived from export. Therefore, profits earned as a result of deployment of technical manpower at the client's place abroad specifically for software development work pursuant to a contract between the client and the eligible unit should not be denied benefit under section 10AA provided such deputation of manpower is for the development of such software and all the prescribed conditions are fulfilled.
(3)	Is it necessary to have separate master service agreement (MSA) for each work contract?	As per the practice prevalent in the software development industry, generally two types of agreement are entered into between the Indian software developer and the foreign client. Master Services Agreement (MSA) is an initial general agreement between a foreign client and the Indian software developer setting out the broad and

		<i>general terms and conditions of business under the umbrella of which specific and individual Statement of Works (SOW) are formed. These SOWs, in fact, enumerate the specific scope and nature of the particular task or project that has to be rendered by a particular unit under the overall ambit of the MSA. Clarification has been sought whether more than one SOW can be executed under the ambit of a particular MSA and whether SOW should be given precedence over MSA.</i> <i>It is clarified that the tax benefits under section 10AA would not be denied merely on the ground that a separate and specific MSA does not exist for each SOW. The SOW would normally prevail over the MSA in determining the eligibility for tax benefits unless the Assessing Officer is able to establish that there has been splitting up or reconstruction of an existing business or non-fulfillment of any other prescribed condition.</i>
(4)	<i>Would tax benefit under section 10AA continue to be available in case of a slump sale of a unit?</i>	<i>The answer to this issue would depend on the facts of each case, such as how a slump-sale is made and what is its nature. It will also be important to ensure that the slump sale would not result into any splitting or reconstruction of existing business.</i> <i>It is, however, clarified that on the sole ground of change in ownership of an undertaking, the claim of exemption cannot be denied to an otherwise eligible undertaking and the tax holiday can be availed of for the unexpired period at the rates as applicable for the remaining years, subject to fulfillment of prescribed conditions.</i>
(5)	<i>Can tax benefits under section 10AA be enjoyed by an eligible SEZ unit consequent to its transfer to another SEZ?</i>	<i>It is clarified that the tax holiday should not be denied merely on the ground of physical relocation of an eligible SEZ unit from one SEZ to another in accordance with Instruction No. 59 of Department of Commerce, if all the prescribed conditions are satisfied under the Income-tax Act, 1961.</i> <i>It is further clarified that the unit so relocated will be eligible to avail of the tax benefit for the unexpired period at the rates applicable to such years.</i>
(6)	<i>Whether new units set up in the same location where there is an existing eligible unit would amount to</i>	<i>This issue is a matter of fact requiring examination and verification. However, it has been clarified that setting up of such a fresh unit in itself would not make the unit ineligible for tax benefits, provided –</i> <i>(i) the unit is set-up after obtaining necessary approvals from the competent authorities;</i>

	<i>expansion of the existing unit?</i>	<i>(ii) it has not been formed by splitting or reconstruction of an existing business; and</i> <i>(iii) it fulfils all other conditions prescribed under section 10AA.</i>

3.4 Charitable or Religious Trusts and Institutions [Sections 11 to 13]

(1) General discussion on trusts - Before considering the provisions of sections 11 to 13 which govern the exemption in respect of income from property held for charitable or religious purposes, let us see briefly what exactly the term trust signifies, the types of trusts and the manner of their creation. Though this aspect of the topic does not strictly fall within the purview of income-tax, such a general knowledge would be useful in understanding the provisions of tax laws relating to charitable trusts.

A trust is an obligation annexed to the ownership and arising out of a confidence reposed in and accepted by the owner if declared and accepted by him for the benefit of another or of another and the owner. The person who reposes or declares the confidence is called the 'author of the trust'; the person who accepts the confidence is called the trustee; the person for whose benefit the confidence is accepted is called the 'beneficiary'; the subject matter of the trust is called the 'trust property'; the 'beneficial interest' or 'interest' of the beneficiary is his right against the trustees or owner of the trust property and the instrument, if any, by which trust is declared is called the 'instrument of trust'.

Trusts can be broadly classified into two groups - Public and Private. The distinction between a public and private trust is that, whereas in the former, the beneficiaries are the general public or a class thereof, in the latter they are specific individuals. While in the former the beneficiaries constitute a body which is incapable of ascertainment, in the latter they are persons who are ascertained or capable of being ascertained. In some cases, private trusts may ensure for the benefit of the public. Some religious trust may also be in the nature of public-cum-private trust.

Private trusts are governed by the Indian Trust Act, 1882. This Act does not apply to the following:

- (1) The rules of Mohammedan law as to wakf;
- (2) The mutual relations of the members of undivided family as determined by any customary or personal law;
- (3) Public or private religious or charitable endowments; and
- (4) Trust to distribute prizes taken in war among the captors.

From the above, it will be clear that public charitable trusts are not governed by the Indian Trust Act.

There are three requirements for creation of a public trust. They are (1) a declaration of trust which is binding on the settlor, (2) setting apart definite property and depriving himself of the ownership, and (3) a statement of subjects for which the property is thereafter to be held. In the case of a private trust also, more or less similar requirements exist.

The word 'trust' as used in the context of sections 11 to 13 includes, in addition to the 'trust' as

explained above, 'any other legal obligation'. This is made clear in Explanation 1 to section 13. The words 'any other legal obligation' are wide enough to cover Muslim wakfs, Hindu endowments and dedications to deities. It would also cover a case in which the trustees of a settlement are to pay the income to other trustees who in their turn are bound to apply it for purposes which are religious or charitable.

(2) Tax Exemption [Section 11]

(i) Subject to the provisions of sections 60 to 63, the income of a religious or charitable trust or institution, to the extent specified in the Act, is exempt from tax when certain prescribed conditions are fulfilled. The relevant income does not even form part of the total income of the trust or institution.

(ii) Section 11 deals with the exemption of income from property held in trust or other legal obligation for religious or charitable purposes wholly or in part. Section 12 deals with exemption of income derived by such a trust from voluntary contributions. Section 12A prescribes the conditions as to registration of trust etc. Section 13 enumerates the circumstances under which the exemption available under sections 11 to 12 will be denied.

(iii) **Income from property held for charitable or religious purposes** - The following income shall not be included in the total income of the previous year of the person in receipt of the income:

- (a) Income derived from property held under trust wholly for charitable and religious purposes to the extent such income is applied in India for such purpose.
- (b) Income derived from property held under trust in part only for such purpose, to the extent such income is applied in India for such purposes. However, the trust in question must have been created before 1.4.1962.
- (c) Income derived from property held under trust, created on after 1.4.1952 for charitable purpose which tends to promote international welfare in which India is interested to the extent to which such income is applied to such purpose outside India. This does not cover religious trusts.
- (d) Income derived from property held under a trust for charitable or religious purposes, created before 1.4.1952, to the extent to which such income is applied for such purposes outside India.
- (e) Income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution.

Thus, it may be noted that only such income derived from property held under trust wholly for charitable or religious purposes is exempt. If the property is held in part only for such purposes, it is necessary that such a trust must have been created before the commencement of the Act. In both the cases, the exemption is limited to the extent such income is applied in India for such specified purposes.

(iv) **Types of trusts** - To get exemption in respect of income applied outside India, the trusts are divided into two types:

- (a) If the object of the trust is to promote international welfare in which India is interested, such trust may have been created on or after 1.4.1952.

(b) If the trust is for any other charitable purpose it must have been created before 1.4.1952. Here also, the exemption is limited to the extent to which such income is applied outside India for such specified purposes. It is to be noted however that a direction from CBDT by a general or special order is necessary before such exemption can be claimed.

(v) Conditions for claiming exemption

(a) Property should be held under trust - The exemptions explained in the preceding paragraphs are available if and only if there is a valid trust or there is a legal obligation, under which the income derived from the property held under such trust or legal obligation is to be applied for charitable or religious purposes. If there is no trust nor any legal obligation, the income will not be exempt even if the whole of such income is applied to charitable or religious purposes. A mere creation of a trust for the income is not sufficient, there must be a trust of the property out of which the income is derived before one can consider any exemption under section 11.

(b) Income should be applied for charitable purposes - Section 2(15) states that 'charitable purpose' includes relief of the poor, education, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility.

The definition of "charitable purpose" includes "any other object of general public utility" The question arises as to what is an object of "general public utility". This expression has not been defined anywhere in the Act.

In *CIT v. Gujarat Maritime Board* (2007) 295 ITR 561, the Supreme Court observed that the Gujarat Maritime Board was established for the predominant purpose of development of minor ports within the State of Gujarat, the management and control of the Board was essentially with the State Government and there was no profit motive. The assessee, Gujarat Maritime Board, was under a legal obligation to apply its income which was directly and substantially from the business held under trust for the development of minor ports in Gujarat. Therefore, the Supreme Court held that the assessee was entitled to be registered as "charitable trust" under section 12A.

A number of entities functioning on commercial basis claim exemption of their income either under section 10(23C) or section 11 on the foundation that they are charitable institutions. This is based on the contention that they are engaged in the "advancement of an object of general public utility" as is included in the fourth part of the present definition of "charitable purpose". There were many decisions rendered in the past supporting the view that if unconnected business is held under a trust for promoting the object of general public utility and if profits are used for promoting such objects, income thereof shall be exempt, for example, the decision of the Supreme Court in *CIT v. Madras Stock Exchange Ltd.* (1981) 130 ITR 184. However, such a claim in respect of an activity carried out on commercial basis, goes against the basic intention of the provision.

Therefore, in order to limit the ambit of the phrase "advancement of any other object of general public utility", section 2(15) has been amended to provide that "the advancement of

any other object of general public utility” would not be a charitable purpose if it involves the carrying on of –

- (a) any activity in the nature of trade, commerce or business or,
- (b) any activity of rendering of any service in relation to any trade, commerce or business, for a fee or cess or any other consideration, irrespective of the nature of use or application of the income from such activity, or the retention of such income, by the concerned entity.

Therefore, the institutions which were engaged in charitable activities and having the object of general public utility were denied exemption, if they were engaged in any activity of trade, commerce or business or activity of rendering any service in relation to any trade, commerce or business for a cess or fees.

In order to provide relief to the genuine hardship faced by charitable organizations which receive marginal consideration from such activities, it has been provided that such benefit of exemption will not be denied to the institutions having object of advancement of general public utility, even where they are engaged in the activity of trade, commerce or business or rendering any service for a cess or fee, provided the aggregate value of receipts from such activities does not exceed ₹ 25 lakh in the year under consideration.

Therefore, in effect, “advancement of any other object of general public utility” would continue to be a “charitable purpose”, if the total receipts from any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business does not exceed ₹ 25 lakh in the previous year.

This amendment may have the effect of changing the “charitable” status of the trust/institution every year depending on whether or not the total receipts from such activities exceed ₹ 25 lakh in that year.

Illustration 21

An institution having its main object as “advancement of general public utility” received ₹ 30 lakhs in aggregate during the P.Y.2013-14 from an activity in the nature of trade. It applied 85% of its receipt from such activity during the same year for its main object i.e. advancement of general public utility.

- (i) What would be the tax consequence of such receipt and application thereof by the institution?
- (ii) Would your answer be different if the institution had received ₹ 23 lakhs (instead of ₹ 30 lakhs) in aggregate during the P.Y.2013-14 from an activity in the nature of trade?
- (iii) What would be your answer if the main object of the institution is “relief of the poor” and the institution receives ₹ 30 lakhs from a trading activity and applies 85% of the said receipts for its main object?

Solution

- (i) As the main object of the institution is “advancement of object of general public utility”, the institution will lose its “charitable” status for the P.Y.2013-14, since it has received ₹ 30 lakhs from an activity in the nature of trade. The application of 85% of such receipt for its main object during the year would not help in retaining its “charitable” status for that year. The institution will lose its

charitable status and consequently, the benefit of exemption of income for the P.Y.2012-13, irrespective of the fact that its approval is not withdrawn or its registration is not cancelled.

(ii) If the institution receives only ₹ 23 lakhs in aggregate from an activity in the nature of trade during the P.Y.2013-14, then it will not lose its “charitable” status since receipt of upto ₹ 25 lakhs in a year from such activity is permissible. The institution can claim exemption subject to fulfillment of other conditions under sections 11 to 13.

(iii) The restriction regarding carrying on of a trading activity for a cess, fee or other consideration will not apply if the main object of the institution is “relief of the poor”. Therefore, receipt of ₹ 30 lakhs from a trading activity by such an institution will not affect its “charitable” status. The institution can claim exemption subject to fulfillment of other conditions under sections 11 to 13.

Circular No.11/2008 dated 19.12.2008

Exemption under section 11 in case of an assessee claiming both to be a charitable institution as well as a mutual organisation

The proviso to section 2(15) will apply only to entities whose purpose is advancement of any other object of general public utility i.e. the last limb of the definition of charitable purpose contained in section 2(15). Hence, such entities will not be eligible for exemption under section 11 or under section 10(23C) if they carry on commercial activities. Whether such an entity is carrying on an activity in the nature of trade, commerce or business is a question of fact which will be decided based on the nature, scope, extent and frequency of the activity.

There are industry and trade associations who claim exemption from tax under section 11 on the ground that their objects are for charitable purpose as these are covered under any other object of general public utility. Under the principle of mutuality, if trading takes place between persons who are associated together and contribute to a common fund for the financing of some venture or object and in this respect have no dealings or relations with any outside body, then any surplus returned to the persons forming such association is not chargeable to tax. In such cases, there must be complete identity between the contributors and the participants.

Therefore, where industry or trade associations claim both to be charitable institutions as well as mutual organizations and their activities are restricted to contributions from and participation of only their members, these would not fall under the purview of the proviso to section 2(15) owing to the principle of mutuality. However, if such organizations have dealings with non-members, their claim to be charitable organizations would now be governed by the additional conditions stipulated in the proviso to section 2(15).

In the final analysis, however, whether the assessee has for its object the advancement of any other object of general public utility is a question of fact. If such assessee is engaged in any activity in the nature of trade, commerce or business or renders any service in relation to trade, commerce or business, it would not be entitled to claim that its object is charitable purpose. In such a case, the object of general public utility will be only a mask or a device to hide the true purpose which is trade, commerce or business or the rendering of any service in relation to trade, commerce or business. Each case would, therefore, be decided on its own facts and no generalization is possible.

Circular No. 395, dated 24.9.1984 - Promotion of sports and games is considered to be charitable purposes within the meaning of section 2(15). Therefore, an association or institution engaged in the promotion of games and sports can claim exemption under section 11 even if it is not approved under section 10(23).

A trust will be treated as a charitable trust under section 2(15) even if its object involves the carrying on of an activity for profit. Such a trust will not be denied exemption under section 11 on the ground that its objects are non-charitable.

(vi) **Application and accumulation** - We have seen that the exemption is limited to the extent to which such income is applied in India or outside India as the case may be. Is it necessary that the entire income should be so applied? The Act gives a concession here. It is possible to claim the exemption even if the trust or institution applies only 85 per cent of the income derived from the trust property for the purpose of the trust, during the relevant previous year.

An accumulation not exceeding 15 per cent of the income from such property is permissible. For computing this 15 per cent, voluntary contributions referred to in section 12 shall be deemed to be part of the income. It must be clearly noted that accumulation must be with the object of application of the accumulated amount to charitable or religious purpose in India at a later date. Such a facility for accumulation is not available for those trusts whose income is to be applied outside India.

(vii) **Inability to apply in full 85 per cent of the income** - It is clear from the above discussion that free accumulation not exceeding 15 per cent of income from property is permissible. Hence, the balance 85 per cent must be applied during the previous year for the purposes for which the trust has been created. However, it is possible that the trust is unable to apply the minimum of 85 per cent of its income during the previous year due to either of the following reasons.

- (1) The whole or any part of the income has not been received during that year.
- (2) Any other reason.

In the first class of cases, the period of application is extended to cover the previous year in which the income is actually received and the previous year immediately following the year. But the amount which may be so claimed to have been so applied during the subsequent previous year cannot exceed the amount of the income which had not been received earlier but received during a subsequent previous year.

Example 1 - During the previous year ending 31st March, 2014, a charitable trust earned an income of ₹ 1,00,000 but it received only ₹ 60,000 in that year. The balance of ₹ 40,000 is received in the year ending 31-3-2015.

	₹
Total income earned during the P.Y.2013-14	1,00,000
Actual receipt in P.Y.2013-14	60,000
Permissible accumulation @15% of ₹ 1,00,000	15,000

Balance to be applied during P.Y. 2013-14	45,000
Amount received in P.Y.2014-15 to be applied in P.Y.2014-15 or P.Y.2015-16	40,000

Since this amount of ₹ 40,000 is received during the P.Y. 2014-15, this can be applied in the P.Y.2014-15 or in the P.Y. 2015-16. If the entire amount of ₹ 40,000 is duly spent for charitable purposes in these two years, the exemption is fully available but if only part of the amount is so spent within the period, the exemption is restricted to that part only.

There may be a case where the inability springs from some other reason e.g. late receipt of the income making it impossible to spend it before the end of the year.

Example 2 - A trust receives a sum of ₹ 50,000 on 30th March, 2014. Its previous year ends on 31-3-2014.

It is obvious that it is impossible to apply the requisite sum within one day. Therefore, it has been provided that such sum can be applied at any time during the immediately following previous year i.e. up to 31-3-2015.

(viii) **Formalities: Exercise of option** - To avail the facility of the extended period of application of income, the trust has to exercise an option in writing that the income applied later as prescribed may be deemed to be income applied to the relevant charitable purposes during the previous year in which the income was derived.

Such option has to be exercised before the expiry of the time allowed statutorily under section 139(1).

The income so deemed to have been applied shall not however be taken into account in calculating the amount of income applied to such purposes, during the previous year in which the income is actually received or during the immediately following previous year as the case may be. Thus, in the Example I given above, the amount of ₹ 40,000, received subsequently in the year 2014-15 and applied to charitable purposes in the year 2014-15, will by virtue of the option exercised by the trust, be deemed to be applied for charitable purposes in the year 2013-14 itself. Therefore, such an amount will not be taken into consideration in determining the amount of income applied for charitable purposes in the year 2014-15.

Sub-section (1B) of section 11 provides that where the income for which an option has been exercised as discussed above, is not actually applied, it is to be treated as the income of the previous year immediately following the year of receipt or the previous year in which it was derived as the case may be.

(ix) **Conditional accumulation** - Apart from the provision for accumulation upto 15 per cent, a trust has also got the rights for conditional accumulation. The relevant provisions are contained in section 11(2).

Where 85 per cent of the income is not applied or is not deemed to have been applied to charitable or religious purposes in India but is accumulated or set apart either wholly or in part for application to such purposes in India, such income shall not be included in the total income of the previous year if the following conditions are satisfied.

- (a) A notice in writing is given to the Assessing Officer in the prescribed manner specifying the purpose for accumulation and the period for which the income is to be accumulated or set apart. Such period should not exceed five years.

Any amount credited or paid, out of income which is accumulated or set apart, to any trust or institution registered under section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) of sub-clause (vi) or sub-clause (via) of clause (23C) of section 10, shall not be treated as application of income for charitable or religious purposes, either during the period of accumulation or thereafter.

(b) The money so accumulated or set apart should be invested or deposited in the following modes specified in section 11(5):

- (1) Investment in Government Saving Certificates.
- (2) Deposits with Post Office Savings Banks.
- (3) Deposit with Scheduled banks or Co-operative Banks.
- (4) Investment in units of the Unit Trust of India.
- (5) Investment in Central or State Government Securities.
- (6) Investments in debentures issued by or on behalf of any company or corporation. However, both the principal and interest thereon must have been guaranteed by the Central or the State Government.
- (7) Investment or deposits in any public sector company.

Where an investment is made in the shares of any public sector company and such public sector company ceases to be a public sector company, the investment so made shall be deemed to be an investment made for a period of three years from the date of such cessation and in the case of any other investment or deposit, till the date of its maturity.

- (8) Investment in bonds of approved financial corporation providing long term finance for industrial development in India and eligible for deduction under section 36(1)(viii).
- (9) Investment in bonds of approved public companies whose principal object is to provide long-term finance for construction or purchase of houses in India for residential purposes and eligible for deduction under section 36(1)(viii).
- (10) Deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for urban infrastructure in India.

"Long-term finance" means any loan or advance where the terms under which moneys are loaned or advanced provide for repayment along with interest thereof during a period of not less than five years.

"Urban infrastructure" means a project for providing potable water supply, sanitation and sewerage, drainage, solid waste management, road, bridges and flyovers or urban transport.

- (11) Investment in immovable property excluding plant and machinery, not being plant and machinery installed in a building for the convenient occupation thereof.
- (12) Deposits with Industrial Development Bank of India.
- (13) Any other mode of investment or deposit as may be prescribed. Rule 17C specifies the following other modes: (1) Investments in units issued under any scheme of mutual fund referred to in section 10(23D); (2) Any transfer of deposits to Public Account of India; (3) Deposits made with an authority constituted in India or under any law enacted either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages, or for both; (4) investment by way of acquiring equity shares of a 'depository'; (5) investment by a recognized Stock Exchange, in the equity shares of a company promoted by it to acquire the membership rights of other stock exchanges, where at least 51% of the paid-up share capital is held by the Stock Exchange and the balance is held by its members; (6) investment by way of acquiring equity shares of an incubatee by an incubator; (7) *investment in debt instruments issued by any infrastructure finance company registered with RBI.*

Where the income of the trust -

- (a) is applied for purposes other than charitable or religious purposes; or
- (b) ceases to be accumulated or set apart for application thereto; or
- (c) ceases to remain invested or deposited in any modes mentioned under section 11(5) above; or
- (d) is not utilised for the purpose for which it is so accumulated or set apart during the period specified (not exceeding 5 years) or in the year immediately following thereof.

However, in computing the aforesaid period of 5 years, the period during which the income could not be applied for the purposes for which it is so accumulated or set apart due to an order or injunction of any Court shall be excluded.

- (e) accumulated or set apart for application to charitable and religious purposes in India, is credited or paid to any trust or institution registered under section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or (v) or (vi) or (via) of clause (23C) of section 10,

such income shall be deemed to be the income of the previous year –

- (a) in which it is so applied; or
- (b) in which it ceases to be accumulated or set apart; or
- (c) in which it ceases to remain so invested or deposited; or
- (d) immediately following the expiry of the period aforesaid; or
- (e) in which it is paid or credited.

It is possible that due to circumstances beyond the control of the person in receipt of the income, any income invested or deposited in approved modes cannot be applied for the purpose for which it was accumulated or set apart. In such a case, an application may be made to the Assessing Officer specifying such other purposes as are in conformity with the objects of the trust. The Assessing Officer may allow the application of income to such other purposes. If such a permission is granted by the Assessing Officer, the new purposes will be deemed to be purposes specified in the written notice given to the Assessing Officer.

It is to be noted that the Assessing Officer cannot allow transfer of any such accumulated income to other charitable trusts/institutions as application of income towards charitable purposes. This has created genuine problems for those trusts and institutions which are wound up. However, in case of a trust or institution which has invested or deposited its income in any of the forms mentioned in section 11(5), the Assessing Officer can allow application of such income for crediting or payment to any trust or institution registered under section 12AA or any fund or institution or trust or university or education institution or hospital or medical institution covered by section 10(23C). Such application can be allowed only in the year in which such trust or institution is dissolved.

(x) **Cases where trust property consists of a business undertaking** - Section 11(4) clarifies that for the purposes of section 11, property held under trust may consist of a business undertaking so held. If that be so, the trustees may claim that the income of such undertaking enjoys exemption under section 11. Section 11(4) provides for two things -

- (1) The Assessing Officer shall have the power to determine the income of the undertaking in accordance with the provisions of the Act relating to assessment, and
- (2) Where the income determined by the Assessing Officer is in excess of that shown in the books of the undertaking, such excess shall be deemed to be applied to purposes other than charitable or religious purposes and accordingly be deemed to be the income of the previous year in which it has been deemed to have been so applied.

(xi) **Charitable trust engaged in business activity [Section 11(4A)]** - Consequently, a charitable trust engaged in business activity will be liable to any tax on income from the activity. However, exemption would be available to the trust in respect of income earned from such business activity if -

- (i) such business is incidental to the attainment of the objects of the trust/institution; and
- (ii) separate books of account are maintained by such trust/institution in respect of such business.

Note - Profits derived by a trust/institution referred to in clauses (21), (23A), (23B), (23BB) and (23C) of section 10 will continue to be exempt from income-tax, since section 11(4A) does not override the provisions of section 10.

(xii) **Instances where capital gains would be deemed to have been applied for charitable purposes [Section 11(1A)]**

(a) **Transfer of a capital asset held under trust wholly for charitable or religious purposes [Section 11(1A)(a)]** - Where the whole of the net consideration from the transfer of the capital asset is utilised for acquiring a new capital asset which is held under trust wholly

for charitable or religious purposes, the entire amount of capital gains arising from the transfer would be deemed to have been applied for charitable or religious purposes. If, however, only a part of the net consideration is utilised in acquiring the new capital asset, the amount of capital gains deemed to have been utilised for charitable or religious purposes shall be equal to the excess of the proceeds utilised over the cost of the asset transferred.

Example

Original cost of capital asset transferred	₹ 1,00,000
Consideration for which it is transferred	₹ 1,50,000
Situation 1 Cost of new capital asset acquired	₹ 1,50,000
Situation 2 Cost of new capital asset acquired	₹ 1,20,000
Amount that will be deemed to have been applied for charitable purposes.	
Situation 1	₹ 50,000
Situation 2	₹ 20,000

(b) Transfer of a capital asset held under trust in part only for charitable and religious purposes [Section 11(1A)(b)] - Where only a part of a capital asset has been transferred, only the "appropriate fraction" of the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes. Where the whole of the net consideration is utilised in acquiring the new capital asset, the whole of the appropriate fraction of such capital gain will be deemed to have been so applied. In any other case, the exemption will be limited to so much of the appropriate fraction of the amount utilised for acquiring the new asset as exceeds the appropriate fraction of the cost of the transferred asset.

"Appropriate fraction" means the fraction which represents the extent to which the income derived from the capital asset transferred was applicable to charitable or religious purposes before such transfer.

Example: A capital asset is being held under trust. Two-thirds of the income derived from such capital asset are being utilised for the charitable purposes of the trust. The asset is being transferred.

Cost of transferred asset	₹ 1,20,000
Net consideration	₹ 1,80,000
Cost of new asset acquired	₹ 1,50,000
Capital gains	₹ 60,000 [₹ 1,80,000 – ₹ 1,20,000]
Appropriate fraction	2/3rd

Income represented by 'appropriate fraction' = 2/3rds of ₹ 60,000 = ₹ 40,000

Since the entire net consideration has not been utilised in acquiring the new asset, the amount deemed to have been utilised for charitable purpose will be (2/3rds of ₹ 1,50,000) – (2/3rds of ₹ 1,20,000) = ₹ 1,00,000 – ₹ 80,000 = ₹ 20,000.

(xiii) **Voluntary Contributions [Section 12]** - Any voluntary contribution received by a trust created wholly for charitable or religious purposes or by an institution established wholly for such purposes shall for the purposes of section 11, be deemed to be income derived from property held under trust wholly for charitable or religious purposes. However, corpus donations (i.e. contributions made with a specific direction that they shall form part of the corpus of the trust or institution) shall not be treated as income. Such corpus donations are treated as capital receipts not chargeable to tax. Other voluntary contributions would be treated as income. However, exemption can be claimed in respect of such income subject to fulfillment of the conditions mentioned below –

- (i) The trust should be registered under section 12AA with the Commissioner of Income-tax;
- (ii) If the total income of the trust exceeds the basic exemption limit, the accounts of the trust should be audited.
- (iii) The trust should apply at least 85% of its income for the approved purposes.
- (iv) The balance should be invested or deposited in specified forms or modes.

Note – It may be noted that the corpus donations are to be considered for the purpose of determining whether the accounts of the trust are to be audited. Further, corpus donations have to be invested only in the investments approved under section 11(5). If invested elsewhere, the income from unapproved investment would be chargeable to tax.

(3) Conditions for applicability of sections 11 & 12 [Section 12A]

(i) The exemption provisions contained in section 11 and 12 as explained above shall not apply in relation to the income of any trust or institution unless the following conditions are satisfied:

- (a) A charitable or religious trust or institution is required to make an application for registration in the prescribed form and in the prescribed manner to the Commissioner. The trust should be registered under section 12AA. In such cases, the exemption provisions of section 11 and 12 would apply from the date of creation of the trust or establishment of the institution [Section 12A(1)].

This requirement of filing an application for registration under section 12A within one year of creation of the religious or charitable trust or institution has been removed. The application can be filed at any time now.

Accordingly, in respect of applications filed on or after 1st June, 2007, the provisions of sections 11 and 12 shall apply from the assessment year relevant to the financial year in which the application is made i.e. the exemption would be available only with effect from the assessment year relevant to the previous year in which the application is filed. It would not be available in respect of any earlier assessment year [Section 12A(2)].

- (b) **Audit** - Where the total income of the trust without giving effect to the provisions of section 11 and 12 exceeds the maximum amount which is not chargeable to income-tax in any previous year, the accounts of the trust must be audited by a chartered accountant and the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such prescribed particulars, should be furnished along with the return.

(ii) **Procedure for Registration [Section 12AA]** - Accordingly, the Commissioner, on receipt of an application for registration of a trust or institution made under section 12A(1) shall proceed as follows :

- (a) He would call for such documents or information from the trust or institution as he thinks necessary in order to satisfy himself about the genuineness of activities of the trust or institution and may also make such enquiries as he may deem necessary in this behalf.
- (b) After satisfying himself about the objects of the trust or institution and the genuineness of its activities, he shall pass an order in writing registering the trust or institution.
- (c) If he is not satisfied, he shall pass an order in writing refusing to register the trust or institution.
- (d) A copy of such an order issued under (b) or (c) above shall be sent to the applicant. However, an order under (c) shall not be passed unless the applicant has been given a reasonable opportunity of being heard.
- (e) Every order granting or refusing registration shall be passed within six months from the end of the month in which the application for registration of trust or institution is received by the Commissioner.
- (f) Where a trust or an institution has been granted registration and subsequently, if the Commissioner of Income-tax is satisfied that the activities of any trust or institution are not genuine or are not being carried out in accordance with the objects of the trust or institution, he can pass an order in writing canceling the registration granted under section 12AA and 12A (as it stood before its amendment by the Finance (No.2) Act, 1996). However, the trust or institution should be given a reasonable opportunity of being heard.
- (g) Any order passed by the Commissioner of Income-tax under section 12AA refusing registration is appealable under section 253 to the Income-tax Appellate Tribunal.

(4) Denial of Exemption [Section 13]

(i) The following incomes of charitable or religious trusts and institutions would not be eligible for exemption under sections 11 and 12:

- (a) Where the property is held under a trust for private religious purposes, no part of the income will be exempt if it does not ensure for the benefit of the public [Section 13(1)(a)].
- (b) Where a trust has been established for the benefit of any particular religious community or caste, the income thereof will not be eligible for exemption. However, a trust or institution created or established for the benefit of scheduled caste, backward classes, scheduled tribes or women and children shall not be treated as a trust or institution created or established for the benefit of a religious community or caste within the meaning of section 13(1)(b).
- (c) Where the trust or the institution has been created or established after 31.3.1962, if any part of its income enures directly or indirectly for the benefit of any person referred to in section 13(3) [Section 13(1)(c)].
- (d) Irrespective of the date of the creation of the trust or the establishment of the institution, if any part of its income or any property belonging to it during the relevant previous year

is used or applied directly or indirectly for the benefit of any person referred to in section 13(3) [Section 13(1)(c)].

- (e) Any income of a trust or institution, if –
- (i) its funds are invested or deposited otherwise than in the forms or modes specified in section 11(5);
 - (ii) it holds shares in a company other than -
 - (1) a public sector company; or
 - (2) shares prescribed as a form or mode of investment under section 11(5)(xii).

However, these restrictions do not apply in respect of :

- (i) any assets forming part of the trust as on 1-6-1973.
- (ii) Any accretion to the corpus shares by way of bonus shares allotted to the trust.
- (iii) debentures issued by or on behalf of any company or corporation and acquired by the trust before March 1, 1983.
- (iv) any asset not covered under section 11(5), where such asset is held for not more than one year from the end of the previous year in which such asset is acquired.
- (v) any funds representing the profits and gains of business, being profits and gains of any previous year relevant to the assessment year 1984-85 or any subsequent assessment year. However, such relaxation of the restriction will be denied unless the trust keeps separate accounts for the business. As already noted, subject to certain exceptions, such business profits are no longer eligible for exemption under section 11.

(ii) **Prohibited use or application** - We have noted above that when any part of the income or any property of the trust whenever created, is, during the previous year, used or applied directly, for the benefit of any person referred to in section 13(3), the denial of exemption operates. Section 13(2) specifies a few particular instances where the income or the property is to be deemed to have been used for the benefit of a person referred to in section 13(3). It should be noted that those particular instances do not in any way restrict the general meaning of the expression “used or applied for the benefit of a person”. The provisions of section 13(2) are as follows:

The income or the property of the trust or institution or any part of such income or property is to be deemed to have been used or applied for the benefit of a person referred to in section 13(3) in the following cases:

- (a) **Loan without adequate interest or adequate security** - If any part of the income or the property of the trust or institution is or continues to be lent to any person referred to in section 13(3) for any period during the previous year without either adequate security or adequate interest or both.
- (b) **Allowing use of property without adequate rent** - If any land, building or other property of the trust or institution is or continues to be, made available, for the use of any

person referred to in section 13(3) for any period during the previous year without charging adequate rent or other compensation.

- (c) **Excess payment for services** - If any amount is paid out of the resources of the trust or institution to any of the persons referred to in section 13(3) for services rendered to the trust or institution but such amount is in excess of a reasonable sum payable for such services.
- (d) **Inadequate remuneration for services rendered** - If the services of the trust or institution are made available to any person referred to section 13(3) without adequate remuneration or other compensation.
- (e) **Excess payment for purchase of property** - If any share, security or other property is purchased by or on behalf of the trust or institution from any person referred to in section 13(3) during the previous year for a consideration which is more than adequate.
- (f) **Inadequate consideration for property sold** - If any share, security or other property is sold by or on behalf of the trust or institution to any person referred to in section 13(3) during the previous year for a consideration which is less than adequate.
- (g) **Diversion of income or property exceeding ₹ 1,000** - If any income or property of the trust or institution is diverted during the previous year in favour of any person referred to in section 13(3) provided the aggregate value of such income and property diverted exceeds ₹ 1,000.
- (h) **Investment in substantial interest concerns** - If any funds of the trust or institution are, or continue to remain, invested for any period during the previous year in any concern in which any person referred to in section 13(3) has a substantial interest.

Section 13(4) provides some respite where the aggregate of the funds invested in the said concern does not exceed five per cent of the capital of that concern. In such a case, the exemption under section 11 will be denied only in relation to such income as arises out of the said investment.

(iii) **Exemption not to be denied to charitable trusts providing educational or medical facilities to specified persons [Section 13(6)]**: A charitable or religious trust running an educational institution or a medical institution or a hospital shall not be denied the benefit of exemption under section 11 merely due to the reason that the benefit of educational or medical facilities have been provided to the specified persons referred to in section 13(3). However, the value of such facilities provided to such specified persons either free of cost or at a concessional rate would be deemed to be the income of the trust. Such income would not be eligible for exemption under section 11.

(iv) **Anonymous donations [Section 13(7)]** - The exemption provisions contained in section 11 or section 12 shall not be applicable in respect of any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of that section. For example, section 11(1)(d) provides that any income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the total income of such trust/institution for the relevant previous year.

However, if a trust or institution established wholly for charitable purposes receives an anonymous donation with a specific direction that the donation shall form part of the corpus of the trust or institution, such anonymous donation would not be exempt by virtue of section 11(1)(d). It would be taxable at 30% as provided in section 115BBC.

(v) Exemption to be denied to a charitable trust having its main object as “advancement of any other object of general public utility” if its trading receipts exceed the specified threshold irrespective of withdrawal of approval or cancellation of registration or rescindment of notification [Section 13(8)]

(a) Under sections 11 and 12, income of any charitable trust or institution is exempt if such income is applied for charitable purposes in India and such institution is registered under section 12AA.

(b) The definition of “charitable purpose” under section 2(15) includes “advancement of any other object of general public utility” as charitable purpose provided that it does not involve carrying on of any activity in the nature of trade, commerce or business.

(c) However, as per the second proviso to section 2(15), “advancement of any other object of general public utility” would continue to be a “charitable purpose” in the relevant previous year even if it carries on a trading activity, if the total receipts from any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business does not exceed ₹ 25 lakhs in that year. However, if such receipts exceed ₹ 25 lakhs in the next year, then the trust will lose its charitable status for that year.

(d) Thus, a charitable trust or institution pursuing “advancement of object of general public utility” may be a charitable trust in one year and not a charitable trust in another year depending on the aggregate value of receipts from commercial activities.

(e) Therefore, no exemption would be available to a trust or institution for the previous year in which the receipts from commercial activities exceed ₹ 25 lakhs. However, this temporary excess in one year may not be treated as altering the very nature of the trust or institution so as to lead to cancellation of registration or withdrawal of approval or rescinding of notification issued in respect of trust or institution.

(f) Therefore, there is need to ensure that if the purpose of a trust or institution does not remain charitable in a previous year on account of the commercial receipts exceeding the specified threshold of ₹ 25 lakhs, then, such trust or institution would not be entitled to get benefit of exemption in respect of its income for that previous year in which the commercial receipts exceed the specified threshold. The denial of exemption would be compulsory by operation of law and would not be dependent on any approval being withdrawn or registration being cancelled or a notification being rescinded.

(g) Accordingly, section 13 has been amended to ensure that such trust and institution does not get benefit of tax exemption under section 11 or 12 in the year in which its receipts from commercial activities exceed the specified threshold of ₹ 25 lakhs, whether or not the registration or approval granted or notification issued is cancelled, withdrawn or rescinded in respect of such trust or institution.

(vi) **Prohibited category of persons** - Section 13(3) gives the list of persons, use or application of the income or property of a trust for whose direct or indirect benefit results in a denial of the exemption contemplated in section 11 for a charitable or religious trust or institution. The said persons are:

- (1) The author of the trust or the founder of the institution.
- (2) Any person who has made a substantial contribution to the trust or institution, that is, any person whose total contribution up to the end of the relevant previous year exceeds ₹ 50,000.
- (3) Where the author, founder or the person making a substantial contribution is a HUF, any member of the family.
- (4) Any trustee of the trust or manager (by whatever name called) of the institution.
- (5) Any relative of any such author, founder, person, member, trustee or manager as referred to above.
- (6) Any concern in which any of the persons referred to in clauses (1) to (5) above has a substantial interest.

Relative - The expression "relative", in relation to an individual, means -

- (a) spouse of the individual;
- (b) brother or sister of the individual;
- (c) brother or sister of the spouse of the individual;
- (d) any lineal ascendant or descendant of the individual;
- (e) any lineal ascendant or descendant of the spouse of the individual;
- (f) spouse of a person referred to in (b), (c), (d) or (e) above;
- (g) any lineal descendant of a brother or sister of either the individual or the spouse of the individual;

Substantial interest in a concern - Section 13(2)(h), section 13(3) and section 13(4) refers to cases where a person has a substantial interest in a concern. These references occur where the "Prohibited use or application" and "Prohibited category of persons" have been described. The circumstances in which a person shall be deemed to have a substantial interest in a concern, have been laid down in Explanation 3 to section 13. Accordingly, a person shall be deemed to have a substantial interest in a concern -

- (i) Where the concern is a company, if its shares, other than preference shares, carrying not less than 20 per cent of the voting power are, at any time during the previous year, owned beneficially by him alone or partly by him and partly by one or more of the other persons referred to in section 13(3).
- (ii) When the concern is not a company, if he is entitled or he and one or more of the other persons referred to in section 13(3) are entitled in the aggregate, at any time during the previous year, to not less than 20 per cent of the profits of such concern.

(5) Anonymous Donations received by Charitable Trusts/Institutions to be subject to tax [Section 115BBC]

(i) As per the provisions of the Income-tax Act, 1961, tax exemption under section 10(23C) and section 11 are available to certain entities, as briefed in the table below, on fulfillment of the conditions prescribed under the relevant sections –

Entity	Applicable section
Charitable or religious trusts/institutions	11
Universities and other educational institutions	10(23C)(iiiad) and (vi)
Hospitals and other medical institutions	10(23C) (iii ae) and (vi a)
Notified funds or institutions established for charitable purposes	10(23C)(iv)
Notified trusts or institutions established wholly for public religious purposes or wholly for public religious and charitable purposes	10(23C)(v)

(ii) Section 115BBC has been inserted to tax anonymous donations received by the above entities at 30%.

(iii) In order to provide relief to these trusts and institutions and to reduce their compliance burden, an exemption limit has been introduced, and only the anonymous donations in excess of this limit would be subject to tax@30% under section 115BBC.

(iv) The exemption limit is the higher of the following –

- (1) 5% of the total donations received by the assessee; or
- (2) ₹ 1 lakh.

(v) The total tax payable by such institutions would be –

- (1) tax@30% on anonymous donations exceeding the exemption limit as calculated above; and
- (2) tax on the balance income i.e. total income as reduced by the aggregate of anonymous donations received.

(v) The following table illustrates the calculation of anonymous donations liable to tax @30% under section 115BBC –

Situation	Total donations during the year (₹)	Anonymous donations received during the year (₹)	Exemption (₹)	Anonymous donations taxable@30% (₹)
1	15,00,000	4,00,000	1,00,000	3,00,000
2	30,00,000	7,00,000	1,50,000	5,50,000
3	40,00,000	10,00,000	2,00,000	8,00,000

(vi) For this purpose, “anonymous donation” means any voluntary contribution referred to in section 2(24)(iia), where the person receiving such contribution does not maintain a record of

the identity indicating the name and address of the person making such contribution and such other particulars as may be prescribed.

(vii) However, the above provision does not apply to a trust or institution created or established wholly for religious purposes.

(viii) Further, anonymous donations to trusts/institutions created or established wholly for religious and charitable purposes (i.e. partly charitable and partly religious institutions/trusts) would be taxed only if such anonymous donation is made with a specific direction that such donation is for any university or other educational institution or any hospital or other medical institution run by such trust or institution. Other anonymous donations received by such trusts/institutions are not taxable.

(ix) Section 13(7) provides that the exemption provisions contained in section 11 or section 12 shall not be applicable in respect of any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of that section.

(x) For example, section 11(1)(d) of the Act provides that any income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the total income of such trust/institution for the relevant previous year. However, if a trust or institution established wholly for charitable purposes receives an anonymous donation with a specific direction that the donation shall form part of the corpus of the trust or institution, such anonymous donation would not be exempt by virtue of section 11(1)(d). It would be taxable at 30% as provided in section 115BBC.

(xi) Similarly, section 10(23C) provides that any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of the said section shall be included in the total income. The amendments to section 10(23C) and 13 are consequential amendments to provide that any income by way of any anonymous donation which is taxable under the provisions of section 115BBC shall not be excluded from the total income of the trust or institution.

3.5 Tax Exemption to Political Parties [Section 13A]

Section 13A of the Income-tax Act, 1961 grants exemption from tax to political parties in respect of their income specified below:

- (i) Income from house property;
- (ii) Income from other sources;
- (iii) Capital gains; and
- (iv) Income by way of voluntary contributions received by the political parties from any person.

The aforesaid categories of income would qualify for exemption without any monetary or other limit and the income so exempted would not even be includible in the total income of the political party for the purpose of assessment. The tax exemption will be applicable only if the following conditions are fulfilled:

- (i) The political party must keep and maintain such books and other documents as would enable the Assessing Officer to properly deduce the income of the political party from those accounts.
- (ii) The political party must keep and maintain records in respect of each such voluntary

contribution which is in excess of ₹ 20,000 giving details of the amount received, the name and address of the person who has made the contribution, the date of receipt and such other details as may be relevant or appropriate. However, this does not mean that the political party need not disclose smaller contributions in its accounts which are maintained by it. The obligation to maintain proper record of voluntary contribution in excess of ₹ 20,000 is over and above the obligation to maintain proper records and books of accounts in respect of all the income and expenses of the party.

- (iii) The accounts of the political party must be audited by a Chartered Accountant.
- (iv) A report under section 29C(3) of the Representation of People Act, 1951 has to be submitted by the treasurer of such political party or any other person authorised by the political party in this behalf for every financial year. If there is a failure to submit the above report, no exemption under this section shall be available for the political party for that financial year.

For the purposes of this section, "political party" means a political party registered under section 29A of the Representation of the People Act, 1951.

3.6 Exemption for Voluntary Contributions Received by Electoral Trusts [Section 13B]

(i) Any voluntary contribution received by an electoral trust (as may be approved by the CBDT in accordance with the scheme to be made by the Central Government) shall be treated as its income under section 2(24), but shall be exempt under section 13B, if the trust distributes to a registered political party during the year, 95% of the aggregate donations received by it during the year along with the surplus if any, brought forward from any earlier previous year.

(ii) Another condition for availing the benefit under this section is that the electoral trust should function in accordance with the rules made by the Central Government. *Accordingly, the Central Government has notified Rule 17CA which provides that the following shall be the functions of an electoral trust referred to in section 13B -*

- (1) *The electoral trust may receive voluntary contributions from*
 - a) *an individual who is a citizen of India;*
 - b) *a company which is registered in India; and*
 - c) *a firm or Hindu undivided family or an Association of persons or a body of individuals, resident in India.*
- (2) *A receipt indicating the following shall be issued by the trust immediately on receipt of any contribution indicating the following:*
 - a) *name and address of the contributor;*
 - b) *Permanent account number of the contributor or passport number in the case of a citizen who is not a resident;*
 - c) *amount and mode of contribution including name and branch of the Bank and date of receipt of such contribution;*
 - d) *name of the electoral trust;*

- e) *Permanent account number of the electoral trust;*
- f) *date and number of approval by the prescribed authority; and*
- g) *Name and designation of the person issuing the receipt.*
- (3) *The electoral trust shall not accept contributions-*
 - a) *from an individual who is not a citizen of India or from any foreign entity whether incorporated or not; and*
 - b) *from any other electoral trust which has been registered a company under section 25 of the Companies Act, 1956² and approved as an electoral trust under the Electoral Trusts Scheme, 2013.*
- (4) *The electoral trust shall accept contributions only by way of an account payee cheque drawn on a bank or account payee bank draft or by electronic transfer to its bank account and shall not accept any contribution in cash.*
- (5) *The electoral trust shall not accept any contribution without the PAN of the contributor, who is a resident and the passport number in the case of a citizen of India, who is not a resident.*
- (6) *A political party registered under section 29A of the Representation of the People Act, 1951 shall be an eligible political party and an electoral trust shall distribute funds only to the eligible political parties.*
- (7) (i) *The electoral trust may, for the purposes of managing its affairs, spend upto 5% of the total contributions received in a year subject to an aggregate limit of Rs.5 lakh in the first year of incorporation and Rs.3 lakh in subsequent years;*
 (ii) *the total contributions received in any financial year alongwith the surplus from any earlier financial year, if any, as reduced by the amount spent on managing its affairs, shall be the distributable contributions for the financial year;*
 (iii) *an electoral trust shall be required to distribute the distributable contributions received in a financial year, referred to in item (ii), to the eligible political parties before the 31st March of the said financial year, subject to the condition that at least 95% of the total contributions received during the financial year along with the surplus brought forward from earlier financial year, if any, are distributed.*
- (8) *The trust shall obtain a receipt from the eligible political party indicating the name of the political party, its permanent account number, registration number, amount of fund received from the trust, date of the receipt and name and designation of person signing such receipt.*
- (9) *The electoral trust shall not utilize any contributions for the direct or indirect benefit of the members or contributors, or for any of the following persons,*

² Section 8 of the Companies Act, 2013

namely:

- (a) the members (including members of its Executive Committee, Governing Committee or Board of Directors) of the electoral trust;
 - (b) any relative of such Members;
 - (c) where such member or contributor is a Hindu undivided family, a member of that Hindu undivided family;
 - (d) any person who has made a contribution to the trust;
 - (e) any person referred in sub-section (3) of section 13; and
 - (f) any concern in which any of the persons referred to in clauses (a),(b),(c),(d) and (e) has a substantial interest.
- (10) (i) An electoral trust shall keep and maintain such books of account and other documents in respect of its receipts, distributions and expenditure as may enable the computation of its total income in accordance with the provisions of the Act;
- (ii) The electoral trust shall also maintain a list of persons from whom contributions have been received and to whom the same have been distributed, containing the name, address and permanent account number (PAN) of each such person along with the details of the amount and mode of its payment including the name and branch of the bank.
- (11) Every electoral trust shall get its accounts audited by an accountant as defined in the Explanation below section 288(2) and furnish the audit report in Form No.10BC along with particulars forming part of its Annexure, to the Commissioner of Income-tax or the Director of Income-tax, as the case may be, having jurisdiction over the electoral trust, on or before the due date specified for furnishing the return of income by a company under section 139.
- (12) An electoral trust shall maintain a regular record of proceedings of all meetings and decisions taken therein.
- (13) Every electoral trust shall furnish a certified copy of list of contributors and a list of political parties, to whom sums were distributed in the manner prescribed in sub rule (8), to the Commissioner of Income-tax or the Director of Income-tax, as the case may be, every year along with the audit report as stipulated under sub-rule (12);
- (14) Any change in the shareholders, subsequent to the approval granted under the Electoral Trusts Scheme, 2013 shall be intimated to the Board within thirty days of such change.

Section 2(22AAA) defines 'Electoral Trust' to mean a trust so approved by the CBDT, in accordance with the scheme made in this regard by the Central Government.

In exercise of the powers conferred by section 2(22AAA), the Central Government, has through Notification No.8/2013 dated 31.1.2013, notified the Electoral Trusts

Scheme, 2013 to lay down the procedure for grant of approval to an electoral trust which will receive voluntary contributions and distribute the same to political parties.

Eligibility

A company registered for the purposes of section 25 of the Companies Act, 1956 satisfying all of the following conditions shall be eligible to make an application for approval as an electoral trust, namely –

- (i) The company should be registered on or after 1.4.2012 for the purposes of section 25 of the Companies Act, 1956;*
- (ii) The name of the company registered for the purposes of section 25 of the Companies Act, 1956 has to include the phrase “electoral trust”;*
- (iii) The sole object of the electoral trust should be to distribute the contributions received by it to the political party, registered under section 29A of the Representation of the People Act, 1951;*
- (iv) The electoral trust should have a permanent account number.*

Criteria for Approval

An electoral trust shall be considered for approval if it fulfills all of the following conditions, namely –

- (i) The company registered for the purposes of section 25 of the Companies Act, 1956, which satisfies the above conditions;*
- (ii) The object of the electoral trust shall not be to earn any profit or pass any direct or indirect benefit to its members or contributors, or to any person referred to in section 13(3) or any person referred to in Rule 17CA of the Rules;*
- (iii) It has made adequate arrangement for recording the receipts from the contributors in accordance with Rule 17CA;*
- (iv) The stipulations contained in Rule 17A for functioning of the electoral trust are specifically included in the articles of association of the company registered for the purposes of section 25 of the Companies Act, 1956.*

Renewal of approval

- (i) The approval shall be valid for the assessment year relevant to the financial year in which such application has been made and for a further period, not exceeding three assessment years, as may be specified in the approval.*
- (ii) The electoral trust may apply for renewal of approval at any time during the financial year immediately preceding the last assessment year, for which the approval has been originally granted, and such renewal of approval may be granted after examining the application in the same manner as laid out for approval in this scheme.*

Income from Salaries

4.1 Salary

The meaning of the term 'salary' for purposes of income tax is much wider than what is normally understood. Every payment made by an employer to his employee for service rendered would be chargeable to tax as income from salaries. The term 'salary' for the purposes of Income-tax Act, 1961 will include both monetary payments (e.g. basic salary, bonus, commission, allowances etc.) as well as non-monetary facilities (e.g. housing accommodation, medical facility, interest free loans etc).

(1) **Employer-employee relationship:** Before an income can become chargeable under the head 'salaries', it is vital that there should exist between the payer and the payee, the relationship of an employer and an employee. Consider the following examples:

- (a) Sujatha, an actress, is employed in Chopra Films, where she is paid a monthly remuneration of ₹ 2 lakh. She acts in various films produced by various producers. The remuneration for acting in such films is directly paid to Chopra Films by the different producers. In this case, ₹ 2 lakh will constitute salary in the hands of Sujatha, since the relationship of employer and employee exists between Chopra Films and Sujatha.
- (b) In the above example, if Sujatha acts in various films and gets fees from different producers, the same income will be chargeable as income from profession since the relationship of employer and employee does not exist between Sujatha and the film producers.
- (c) Commission received by a Director from a company is salary if the Director is an employee of the company. If, however, the Director is not an employee of the company, the said commission cannot be charged as salary but has to be charged either as income from business or as income from other sources depending upon the facts.
- (d) Salary paid to a partner by a firm is nothing but an appropriation of profits. Any salary, bonus, commission or remuneration by whatever name called due to or received by partner of a firm shall not be regarded as salary. The same is to be charged as income from profits and gains of business or profession. This is primarily because the relationship between the firm and its partners is not that of an employer and employee.

(2) **Full-time or part-time employment:** It does not matter whether the employee is a full-time employee or a part-time one. Once the relationship of employer and employee exists, the income is to be charged under the head "salaries". If, for example, an employee works with more than one employer, salaries received from all the employers should be clubbed and brought to charge for the relevant previous years.

(3) **Foregoing of salary:** Once salary accrues, the subsequent waiver by the employee does not absolve him from liability to income-tax. Such waiver is only an application and hence, chargeable to tax.

Example: Mr. A, an employee instructs his employer that he is not interested in receiving the salary for April 2013 and the same might be donated to a charitable institution. In this case, Mr. A cannot claim that he cannot be charged in respect of the salary for April 2013. It is only due to his instruction that the donation was made to a charitable institution by his employer. It is only an application of income. Hence, the salary for the month of April 2013 will be taxable in the hands of Mr. A. He is however, entitled to claim a deduction under section 80G for the amount donated to the institution. [The concept of deductions is explained in detail in Chapter 11].

(4) **Surrender of salary:** However, if an employee surrenders his salary to the Central Government under section 2 of the Voluntary Surrender of Salaries (Exemption from Taxation) Act, 1961, the salary so surrendered would be exempt while computing his taxable income.

(5) **Salary paid tax-free:** This, in other words, means that the employer bears the burden of the tax on the salary of the employee. In such a case, the income from salaries in the hands of the employee will consist of his salary income and also the tax on this salary paid by the employer.

4.2 Definition of Salary

The term 'salary' has been defined differently for different purposes in the Act. The definition as to what constitutes salary is very wide. As already discussed earlier, it is an inclusive definition and includes monetary as well as non-monetary items. There are different definitions of 'salary' say for calculating exemption in respect of gratuity, house rent allowance etc.

'Salary' under section 17(1), includes the following:

- (i) wages,
- (ii) any annuity or pension,
- (iii) any gratuity,
- (iv) any fees, commission, perquisite or profits in lieu of or in addition to any salary or wages,
- (v) any advance of salary,
- (vi) any payment received in respect of any period of leave not availed by him i.e. leave salary or leave encashment,
- (vii) the portion of the annual accretion in any previous year to the balance at the credit of an employee participating in a recognised provident fund to the extent it is taxable and
- (viii) transferred balance in recognized provident fund to the extent it is taxable,
- (ix) the contribution made by the Central Government or any other employer in the previous year to the account of an employee under a pension scheme referred to in section 80CCD.

4.3 Basis of charge

1. Section 15 deals with the basis of charge. Salary is chargeable to tax either on 'due' basis or on 'receipt' basis, whichever is earlier.
2. However, where any salary, paid in advance, is assessed in the year of payment, it cannot be subsequently brought to tax in the year in which it becomes due.
3. If the salary paid in arrears has already been assessed on due basis, the same cannot be taxed again when it is paid.

Examples:

- i. If A draws his salary in advance for the month of April 2014 in the month of March 2014 itself, the same becomes chargeable on receipt basis and is to be assessed as income of the P.Y.2013-14 i.e., A.Y.2014-15. However, the salary for the A.Y.2015-16 will not include that of April 2014.
- ii. If the salary due for March 2014 is received by A later in the month of April 2014, it is still chargeable as income of the P.Y.2013-14 i.e. A.Y.2014-15 on due basis. Obviously, salary for the A.Y.2015-16 will not include that of March 2014.

4.4 Place of accrual of salary

Under section 9(1)(ii), salary earned in India is deemed to accrue or arise in India even if it is paid outside India or it is paid or payable after the contract of employment in India comes to an end.

Example: If an employee gets pension paid abroad in respect of services rendered in India, the same will be deemed to accrue in India. Similarly, leave salary paid abroad in respect of leave earned in India is deemed to accrue or arise in India.

Suppose, for example, A, a citizen of India is posted in the United States as our Ambassador. Obviously, he renders his services outside India. He also receives his salary outside India. He is also a non-resident. The question, therefore, arises whether he can claim exemption in respect of his salary paid by the Government of India to him outside India. Under general principles of income tax such salary cannot be charged in his hands. For this purpose, section 9(1)(iii) provides that salaries payable by the Government to a citizen of India for services outside India shall be deemed to accrue or arise in India. However, by virtue of section 10(7), any allowance or perquisites paid or allowed outside India by the Government to a citizen of India for rendering services outside India will be fully exempt.

4.5 Profits in lieu of salary [Section 17(3)]

It includes the following:

- (i) The amount of any compensation due to or received by an assessee from his employer or former employer at or in connection with the termination of his employment.
- (ii) The amount of any compensation due to or received by an assessee from his employer or former employer at or in connection with the modification of the terms and conditions

of employment. Usually, such compensation is treated as a capital receipt. However, by virtue of this provision, the same is treated as a revenue receipt and is chargeable as salary.

Note: It is to be noted that merely because a payment is made by an employer to a person who is his employee does not automatically fall within the scope of the above provisions. The payment must be arising due to master-servant relationship between the payer and the payee. If it is not on that account, but due to considerations totally unconnected with employment, such payment is not profit in lieu of salary.

Example: A was an employee in a company in Pakistan. At the time of partition, he migrated to India. He suffered loss of personal movable property in Pakistan due to partition. He applied to his employer for compensating him for such loss. Certain payments were given to him as compensation. It was held that such payments should not be taxed as 'profit in lieu of salary' - *Lachman Dass Vs. CIT [1980] 124 ITR 706 (Delhi)*.

- (iii) Any payment due to or received by an assessee from his employer or former employer from a provident or other fund, to the extent to which it does not consist of employee's contributions or interest on such contributions.

Example: If any sum is paid to an employee from an unrecognised provident fund it is to be dealt with as follows :

- (a) that part of the sum which represents the employer's contribution to the fund and interest thereon is taxable under salaries.
- (b) that part of the sum which represents employee's contribution and interest thereon is not chargeable to tax since the same have already been taxed under the head 'salaries' and 'other sources' respectively on an yearly basis.

Note: It does not include exempt payments from superannuation fund, gratuity, commuted pension, retrenchment compensation, HRA.

- (iv) Any sum received by an assessee under a Keyman Insurance policy including the sum allocated by way of bonus on such policy.
- (v) Any amount, whether in lumpsum or otherwise, due to the assessee or received by him, from any person -
 - (a) before joining employment with that person, or
 - (b) after cessation of his employment with that person.
- (vi) Any other sum received by the employee from the employer.

4.6 Advance Salary

Advance salary is taxable when it is received by the employee irrespective of the fact whether it is due or not. It may so happen that when advance salary is included and charged in a particular previous year, the rate of tax at which the employee is assessed may be higher than the normal rate of tax to which he would have been assessed. Section 89(1) provides for relief in these types of cases. [The concept of relief under section 89(1) is explained in para 4.23 of this Chapter].

4.7 Loan or Advance against salary

Loan is different from salary. When an employee takes a loan from his employer, which is repayable in certain specified installments, the loan amount cannot be brought to tax as salary of the employee.

Similarly, advance against salary is different from advance salary. It is an advance taken by the employee from his employer. This advance is generally adjusted with his salary over a specified time period. It cannot be taxed as salary.

4.8 Arrears of salary

Normally speaking, salary arrears must be charged on due basis. However, there are circumstances when it may not be possible to bring the same to charge on due basis. For example if the Pay Commission is appointed by the Central Government and it recommends revision of salaries of employees, the arrears received in that connection will be charged on receipt basis. Here, also relief under section 89(1) is available.

4.9 Annuity

1. As per the definition, 'annuity' is treated as salary. Annuity is a sum payable in respect of a particular year. It is a yearly grant. If a person invests some money entitling him to series of equal annual sums, such annual sums are annuities in the hands of the investor.
2. Annuity received by a present employer is to be taxed as salary. It does not matter whether it is paid in pursuance of a contractual obligation or voluntarily.
3. Annuity received from a past employer is taxable as profit in lieu of salary.
4. Annuity received from person other than an employer is taxable as "income from other sources".

4.10 Gratuity [Section 10(10)]

Gratuity is a voluntary payment made by an employer in appreciation of services rendered by the employee. Now-a-days gratuity has become a normal payment applicable to all employees. In fact, Payment of Gratuity Act, 1972 is a statutory recognition of the concept of gratuity. Almost all employers enter into an agreement with employees to pay gratuity. For details refer to Chapter 3.

4.11 Pension

Concise Oxford Dictionary defines 'pension' as a periodic payment made especially by Government or a company or other employers to the employee in consideration of past service payable after his retirement.

Commuted pension: Commutation means inter-change. Many persons convert their future right to receive pension into a lumpsum amount receivable immediately. For example, suppose a person is entitled to receive a pension of say ₹ 2000 p.m. for the rest of his life. He may commute $\frac{1}{4}$ th i.e., 25% of this amount and get a lumpsum of say ₹ 30,000. After

commutation, his pension will now be the balance 75% of ₹ 2,000 p.m. = ₹ 1,500 p.m.

For details refer to Chapter 3.

4.12 Leave Salary [Section 10(10AA)]

For details refer to Chapter 3.

4.13 Retrenchment Compensation [Section 10(10B)]

For details refer to Chapter 3.

4.14 Compensation received on Voluntary Retirement [Section 10(10C)]

Any compensation received by an employee of a public sector company or of any other company or other specified bodies at the time of his voluntary retirement or termination of his service is exempt upto a maximum limit of ₹ 5,00,000. However, such payment should be in accordance with a scheme of voluntary retirement or in the case of a public sector company, a scheme of voluntary separation. Such schemes should be in accordance with prescribed guidelines. These guidelines may include economic viability as one of the criteria.

For details refer to Chapter 3.

4.15 Provident Fund

Provident fund scheme is a scheme intended to give substantial benefits to an employee at the time of his retirement. Under this scheme, a specified sum is deducted from the salary of the employee as his contribution towards the fund. The employer also generally contributes the same amount out of his pocket, to the fund. The contribution of the employer and the employee are invested in approved securities. Interest earned thereon is also credited to the account of the employee. Thus, the credit balance in a provident fund account of an employee consists of the following:

- (i) employee's contribution
- (ii) interest on employee's contribution
- (iii) employer's contribution
- (iv) interest on employer's contribution.

The accumulated balance is paid to the employee at the time of his retirement or resignation. In the case of death of the employee, the same is paid to his legal heirs.

The provident fund represents an important source of small savings available to the Government. Hence, the Income-tax Act, 1961 gives certain deductions on savings in a provident fund account.

There are four types of provident funds:

- (i) Statutory Provident Fund (SPF)
- (ii) Recognised Provident Fund (RPF)

4.7 Income Tax

(iii) Unrecognised Provident Fund (URPF)

(iv) Public Provident Fund (PPF)

The tax treatment is given below:

Particulars	Recognized PF	Unrecognized PF	Statutory PF	Public PF
Employer's Contribution	Amount in excess of 12% of salary is taxable	Not taxable yearly	Fully exempt	N.A. (as there is only assessee's own contribution)
Employee's Contribution	Eligible for deduction u/s 80C	Not eligible for deduction	Eligible for deduction u/s 80C	Eligible for deduction u/s 80C
Interest Credited	Amount in excess of 9.5% p.a. is taxable	Not taxable yearly	Fully exempt	Fully exempt
Amount received on retirement, etc.	See Note (1)	See Note (3)	Fully exempt u/s 10(11)	Fully exempt u/s 10(11)

Notes:

- (1) Amount received on the maturity of RPF is fully exempt in case of an employee who has rendered continuous service for a period of 5 years or more. In case the maturity of RPF takes place within 5 years then the amount received would be fully exempt only if the service had been terminated due to employee's ill-health or discontinuance or contraction of employer's business or other reason beyond control of the employee. In any other case, the amount received will be taxable in the same manner as that of an URPF.
 - (2) If, after termination of his employment with one employer, the employee obtains employment under another employer, then, only so much of the accumulated balance in his provident fund account will be exempt which is transferred to his individual account in a recognised provident fund maintained by the new employer. In such a case, for exemption of payment of accumulated balance by the new employer, the period of service with the former employer shall also be taken into account for computing the period of five years' continuous service.
 - (3) Employee's contribution is not taxable but interest thereon is taxable under 'Income from Other Sources'. Employer's contribution and interest thereon is taxed as Salary.
 - (4) Salary for this purpose means basic salary and dearness allowance - if provided in the terms of employment for retirement benefits and commission as a percentage of turnover.
- (1) Statutory Provident Fund (SPF): The SPF is governed by Provident Funds Act, 1925. It applies to employees of government, railways, semi-government institutions, local bodies, universities and all recognised educational institutions. Under the Income-tax Act, 1961, the rules governing the SPF are as follows:

(2) **Recognised Provident Fund (RPF):** Recognised provident fund means a provident fund recognised by the Commissioner of Income-tax for the purposes of income-tax. It is governed by Part A of Schedule IV to the Income-tax Act, 1961. This schedule contains various rules regarding the following:

- (a) Recognition of the fund
- (b) Employee's and employer's contribution to the fund
- (c) Treatment of accumulated balance etc.

A fund constituted under the Employees's Provident Fund and Miscellaneous Provisions Act, 1952 will also be a Recognised Provident Fund.

(3) **Unrecognised Provident Fund (URPF):** A fund not recognised by the Commissioner of Income-tax is Unrecognised Provident Fund.

(4) **Public Provident Fund (PPF):** Public provident fund is operated under the Public Provident Fund Act, 1968. A membership of the fund is open to every individual though it is ideally suited to self-employed people. A salaried employee may also contribute to PPF in addition to the fund operated by his employer. An individual may contribute to the fund on his own behalf as also on behalf of a minor of whom he is the guardian.

For getting a deduction under section 80C, a member is required to contribute to the PPF a minimum of ₹ 500 in a year. The maximum amount that may qualify for deduction on this account is ₹ 1,00,000 as per PPF rules.

A member of PPF may deposit his contribution in as many installments in multiples of ₹ 500 as is convenient to him. The sums contributed to PPF earn interest at 8%. The amount of contribution may be paid at any of the offices or branch offices of the State Bank of India or its subsidiaries and specified branches of Nationalised Banks or any Head Post Office.

Illustration 1

Mr. A retires from service on December 31, 2013, after 25 years of service. Following are the particulars of his income/investments for the previous year 2013-14:

Particulars	₹
Basic pay @ ₹ 16,000 per month for 9 months	1,44,000
Dearness pay (50% forms part of the retirement benefits) ₹ 8,000 per month for 9 months	72,000
Lumpsum payment received from the Unrecognised Provident Fund	6,00,000
Deposits in the PPF account	40,000

Out of the amount received from the provident fund, the employer's share was ₹ 2,20,000 and the interest thereon ₹ 50,000. The employee's share was ₹ 2,70,000 and the interest thereon ₹ 60,000. What is the taxable portion of the amount received from the unrecognized provident fund in the hands of Mr. A for the assessment year 2014-15?

Solution

Taxable portion of the amount received from the URPF in the hands of Mr. A for the A.Y. 2014-15 is computed hereunder:

Particulars	₹
Amount taxable under the head "Salaries":	
Employer's share in the payment received from the URPF	2,20,000
Interest on the employer's share	<u>50,000</u>
Total	2,70,000
Amount taxable under the head "Income from Other Sources" :	
Interest on the employee's share	<u>60,000</u>
Total amount taxable from the amount received from the fund	<u>3,30,000</u>

Note: Since the employee is not eligible for deduction under section 80C for contribution to URPF at the time of such contribution, the employee's share received from the URPF is not taxable at the time of withdrawal as this amount has already been taxed as his salary income.

Illustration 2

Will your answer be any different if the fund mentioned above was a recognised provident fund?

Solution

Since the fund is a recognised one, and the maturity is taking place after a service of 25 years, the entire amount received on the maturity of the RPF will be fully exempt from tax.

Illustration 3

Mr. B is working in XYZ Ltd. and has given the details of his income for the P.Y. 2013-14. You are required to compute his gross salary from the details given below:

Basic Salary	₹ 10,000 p.m.
D.A. (50% is for retirement benefits)	₹ 8,000 p.m.
Commission as a percentage of turnover	1%
Turnover during the year	₹ 5,00,000
Bonus	₹ 40,000
Gratuity	₹ 25,000
His own contribution in the RPF	₹ 20,000
Employer's contribution to RPF	20% of his basic salary
Interest accrued in the RPF @ 13% p.a.	₹ 13,000

Solution

Computation of Gross Salary of Mr. B for the A.Y.2014-15

Particulars	₹	₹
Basic Salary [₹ 10,000 × 12]		1,20,000
Dearness Allowance [₹ 8,000 × 12]		96,000
Commission on turnover [1% × ₹ 5,00,000]		5,000
Bonus		40,000
Gratuity [Note 1]		25,000
Employee's contribution to RPF [Note 2]		-
Employers contribution to RPF [20% of ₹ 1,20,000]	24,000	
Less : Exempt [Note 3]	20,760	3,240
Interest accrued in the RPF @ 13% p.a.	13,000	
Less : Exempt @ 9.5% p.a.	9,500	3,500
Gross Salary		2,92,740

Note 1 : Gratuity received during service is fully taxable.

Note 2 : Employee's contribution to RPF is not taxable. It is eligible for deduction under section 80C.

Note 3 : Employers contribution in the RPF is exempt up to 12% of the salary.

i.e. 12% of [B.S + D.A. for retirement benefits + Commission based on turnover]

= 12% of [₹ 1,20,000 + (50% × ₹ 96,000) + ₹ 5,000] = 12% of ₹ 1,73,000 = ₹ 20,760

4.16 Approved Superannuation Fund

It means a superannuation fund which has been and continues to be approved by the Commissioner in accordance with the rules contained in Part B of the VIth Schedule to the Income-tax Act, 1961.

The tax treatment of contribution and exemption of payment from tax are as follows:

- Employer's contribution is exempt from tax in the hands of employee (upto ₹ 1,00,000 per employee per annum). Only such contribution exceeding ₹ 1,00,000 is taxable in the hands of the respective employee;
- Employee's contribution qualifies for deduction under section 80C;
- Interest on accumulated balance is exempt from tax.

Section 10(13) grants exemption in respect of payment from the fund—

- to the legal heirs on the death of beneficiary (e.g. payment to widow of the beneficiary) or
- to an employee in lieu of or in commutation of an annuity on his retirement at or after the specified age or on his becoming incapacitated prior to such retirement, or
- by way of refund of contribution on the death of the beneficiary or,
- by way of refund of contribution to an employee on his leaving the service in connection

4.11 Income Tax

with which the fund is established otherwise than in the circumstances mentioned in (b), to the extent to which such payment does not exceed the contribution made prior to April 1, 1962. For example, where the amount received by an employee does not include any contribution made prior to 1.4.1962, the whole amount is taxable.

4.17 Salary from United Nations Organisation

Section 2 of the United Nations (Privileges and Immunities) Act, 1947 grants exemption from income-tax to salaries and emoluments paid by the United Nations to its officials. Besides salary, any pension covered under the United Nations (Privileges and Immunities) Act and received from UNO is also exempt from tax.

4.18 Allowances

Different types of allowances are given to employees by their employers. Generally allowances are given to employees to meet some particular requirements like house rent, expenses on uniform, conveyance etc. Under the Income-tax Act, 1961, allowance is taxable on due or receipt basis, whichever is earlier. Various types of allowances normally in vogue are discussed below:

Allowances		
Fully Taxable	Partly Taxable	Fully Exempt
(i) Entertainment Allowance	(i) House Rent Allowance [u/s 10(13A)]	(i) Allowance granted to Government employees outside India.
(ii) Dearness Allowance	(ii) Special Allowances [u/s 10(14)]	(ii) Sumptuary allowance granted to High Court or Supreme Court Judges
(iii) Overtime Allowance		(iii) Allowance paid by the United Nations Organization.
(iv) Fixed Medical Allowance		(iv) Compensatory Allowance received by a judge
(v) City Compensatory Allowance		
(vi) Interim Allowance (to meet increased cost of living in cities)		
(vii) Servant Allowance		
(viii) Project Allowance		
(ix) Tiffin/Lunch/Dinner Allowance		
(x) Any other cash allowance		
(xi) Warden Allowance		
(xii) Non-practicing Allowance		

Allowances which are fully taxable

(1) **City compensatory allowance:** City Compensatory Allowance is normally intended to compensate the employees for the higher cost of living in cities. It is taxable irrespective of the fact whether it is given as compensation for performing his duties in a particular place or under special circumstances.

(2) **Entertainment allowance:** This allowance is given to employees to meet the expenses towards hospitality in receiving customers etc. The Act gives a deduction towards entertainment allowance only to a Government employee. The details of deduction permissible are discussed later on in this Unit.

Allowances which are partially taxable:

- (1) House rent allowance [Section 10(13A)] : Refer to Chapter 3 for detailed discussion.
- (2) Special allowances [Section 10(14)] : Refer to Chapter 3 for details.

Allowances which are fully exempt:

- (1) **Allowance to High Court Judges:** Any allowance paid to a Judge of a High Court under section 22A(2) of the High Court Judges (Conditions of Service) Act, 1954 is not taxable.
- (2) **Allowance received from United Nations Organisation (UNO):** Allowance paid by the UNO to its employees is not taxable by virtue of section 2 of the United Nations (Privileges and Immunities) Act, 1974.
- (3) **Compensatory allowance under Article 222(2) of the Constitution:** Compensatory allowance received by judge under Article 222(2) of the Constitution is not taxable since it is neither salary nor perquisite—*Bishamber Dayal v. CIT* [1976] 103 ITR 813 (MP).
- (4) **Sumptuary allowance:** Sumptuary allowance given to High Court Judges under section 22C of the High Court Judges (Conditions of Service) Act, 1954 and Supreme Court Judges under section 23B of the Supreme Court Judges (Conditions of Service) Act, 1958 is not chargeable to tax.

4.19 Perquisites

- (1) The term 'perquisite' indicates some extra benefit in addition to the amount that may be legally due by way of contract for services rendered. In modern times, the salary package of an employee normally includes monetary salary and perquisite like housing, car etc.
- (2) Perquisite may be provided in cash or in kind.
- (3) Reimbursement of expenses incurred in the official discharge of duties is not a perquisite.
- (4) Perquisite may arise in the course of employment or in the course of profession. If it arises from a relationship of employer-employee, then the value of the perquisite is taxable as salary. However, if it arises during the course of profession, the value of such perquisite is chargeable as profits and gains of business or profession.
- (5) Perquisite will become taxable only if it has a legal origin. An unauthorised advantage taken by an employee without his employer's sanction cannot be considered as a perquisite under the Act. For example, suppose A, an employee, is given a house by his employer. On 31.3.2013, he is terminated from service. But he continues to occupy the house without the permission of the employer for six more months after which he is evicted by the employer. The question arises whether the value of the benefit enjoyed by him during the six months period can be considered as a perquisite and be charged to salary. It cannot be done since the

relationship of employer-employee ceased to exist after 31.3.2013. However, the definition of income is wide enough to bring the value of the benefit enjoyed by employee to tax as "income from other sources".

(6) Income-tax paid by the employer out of his pocket on the salary of the employee is a perquisite in the hands of the employee whether the payment is contractual or voluntary.

Definition: Under the Act, the term 'perquisite' is defined by section 17(2) to include the following:

- (a) the value of rent free accommodation provided to the assessee by his employer [section 17(2)(i)];
- (b) The value of any concession in the matter of rent respecting any accommodation provided to the assessee by his employer [section 17(2)(ii)];
 - (i) Under section 17(2)(ii), the value of any concession in the matter of rent arising to an employee in respect of any accommodation provided by his employer is considered as "perquisite" chargeable to tax in the hands of the employee.
 - (ii) Rule 3(1) of the Income-tax Rules provides the basis of valuation of perquisites in respect of accommodation provided to an employee, as under:
 - (a) 15% of salary in cities having population exceeding 25 lakh
 - (b) 10% of salary in cities having population above 10 lakh up to 25 lakh
 - (b) 7.5% of salary in cities having population up to 10 lakh.
 - (iii) In case of furnished accommodation provided by an employer, the value arrived as above was to be further increased by 10 per cent of the cost of furniture, where the same is owned by the employer, or the actual hire charges paid by the employer in case the furniture is hired.
 - (iv) This method of perquisite valuation resulted in genuine hardship to employees availing facility of residential accommodation in remote areas, as the value of perquisite was determined as a percentage of salary of the employee, irrespective of the fair rental value of the property (which may be much lower than 15%/10%/7.5% of salary in such cases).
 - (v) Rule 3(1) was challenged as *ultra vires* before the Supreme Court in the case of *Arun Kumar v. UOI* (2006) 286 ITR 89. The Apex court, while holding that the provisions of Rule 3(1) were constitutionally valid, observed that the same would be applicable only if 'concession in the matter of rent' with respect to the accommodation provided by an employer accrues to the employee under the substantive provisions of section 17(2)(ii). The Assessing Officer, before applying Rule 3(1), was required to establish that there was 'concession in the matter of rent' provided to the employee.
 - (vi) Further, as per the Apex court, the difference between the value as per Rule 3(1) and the rent recovered from the employee, could not per se be considered as 'concession in the matter of rent' provided to the employee.

- (vii) In order to clarify the correct intent of law, Explanations have been inserted in section 17(2)(ii) to provide that the difference between the specified rate (as shown in column 2 of the table below) and the amount of rent recoverable/recovered from the employee would be deemed to be the concession in the matter of rent in case of accommodation owned by the employer. In case of accommodation taken on lease or rent by the employer, the difference between the actual lease rent or 15% of salary, whichever is lower, and rent recovered/recoverable from the employee would be deemed to be the concession in the matter of rent.

(1)	(2)
Type of accommodation	Deemed concession in the matter of rent
Accommodation owned by the employer	
In cities having a population exceeding 25 lakh	15% of salary minus rent recoverable from the employee.
In cities having a population exceeding 10 lakh but not exceeding 25 lakh	10% of salary minus rent recoverable from the employee.
In other cities	7½% of salary minus rent recoverable from employee.
Accommodation taken on lease by the employer	Rent paid by the employer or 15% of salary, whichever is lower, minus rent recoverable from the employee.

- (viii) This deeming provision is applicable to employees other than Government employees. In case of furnished accommodation provided to such employees, the excess of hire charges paid or 10% p.a. of cost of furniture, as the case may be, over and above the charges paid or payable by the employee would be added to the value determined in column (2) above for determining whether there is a concession in the matter of rent.

Note – Once there is a deemed concession, the provisions of Rule 3(1) would be applicable in computing the taxable perquisite.

- (ix) “Salary” includes pay, allowances, bonus or commission payable monthly or otherwise or any monetary payment, by whatever name called, from one or more employers, as the case may be. However, it does not include the following, namely–
- (1) dearness allowance or dearness pay unless it enters into the computation of superannuation or retirement benefits of the employee concerned;
 - (2) employer’s contribution to the provident fund account of the employee;
 - (3) allowances which are exempted from the payment of tax;
 - (4) value of the perquisites specified in section 17(2);
 - (5) any payment or expenditure specifically excluded under the proviso to section

17(2) i.e., medical expenditure/payment of medical insurance premium specified therein.

- (x) In case of Government employees, the excess of licence fees determined by the employer as increased by the value of furniture and fixture over and above the rent recovered/recoverable from the employee and the charges paid or payable for furniture by the employee would be deemed to be the concession in the matter of rent.
- (c) The value of any benefit or amenity granted or provided free of cost or at concessional rate in any of the following cases (i.e. in case of specified employees):
 - (i) by a company to an employee in which he is a director;
 - (ii) by a company to an employee being a person who has substantial interest in the company (i.e. 20% or more of the voting rights of the company);
 - (iii) by any employer (including a company) to an employee to whom the provisions of (i) & (ii) do not apply and whose income under the head 'salaries' (whether due from, or paid or allowed by, one or more employers) exclusive of the value of all benefits or amenities not provided for by way of monetary benefits exceeds ₹ 50,000 [Section 17(2)(iii)];
- (d) Any sum paid by the employer in respect of any obligation which, but for such payment, would have been payable by the assessee [Section 17(2)(iv)];
- (e) Any sum payable by the employer whether directly or through a fund, other than a recognised provident fund or approved superannuation fund or deposit-linked insurance fund to effect an assurance on the life of the assessee or to effect a contract for an annuity [Section 17(2)(v)];
- (f) the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer or former employer, free of cost or at concessional rate to the assessee [Section 17(2)(vi)];

Specified security means "securities" as defined in section 2(h) of the Securities Contracts (Regulation) Act, 1956. It also includes the securities offered under employees stock option plan or scheme. Sweat equity shares means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

The value of specified security or sweat equity shares shall be the fair market value of such security or shares on the date on which the option is exercised by the assessee, as reduced by any amount actually paid by, or recovered from, the assessee in respect of such security or shares. The fair market value means the value determined in accordance with the method as may be prescribed by the CBDT. "Option" means a right but not an obligation granted to an employee to apply for the specified security or sweat equity shares at a pre-determined price.

- (g) the amount of any contribution to an approved superannuation fund by the employer in respect of the assessee, to the extent it exceeds ₹ 1 lakh [Section 17(2)(vii)];

- (h) the value of any other fringe benefit or amenity as may be prescribed by the CBDT [Section 17(2)(viii)].

It can be noted that the aforesaid definition of perquisite is an inclusive one. More terms can be added in.

Types of perquisites: Perquisites may be divided into three broad categories:

- (1) Perquisites taxable in the case of all employees
- (2) Perquisites exempt from tax in the case of all employees
- (3) Perquisites taxable only in the hands of specified employees.

(1) **Perquisites taxable in the case of all employees:** The following perquisites are chargeable to tax in all cases.

- (i) Value of rent-free accommodation provided to the assessee by his employer [Section 17(2)(i)].

Exception: Rent-free official residence provided to a Judge of a High Court or to a Judge of the Supreme Court is not taxable. Similarly, rent-free furnished house provided to an Officer of Parliament, is not taxable. [For valuation, refer to para 4.20]

- (ii) Value of concession in rent in respect of accommodation provided to the assessee by his employer [Section 17(2)(ii)].
- (iii) Amount paid by an employer in respect of any obligation which otherwise would have been payable by the employee [Section 17(2)(iv)]. For example, if a domestic servant is engaged by an employee and the employer reimburses the salary paid to the servant, it becomes an obligation which the employee would have discharged even if the employer did not reimburse the same. This perquisite will be covered by section 17(2)(iv) and will be taxable in the hands of all employees.
- (iv) Amount payable by an employer directly or indirectly to effect an assurance on the life of the assessee or to effect a contract for an annuity, other than payment made to RPF or approved superannuation fund or deposit-linked insurance fund established under the Coal Mines Provident Fund or Employees' Provident Fund Act. However, there are schemes like group annuity scheme, employees state insurance scheme and fidelity insurance scheme, under which insurance premium is paid by employer on behalf of the employees. Such payments are not regarded as perquisite in view of the fact that the employees have only an expectancy of the benefit in such schemes.
- (v) the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer or former employer, free of cost or at concessional rate to the assessee.
- (vi) the amount of any contribution to an approved superannuation fund by the employer in respect of the assessee, to the extent it exceeds ₹ 1 lakh.
- (vii) The value of any other fringe benefit or amenity as may be prescribed by the CBDT.

(2) **Perquisites exempt from tax in all cases:** The following perquisites are exempt from tax in all cases -

- (1) Telephone provided by an employer to an employee at his residence;
- (2) Goods sold by an employer to his employees at concessional rates;
- (3) Transport facility provided by an employer engaged in the business of carrying of passengers or goods to his employees either free of charge or at concessional rate;
- (4) Privilege passes and privilege ticket orders granted by Indian Railways to its employees;
- (5) Perquisites allowed outside India by the Government to a citizen of India for rendering services outside India;
- (6) Sum payable by an employer to a RPF or an approved superannuation fund or deposit-linked insurance fund established under the Coal Mines Provident Fund or the Employees' Provident Fund Act;
- (7) Employer's contribution to staff group insurance scheme;
- (8) Leave travel concession;
- (9) Payment of annual premium by employer on personal accident policy effected by him on the life of the employee;
- (10) Refreshment provided to all employees during working hours in office premises;
- (11) Subsidized lunch or dinner provided to an employee;
- (12) Recreational facilities, including club facilities, extended to employees in general *i.e.*, not restricted to a few select employees;
- (13) Amount spent by the employer on training of employees or amount paid for refresher management course including expenses on boarding and lodging;
- (14) Medical facilities subject to certain prescribed limits; [Refer to point 10 of para 4.20]
- (15) Rent-free official residence provided to a Judge of a High Court or the Supreme Court;
- (16) Rent-free furnished residence including maintenance provided to an Officer of Parliament, Union Minister and a Leader of Opposition in Parliament;
- (17) Conveyance facility provided to High Court Judges under section 22B of the High Court Judges (Conditions of Service) Act, 1954 and Supreme Court Judges under section 23A of the Supreme Court Judges (Conditions of Service) Act, 1958.

(3) Perquisites taxable only in the hands of specified employees [Section 17(2)(iii)]: The value of any benefit or amenity granted or provided free of cost or at concessional rate which have not been included in 1 & 2 above will be taxable in the hands of specified employees:

Specified employees are:

- (i) **Director employee:** An employee of a company who is also a director is a specified employee. It is immaterial whether he is a full-time director or part-time director. It also does not matter whether he is a nominee of the management, workers, financial institutions or the Government. It is also not material whether or not he is a director throughout the previous year.
- (ii) **An employee who has substantial interest in the company:** An employee of a company who has substantial interest in that company is a specified employee. A person has a substantial interest in a company if he is a beneficial owner of equity shares carrying 20% or

more of the voting power in the company.

Beneficial and legal ownership: In order to determine whether a person has a substantial interest in a company, it is the beneficial ownership of equity shares carrying 20% or more of the voting power that is relevant rather than the legal ownership.

Example: A, Karta of a HUF, is a registered shareholder of Bright Ltd. The amount for purchasing the shares is financed by the HUF. The dividend is also received by the HUF. Supposing further that A is the director in Bright Ltd., the question arises whether he is a specified employee. In this case, he cannot be called a specified person since he has no beneficial interest in the shares registered in his name. It is only for the purpose of satisfying the statutory requirements that the shares are registered in the name of A. All the benefits arising from the shareholding goes to the HUF. Conversely, it may be noted that an employee who is not a registered shareholder will be considered as a specified employee if he has beneficial interest in 20% or more of the equity shares in the company.

(iii) **Employee drawing in excess of ₹ 50,000:** An employee other than an employee described in (i) & (ii) above, whose income chargeable under the head 'salaries' exceeds ₹ 50,000 is a specified employee. The above salary is to be considered exclusive of the value of all benefits or amenities not provided by way of monetary payments.

In other words, for computing the limit of ₹ 50,000, the following items have to be excluded or deducted:

- (a) all non-monetary benefits;
- (b) monetary benefits which are exempt under section 10. This is because the exemptions provided under section 10 are excluded completely from salaries. For example, HRA or education allowance or hostel allowance are not to be included in salary to the extent to which they are exempt under section 10.
- (c) Deduction for entertainment allowance [under section 16(ii)] and deduction toward professional tax [under section 16(iii)] are also to be excluded.

If an employee is employed with more than one employer, the aggregate of the salary received from all employers is to be taken into account in determining the above ceiling limit of ₹ 50,000, i.e. Salary for this purpose

= Basic Salary + Dearness Allowance + Commission, whether payable monthly or turnover based + Bonus + Fees + Any other taxable payment + Any taxable allowances + Any other monetary benefits – Deductions under section 16]

4.20 Valuation of Perquisites

The Income-tax Rules, 1962 contain the provisions for valuation of perquisites. It is important to note that only those perquisites which the employee actually enjoys have to be valued and taxed in his hand. For example, suppose a company offers a housing accommodation rent-free to an employee but the latter declines to accept it, then the value of such accommodation obviously cannot be evaluated and taxed in the hands of the employees. For the purpose of

computing the income chargeable under the head "Salaries", the value of perquisites provided by the employer directly or indirectly to the employee or to any member of his household by reason of his employment shall be determined in accordance with new Rule 3.

(1) **Valuation of residential accommodation [Sub-rule (1)]** - The value of residential accommodation provided by the employer during the previous year shall be determined in the following manner –

Sl. No.	Circumstances	In case of unfurnished accommodation	In case of furnished accommodation
(1)	(2)	(3)	(4)
(1)	Where the accommodation is provided by the Central Government or any State Government to the employees either holding office or post in connection with the affairs of the Union or of such State.	License fee determined by the Central Government or any State Government in respect of accommodation in accordance with the rules framed by such Government as reduced by the rent actually paid by the employee.	The value of perquisite as determined under column (3) and increased by 10% per annum of the cost of furniture (including television sets, radio sets, refrigerators, other household appliances, air-conditioning plant or equipment). If such furniture is hired from a third party, the actual hire charges payable for the same as reduced by any charges paid or payable for the same by the employee during the previous year should be added to the value of the perquisite determined under column (3).
(2)	Where the accommodation is provided by any other employer (a) where the accommodation is owned by the employer	(i) 15% of salary in cities having population exceeding 25 lakhs as per 2001 census; (ii) 10% of salary in cities having population exceeding 10 lakhs but not exceeding 25 lakhs as per 2001 census;	The value of perquisite as determined under column (3) and increased by 10% per annum of the cost of furniture (including television sets, refrigerators, other household appliances, air-conditioning plant or equipment or other similar appliances or gadgets). If such furniture is hired from a third party, the actual hire

		(iii) 7.5% of salary in other areas, in respect of the period during which the said accommodation was occupied by the employee during the previous year as reduced by the rent, if any, actually paid by the employee.	charges payable for the same as reduced by any charges paid or payable for the same by the employee during the previous year, should be added to the value of perquisite determined under column (3).
	(b) where the accommodation is taken on lease or rent by the employer.	Actual amount of lease rental paid or payable by the employer or 15% of salary, whichever is lower, as reduced by the rent, if any, actually paid by the employee.	The value of perquisite as determined under column (3) and increased by 10% per annum of the cost of furniture (including television sets, radio sets, refrigerators, other household appliances, air-conditioning plant or equipment or other similar appliances or gadgets). If such furniture is hired from a third party, the actual hire charges payable for the same as reduced by any charges paid or payable for the same by the employee during the previous year should be added to the value of perquisite determined under column (3).
(3)	Where the accommodation is provided by any employer, whether Government or any other employer, in a hotel.	Not applicable	24% of salary paid or payable for the previous year or the actual charges paid or payable to such hotel, which is lower, for the period during which such accommodation is provided as reduced by the rent, if any, actually paid or payable by the employee. However, where the employee is provided such accommodation for a period not exceeding in aggregate

4.21 Income Tax

			fifteen days on his transfer from one place to another, there would be no perquisite.

Notes:

- (1) If an employee is provided with accommodation, on account of his transfer from one place to another, at the new place of posting while retaining the accommodation at the other place, the value of perquisite shall be determined with reference to only one such accommodation which has the lower perquisite value, as calculated above, for a period not exceeding 90 days and thereafter, the value of perquisite shall be charged for both such accommodations.
- (2) Any accommodation provided to an employee working at a mining site or an on-shore oil exploration site or a project execution site, or a dam site or a power generation site or an off-shore site would not be treated as a perquisite, provided it satisfies either of the following conditions -
 - (i) the accommodation is of temporary nature, has plinth area not exceeding 800 square feet and is located not less than eight kilometers away from the local limits of any municipality or a cantonment board; or
 - (ii) the accommodation is located in a remote area i.e. an area that is located at least 40 kms away from a town having a population not exceeding 20,000 based on latest published all-India census.
- (3) Where the accommodation is provided by the Central Government or any State Government to an employee who is serving on deputation with any body or undertaking under the control of such Government,-
 - (i) the employer of such an employee shall be deemed to be that body or undertaking where the employee is serving on deputation; and
 - (ii) the value of perquisite of such an accommodation shall be the amount calculated in accordance with Sl. No.(2)(a) of the above table, as if the accommodation is owned by the employer.
- (4) "Accommodation" includes a house, flat, farm house or part thereof, or accommodation in a hotel, motel, service apartment, guest house, caravan, mobile home, ship or other floating structure.
- (5) "Hotel" includes licensed accommodation in the nature of motel, service apartment or guest house.

Illustration 4

Mr. C is a Finance Manager in ABC Ltd. The company has provided him with rent-free unfurnished accommodation in Mumbai. He gives you the following particulars:

Basic salary *₹ 6,000 p.m.*

Advance salary for April 2014	₹ 5,000
Dearness Allowance	₹ 2,000 p.m. (30% is for retirement benefits)
Bonus	₹ 1,500 p.m.

Even though the company allotted the house to him on 1.4.2013, he occupied the same only from 1.11.2013. Calculate the taxable value of the perquisite for A.Y. 2014-15.

Solution

Value of the rent free unfurnished accommodation

= 15% of salary for the relevant period

= 15% of [(₹ 6000 × 5) + (₹ 2,000 × 30% × 5) + (₹ 1,500 × 5)] [See Note below]

= 15% of ₹ 40,500 = ₹ 6,075.

Note: Since, Mr. C occupies the house only from 1.11.2013, we have to include the salary due to him only in respect of months during which he has occupied the accommodation. Hence salary for 5 months (i.e. from 1.11.2013 to 31.03.2014) will be considered. Advance salary for April 2014 drawn during this year is not to be considered because it falls in respect of a period beyond the relevant previous year.

Illustration 5

Using the data given in the previous illustration 4, compute the value of the perquisite if Mr. C is required to pay a rent of ₹ 1,000 p.m. to the company, for the use of this accommodation.

Solution

First of all, we have to see whether there is a concession in the matter of rent. In the case of accommodation owned by the employer in cities having a population exceeding ₹ 25 lakh, there would be deemed to be a concession in the matter of rent if 15% of salary exceeds rent recoverable from the employee.

In this case, 15% of salary would be ₹ 6,075 (i.e. 15% of ₹ 40,500). The rent paid by the employee is ₹ 5,000 (i.e. ₹ 1,000 × 5). Since 15% of salary exceeds the rent recovered from the employee, there is a deemed concession in the matter of rent. Once there is a deemed concession, the provisions of Rule 3(1) would be applicable in computing the taxable perquisite.

Value of the rent free unfurnished accommodation	= ₹ 6,075
Less : Rent paid by the employee (₹ 1,000 × 5)	= <u>₹ 5,000</u>
Perquisite value of unfurnished accommodation given at concessional rent	= <u>₹ 1,075</u>

Illustration 6

Using the data given in illustration 4, compute the value of the perquisite if ABC Ltd. has taken this accommodation on a lease rent of ₹ 1,200 p.m. and Mr. C is required to pay a rent of ₹ 1,000 p.m. to the company, for the use of this accommodation.

Solution

Here again, we have to see whether there is a concession in the matter of rent. In the case of accommodation taken on lease by the employer, there would be deemed to be a concession in

the matter of rent if the rent paid by the employer or 15% of salary, whichever is lower, exceeds rent recoverable from the employee.

In this case, 15% of salary is ₹ 6,075 (i.e. 15% of ₹ 40,500). Rent paid by the employer is ₹ 6,000 (i.e. ₹ 1,200 × 5). The lower of the two is ₹ 6,000, which exceeds the rent paid by the employee i.e. ₹ 5,000 (₹ 1,000 × 5). Therefore, there is a deemed concession in the matter of rent. Once there is a deemed concession, the provisions of Rule 3(1) would be applicable in computing the taxable perquisite.

Value of the rent free unfurnished accommodation [Note1]	= ₹ 6,000
Less: Rent paid by the employee (₹ 1,000 × 5)	= <u>₹ 5,000</u>
∴ Value of unfurnished accommodation given at concessional rent	= <u>₹ 1,000</u>

Note 1 : Value of the rent free unfurnished accommodation is lower of

(i) Lease rent paid by the company for relevant period	= ₹ 1,200 × 5 = ₹ 6,000
(ii) 15% of salary for the relevant period (computed earlier)	= ₹ 6,075

Illustration 7

Using the data given in illustration 4, compute the value of the perquisite if ABC Ltd. has provided a television (WDV ₹ 10,000; Cost ₹ 25,000) and two air conditioners. The rent paid by the company for the air conditioners is ₹ 400 p.m. each. The television was provided on 1.1.2014. However, Mr. C is required to pay a rent of ₹ 1,000 p.m. to the company, for the use of this furnished accommodation.

Solution

Here again, we have to see whether there is a concession in the matter of rent. In the case of accommodation owned by the employer in a city having a population exceeding ₹ 25 lakh, there would be deemed to be a concession in the matter of rent if 15% of salary exceeds rent recoverable from the employee. In case of furnished accommodation, the excess of hire charges paid or 10% p.a. of the cost of furniture, as the case may be, over and above the charges paid or payable by the employee has to be added to the value arrived at above to determine whether there is a concession in the matter of rent.

In this case, 15% of salary is ₹ 6,075 (i.e. 15% of ₹ 40,500). The rent paid by the employee is ₹ 5,000 (i.e. ₹ 1,000 × 5). The value of furniture (see Note 1 below) to be added to 15% of salary is ₹ 4,625. The deemed concession in the matter of rent is ₹ 6,075 + ₹ 4,625 - ₹ 5,000 = ₹ 5,700. Once there is a deemed concession, the provisions of Rule 3(1) would be applicable in computing the taxable perquisite.

Value of the rent free unfurnished accommodation (computed earlier)	= ₹ 6,075
Add: Value of furniture provided by the employer [Note 1]	= <u>₹ 4,625</u>
Value of rent free furnished accommodation	= ₹ 10,700
Less: Rent paid by the employee (₹ 1,000 × 5)	= <u>₹ 5,000</u>
Value of furnished accommodation given at concessional rent	= <u>₹ 5,700</u>

Note 1: Value of the furniture provided = (₹ 400 p.m. × 2 × 5 months) + (₹ 25,000 × 10% p.a. for 3 months) = ₹ 4,000 + ₹ 625 = ₹ 4,625

Illustration 8

Using the data given in illustration 7 above, compute the value of the perquisite if Mr. C is a government employee. The licence fees determined by the Government for this accommodation was ₹ 700 p.m.

Solution

In the case of Government employees, the excess of licence fees determined by the employer as increased by the value of furniture and fixture over and above the rent recovered/recoverable from the employee and the charges paid or payable for furniture by the employee would be deemed to be the concession in the matter of rent. Therefore, the deemed concession in the matter of rent is ₹ 3,125 [i.e. ₹ 3,500 (licence fees: 700 × 5) + ₹ 4,625 (Value of furniture) – ₹ 5,000 (₹ 1,000 × 5)]. Once there is a deemed concession, the provisions of Rule 3(1) would be applicable in computing the taxable perquisite.

Value of the rent free unfurnished accommodation (₹ 700 × 5) = ₹ 3,500

Add: Value of furniture provided by the employer (computed earlier) = ₹ 4,625

Value of rent free furnished accommodation = ₹ 8,125

Less: Rent paid by the employee (₹ 1,000 × 5) = ₹ 5,000

Perquisite value of furnished accommodation given at concessional rent = ₹ 3,125

(2) Motor Car [Sub-rule (2) of Rule 3] - The value of perquisite by way of use of motor car to an employee by an employer shall be determined in the following manner -

VALUE OF PERQUISITE PER CALENDAR MONTH

Sl. No.	Circumstances	Where cubic capacity of engine does not exceed 1.6 litres	Where cubic capacity of engine exceeds 1.6 litres
(1)	(2)	(3)	(4)
(1)	Where the motor car is owned or hired by the employer and –		
(a)	is used wholly and exclusively in the performance of his official duties	Not a perquisite, provided the documents specified in Note (2) below the table are maintained by the employer.	Not a perquisite, provided the documents specified in Note (2) below the table are maintained by the employer.
(b)	is used exclusively for the private or personal purposes of the employee or any member of his household and the running and	Actual amount of expenditure incurred by the employer on the running and maintenance of motor car during the relevant previous year including remuneration, if	Actual amount of expenditure incurred by the employer on the running and maintenance of motor car during the relevant previous year including remuneration, if any, paid

	maintenance expenses are met or reimbursed by the employer;	any, paid by the employer to the chauffeur as increased by the amount representing normal wear and tear of the motor car and as reduced by any amount charged from the employee for such use.	by the employer to the chauffeur as increased by the amount representing normal wear and tear of the motor car and as reduced by any amount charged from the employee for such use.
(c)	is used partly in the performance of duties and partly for private or personal purposes of his own or any member of his household and- (i) the expenses on maintenance and running are met or reimbursed by the employer	₹ 1,800 (plus ₹ 900, if chauffeur is also provided to run the motor car)	₹ 2,400 (plus ₹ 900, if chauffeur is also provided to run the motor car)
	(ii) the expenses on running and maintenance for private or personal use are fully met by the assessee.	₹ 600 (plus ₹ 900, if chauffeur is also provided by the employer to run the motor car)	₹ 900 (plus ₹ 900, if chauffeur is also provided by the employer to run the motor car)
(2)	Where the employee owns a motor car but the actual running and maintenance charges (including remuneration of the chauffeur, if any) are met or reimbursed to him by the employer and –		
(i)	such reimbursement is for the use of the vehicle wholly and exclusively for official purposes	Not a perquisite, provided the documents specified in Note (2) below the table are maintained by the employer.	Not a perquisite, provided the documents specified in Note (2) below the table are maintained by the employer.

(ii)	such reimbursement is for the use of the vehicle partly for official purposes and partly for personal or private purposes of the employee or any member of his household.	The actual amount of expenditure incurred by the employer as reduced by the amount specified in Sl. No. (1)(c)(i) above (Also see note (2) below this table).	The actual amount of expenditure incurred by the employer as reduced by the amount specified in Sl. No. (1)(c)(i) above (Also see note (2) below this table).
(3)	Where the employee owns any other automotive conveyance but the actual running and maintenance charges are met or reimbursed to him by the employer and		
(i)	such reimbursement is for the use of the vehicle wholly and exclusively for official purposes	Not a perquisite, provided the documents specified in the note (2) below the table are maintained by the employer.	Not applicable.
(ii)	such reimbursement is for the use of vehicle partly for official purposes and partly for personal or private purposes of the employee	The actual amount of expenditure incurred by the employer as reduced by the amount of ₹ 900. (Also see note (2) below the table)	

Notes:

- (1) Where one or more motor-cars are owned or hired by the employer and the employee or any member of his household are allowed the use of such motor-car or all of any of such motor-cars (otherwise than wholly and exclusively in the performance of his duties), the value of perquisite shall be the amount calculated in respect of one car as if the employee had been provided one motor-car for use partly in the performance of his duties and partly for his private or personal purposes and the amount calculated in respect of the other car or cars as if he had been provided with such car or cars exclusively for his private or personal purposes.
- (2) Where the employer or the employee claims that the motor-car is used wholly and exclusively in the performance of official duty or that the actual expenses on the running and maintenance of the motor-car owned by the employee for official purposes is more than the amounts deductible in Sl. No. 2(ii) or 3(ii) of the above table, he may claim a higher amount attributable to such official use and the value of perquisite in such a case shall be the actual amount of charges met or

reimbursed by the employer as reduced by such higher amount attributable to official use of the vehicle provided that the following conditions are fulfilled :-

- (a) the employer has maintained complete details of journey undertaken for official purpose which may include date of journey, destination, mileage, and the amount of expenditure incurred thereon;
 - (b) the employer gives a certificate to the effect that the expenditure was incurred wholly and exclusively for the performance of official duties.
- (3) For computing the perquisite value of motor car, the normal wear and tear of a motor-car shall be taken at 10% per annum of the actual cost of the motor-car or cars.
- (3) Valuation of benefit of provision of domestic servants [Sub-rule (3) of Rule 3]
- (i) The value of benefit to the employee or any member of his household resulting from the provision by the employer of the services of a sweeper, a gardener, a watchman or a personal attendant, shall be the actual cost to the employer.
 - (ii) The actual cost in such a case shall be the total amount of salary paid or payable by the employer or any other person on his behalf for such services as reduced by any amount paid by the employee for such services.
- (4) Valuation of gas, electricity or water supplied by employer [Sub-rule (4) of Rule 3]
- (i) The value of the benefit to the employee resulting from the supply of gas, electric energy or water for his household consumption shall be determined as the sum equal to the amount paid on that account by the employer to the agency supplying the gas, electric energy or water.
 - (ii) Where such supply is made from resources owned by the employer, without purchasing them from any other outside agency, the value of perquisite would be the manufacturing cost per unit incurred by the employer.
 - (iii) Where the employee is paying any amount in respect of such services, the amount so paid shall be deducted from the value so arrived at.
- (5) Valuation of free or concessional educational facilities [Sub-rule (5) of Rule 3]
- (i) The value of benefit to the employee resulting from the provision of free or concessional educational facilities for any member of his household shall be determined as the sum equal to the amount of expenditure incurred by the employer in that behalf or where the educational institution is itself maintained and owned by the employer or where free educational facilities for such member of employees' household are allowed in any other educational institution by reason of his being in employment of that employer, the value of the perquisite to the employee shall be determined with reference to the cost of such education in a similar institution in or near the locality.
 - (ii) Where any amount is paid or recovered from the employee on that account, the value of benefit shall be reduced by the amount so paid or recovered.

- (iii) However, where the educational institution itself is maintained and owned by the employer and free educational facilities are provided to the children of the employee or where such free educational facilities are provided in any institution by reason of his being in employment of that employer, there would be no perquisite if the cost of such education or the value of such benefit per child does not exceed ₹ 1,000 p.m.

(6) **Free or concessional tickets** [Sub-rule (6) of Rule 3] - The value of any benefit or amenity resulting from the provision by an employer who is engaged in the carriage of passengers or goods, to any employee or to any member of his household for personal or private journey free of cost or at concessional fare, in any conveyance owned, leased or made available by any other arrangement by such employer for the purpose of transport of passengers or goods shall be taken to be the value at which such benefit or amenity is offered by such employer to the public as reduced by the amount, if any, paid by or recovered from the employee for such benefit or amenity.

However, there would be no such perquisite to the employees of an airline or the railways.

(7) **Valuation of other fringe benefits and amenities** [Sub-rule (7) of Rule 3] - Section 17(2)(viii) provides that the value of any other fringe benefit or amenity as may be prescribed would be included in the definition of perquisite. Accordingly, the following other fringe benefits or amenities are prescribed and the value thereof shall be determined in the manner provided hereunder :-

(i) **Interest-free or concessional loan** [Sub-rule 7(i) of Rule 3]

- (a) The value of the benefit to the assessee resulting from the provision of interest-free or concessional loan for any purpose made available to the employee or any member of his household during the relevant previous year by the employer or any person on his behalf shall be determined as the sum equal to the interest computed at the rate charged per annum by the State Bank of India, as on the 1st day of the relevant previous year in respect of loans for the same purpose advanced by it on the maximum outstanding monthly balance as reduced by the interest, if any, actually paid by him or any such member of his household. "Maximum outstanding monthly balance" means the aggregate outstanding balance for each loan as on the last day of each month.
- (b) However, no value would be charged if such loans are made available for medical treatment in respect of prescribed diseases (like cancer, tuberculosis, etc.) or where the amount of loans are petty not exceeding in the aggregate ₹ 20,000.
- (c) Further, where the benefit relates to the loans made available for medical treatment referred to above, the exemption so provided shall not apply to so much of the loan as has been reimbursed to the employee under any medical insurance scheme.

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

- (a) The value of travelling, touring, accommodation and any other expenses paid for or borne or reimbursed by the employer for any holiday availed of by the employee or any member of his household, other than leave travel concession or assistance, shall be determined as the sum equal to the amount of the expenditure incurred by

such employer in that behalf.

- (b) Where such facility is maintained by the employer, and is not available uniformly to all employees, the value of benefit shall be taken to be the value at which such facilities are offered by other agencies to the public.
- (c) Where the employee is on official tour and the expenses are incurred in respect of any member of his household accompanying him, the amount of expenditure so incurred shall also be a fringe benefit or amenity.
- (d) However, where any official tour is extended as a vacation, the value of such fringe benefit shall be limited to the expenses incurred in relation to such extended period of stay or vacation. The amount so determined shall be reduced by the amount, if any, paid or recovered from the employee for such benefit or amenity.

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

- (a) The value of free food and non-alcoholic beverages provided by the employer to an employee shall be the amount of expenditure incurred by such employer. The amount so determined shall be reduced by the amount, if any, paid or recovered from the employee for such benefit or amenity:
- (b) However, the following would not be treated as a perquisite -
 - (1) free food and non-alcoholic beverages provided by such employer during working hours at office or business premises or through paid vouchers which are not transferable and usable only at eating joints, to the extent the value thereof either case does not exceed fifty rupees per meal or
 - (2) tea or snacks provided during working hours or
 - (3) free food and non-alcoholic beverages during working hours provided in a remote area or an off-shore installation.

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

- (a) The value of any gift, or voucher, or token in lieu of which such gift may be received by the employee or by member of his household on ceremonial occasions or otherwise from the employer shall be determined as the sum equal to the amount of such gift:
- (b) However, if the value of such gift, voucher or token, as the case may be, is below ₹ 5,000 in the aggregate during the previous year, the value of perquisite shall be taken as 'Nil'.

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

- (a) The amount of expenses including membership fees and annual fees incurred by the employee or any member of his household, which is charged to a credit card (including any add-on-card) provided by the employer, or otherwise, paid for or reimbursed by such employer shall be taken to be the value of perquisite chargeable to tax as reduced by the amount, if any paid or recovered from the

employee for such benefit or amenity.

- (b) However, such expenses incurred wholly and exclusively for official purposes would not be treated as a perquisite if the following conditions are fulfilled.
- (1) complete details in respect of such expenditure are maintained by the employer which may, inter alia, include the date of expenditure and the nature of expenditure;
 - (2) the employer gives a certificate for such expenditure to the effect that the same was incurred wholly and exclusively for the performance of official duties.

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

- (a) The value of benefit to the employee resulting from the payment or reimbursement by the employer of any expenditure incurred (including the amount of annual or periodical fee) in a club by him or by a member of his household shall be determined to be the actual amount of expenditure incurred or reimbursed by such employer on that account. The amount so determined shall be reduced by the amount, if any, paid or recovered from the employee for such benefit or amenity.

However, where the employer has obtained corporate membership of the club and the facility is enjoyed by the employee or any member of his household, the value of perquisite shall not include the initial fee paid for acquiring such corporate membership.

- (b) Further, if such expenditure is incurred wholly and exclusively for business purposes, it would not be treated as a perquisite provided the following conditions are fulfilled:-
- (1) complete details in respect of such expenditure are maintained by the employer which may, inter alia, include the date of expenditure, the nature of expenditure and its business expediency;
 - (2) the employer gives a certificate for such expenditure to the effect that the same was incurred wholly and exclusively for the performance of official duties.
- (c) There would be no perquisite for use of health club, sports and similar facilities provided uniformly to all employees by the employer.

(vii) Use of moveable assets [Sub-rule 7(vii) of Rule 3] - Value of perquisite is determined as under:

Asset given	Value of benefit
(a) Use of laptops and computers	Nil
(b) Movable assets, other than	
(i) laptops and computers; and	(i) 10% p.a. of the actual cost of such asset, or

(ii) assets already specified	(ii) the amount of rent or charge paid, or payable by the employer as the case may be

Note: Where the employee is paying any amount in respect of such asset, the amount so paid shall be deducted from the value of perquisite determined above.

(viii) **Transfer of moveable assets** [Sub-rule 7(viii) of Rule 3] -Value of perquisite is determined as under:

Assets transferred	Value of perquisite
Computers and electronic items	Depreciated value of asset [depreciation is computed @ 50% on WDV for each completed year of usage]
Motor cars	Depreciated value of asset [depreciation is computed @ 20% on WDV for each completed year of usage]
Any other asset	Depreciated value of asset [depreciation is computed @ 10% on SLM for each completed year of usage]

Note: Where the employee is paying any amount in respect of such asset, the amount so paid shall be deducted from the value of perquisite determined above.

(ix) **Other benefit or amenity** [Sub-rule 7(ix) of Rule 3] - The value of any other benefit or amenity, service, right or privilege provided by the employer shall be determined on the basis of cost to the employer under an arms' length transaction as reduced by the employee's contribution, if any. However, there will be no taxable perquisite in respect of expenses on telephones including mobile phone actually incurred on behalf of the employee by the employer i.e., if an employer pays or reimburses telephone bills or mobile phone charges of employee, there will be no taxable perquisite.

(8) **Valuation of specified security or sweat equity share for the purpose of section 17(2)(vi)** [Sub-rule (8)] - The fair market value of any specified security or sweat equity share, being an equity share in a company, on the date on which the option is exercised by the employee, shall be determined in the following manner -

(1) In a case where, on the date of the exercising of the option, the share in the company is listed on a recognized stock exchange, the fair market value shall be the average of the opening price and closing price of the share on that date on the said stock exchange.

However, where, on the date of exercising of the option, the share is listed on more than one recognized stock exchanges, the fair market value shall be the average of opening price and closing price of the share on the recognised stock exchange which records the highest volume of trading in the share.

Further, where on the date of exercising of the option, there is no trading in the share on any recognized stock exchange, the fair market value shall be—

- (a) the closing price of the share on any recognised stock exchange on a date closest to the date of exercising of the option and immediately preceding such date; or
- (b) the closing price of the share on a recognised stock exchange, which records the highest volume of trading in such share, if the closing price, as on the date closest to the date of exercising of the option and immediately preceding such date, is recorded on more than one recognized stock exchange.

“Closing price” of a share on a recognised stock exchange on a date shall be the price of the last settlement on such date on such stock exchange. However, where the stock exchange quotes both “buy” and “sell” prices, the closing price shall be the “sell” price of the last settlement.

“Opening price” of a share on a recognised stock exchange on a date shall be the price of the first settlement on such date on such stock exchange. However, where the stock exchange quotes both “buy” and “sell” prices, the opening price shall be the “sell” price of the first settlement.

- (2) In a case where, on the date of exercising of the option, the share in the company is not listed on a recognised stock exchange, the fair market value shall be such value of the share in the company as determined by a merchant banker on the specified date.

For this purpose, “specified date” means,—

- (i) the date of exercising of the option; or
- (ii) any date earlier than the date of the exercising of the option, not being a date which is more than 180 days earlier than the date of the exercising.

Note: Where any amount has been recovered from the employee, the same shall be deducted to arrive at the value of perquisites.

- (9) Valuation of specified security not being an equity share in a company for the purpose of section 17(2)(vi) [Sub-rule (9)] - The fair market value of any specified security, not being an equity share in a company, on the date on which the option is exercised by the employee, shall be such value as determined by a merchant banker on the specified date.

For this purpose, “specified date” means,—

- (i) the date of exercising of the option; or
- (ii) any date earlier than the date of the exercising of the option, not being a date which is more than 180 days earlier than the date of the exercising.

Definitions for the purpose of perquisite rules - The following definitions are relevant for applying the perquisite valuation rules -

- (i) “member of household” shall include-
 - (a) spouse(s),
 - (b) children and their spouses,
 - (c) parents, and

- (d) servants and dependants;
- (ii) "Salary" includes the pay, allowances, bonus or commission payable monthly or otherwise or any monetary payment, by whatever name called from one or more employers, as the case may be, but does not include the following, namely:-
- dearness allowance or dearness pay unless it enters into the computation of superannuation or retirement benefits of the employee concerned;
 - employer's contribution to the provident fund account of the employee;
 - allowances which are exempted from payment of tax;
 - the value of perquisites specified in clause (2) of section 17 of the Income-tax Act;
 - any payment or expenditure specifically excluded under proviso to sub-clause (iii) of clause (2) or proviso to clause (2) of section 17;
 - lump-sum payments received at the time of termination of service or superannuation or voluntary retirement, like gratuity, severance pay, leave encashment, voluntary retrenchment benefits, commutation of pension and similar payments;

Illustration 9

X Ltd. provided the following perquisites to its employee Mr. Y for the P.Y.2013-14 –

(1) Accommodation taken on lease by X Ltd. for ₹ 15,000 p.m. ₹ 5,000 p.m. is recovered from the salary of Mr. Y.

(2) Furniture, for which the hire charges paid by X Ltd. is ₹ 3,000 p.m. No amount is recovered from the employee in respect of the same.

(3) A Santro Car which is owned by X Ltd. and given to Mr. Y to be used both for official and personal purposes. All running and maintenance expenses are fully met by the employer. He is also provided with a chauffeur.

(4) A gift voucher of ₹ 10,000 on his birthday.

Compute the value of perquisites chargeable to tax for the A.Y.2014-15, assuming his salary for perquisite valuation to be ₹ 10 lakh.

Solution

Computation of the value of perquisites chargeable to tax in the hands of Mr. Y for the A.Y.2014-15

	Particulars	Amount in ₹		
(1)	Value of concessional accommodation			
	Actual amount of lease rental paid by X Ltd.	1,80,000		
	15% of salary i.e., 15% of ₹ 10,00,000	1,50,000		
	Lower of the above		1,50,000	
	Less: Rent paid by Mr. Y (₹ 5,000 × 12)		60,000	
			90,000	

	Add: Hire charges paid by X Ltd. for furniture provided for the use of Mr.Y		36,000	1,26,000
(2)	Perquisite value of santro car owned by X Ltd. and provided to Mr.Y for his personal and official use $[(\text{₹ } 1,800 + \text{₹ } 900) \times 12]$			32,400
(3)	Value of gift voucher			10,000
	Value of perquisites chargeable to tax			1,68,400

(10) Medical facilities - The following medical facilities will not amount to a perquisite:

- The value of any medical treatment provided to an employee or any member of his family in any hospital maintained by the employer;
- Any sum paid by the employer in respect of any expenditure actually incurred by the employee on his medical treatment or treatment of any member of his family in any hospital maintained by the Government/local authority/any other hospital approved by the Government for the purpose of medical treatment of its employees;
- Any sum paid by the employer in respect of any expenditure actually incurred by the employee on his medical treatment or treatment of any member of his family in respect of the prescribed disease or ailments in any hospital approved by the Chief Commissioner having regard to the prescribed guidelines. However, in order to claim this benefit, the employee shall attach with his return of income a certificate from the hospital specifying the disease or ailment for which medical treatment was required and the receipt for the amount paid to the hospital.

Thus, the two types of facilities are covered:

- payment by the employer for treatment in a Government hospital and
 - payment by an employer for treatment of prescribed diseases in any hospital approved by the Chief Commissioner.
- Any premium paid by an employer in relation to an employee to effect an insurance on the health of such employee. However, any such scheme should be approved by the Central Government or the Insurance Regulatory Development Authority (IRDA) for the purposes of section 36(1)(ib).
 - Any sum paid by the employer in respect of any premium paid by the employee to effect an insurance on his family under any scheme approved by the Central Government for the purposes of section 80D.
 - Any sum paid by the employer in respect of any expenditure actually incurred by the employee on his medical treatment or treatment of any member of his family to the extent of ₹ 15,000 in the previous year.

Note: It is important to note that this expenditure need not be incurred either in the government hospital or in a hospital approved by the Chief Commissioner.

(vii) Any expenditure incurred by the employer on the following:

- (a) medical treatment of the employee or any member of the family of such employee outside India;
- (b) travel and stay abroad of the employee or any member of the family of such employee for medical treatment;
- (c) travel and stay abroad of one attendant who accompanies the patient in connection with such treatment.

Conditions:

1. The perquisite element in respect of expenditure on medical treatment and stay abroad will be exempt only to the extent permitted by the RBI.
2. The expenses in respect of traveling of the patient and the attendant will be exempt if the employee's gross total income as computed before including the said expenditure does not exceed ₹ 2 lakh.

Note: For this purpose, family means spouse and children of the individual. Children may be dependent or independent, married or unmarried. It also includes parents, brothers and sisters of the individual if they are wholly or mainly dependent upon him.

Illustration 10

Compute the taxable value of the perquisite in respect of medical facilities received by Mr. G from his employer during the P.Y. 2013-14:

Medical premium paid for insuring health of Mr. G	₹	7,000
Treatment of Mr. G by his family doctor	₹	5,000
Treatment of Mrs. G in a Government hospital	₹	25,000
Treatment of Mr. G's grandfather in a private clinic	₹	12,000
Treatment of Mr. G's mother (68 years and dependant) by family doctor	₹	8,000
Treatment of Mr. G's sister (dependant) in a nursing home	₹	3,000
Treatment of Mr. G's brother (independent)	₹	6,000
Treatment of Mr. G's father (75 years and dependant) abroad	₹	50,000
Expenses of staying abroad of the patient and	₹	30,000
Limit specified by RBI	₹	75,000

Solution

Computation of taxable value of perquisite in the hands of Mr. G

Particulars	₹	₹
Treatment of Mrs. G in a Government hospital		-
Treatment of Mr. G's father (75 years and dependant) abroad	50,000	

Expenses of staying abroad of the patient and attendant	30,000	
	80,000	
Less : Exempt up to limit specified by RBI	75,000	5,000
Medical premium paid for insuring health of Mr. G		-
Treatment of Mr. G by his family doctor	5,000	
Treatment of Mr. G's mother (dependant) by family doctor	8,000	
Treatment of Mr. G's sister (dependant) in a nursing home	3,000	
	16,000	
Less: Exempt upto ₹ 15,000	15,000	1,000
Add: Treatment of Mr. G's grandfather in a private clinic		12,000
Add: Treatment of Mr. G's brother (independent)		6,000
Taxable value of perquisite		24,000

Note: Grandfather and independent brother are not included within the meaning of family of Mr. G.

(11) Payment of premium on personal accident insurance policies - If an employer takes personal accident insurance policies on the lives of employees and pays the insurance premium, no immediate benefit would become payable and benefit will accrue at a future date only if certain events take place.

Moreover, the employers would be taking such policy in their business interest only, so as to indemnify themselves from payment of any compensation. Therefore, the premium so paid will not constitute a taxable perquisite in the employees' hands [*CIT vs. Lala Shri Dhar* [1972] 84 ITR 19 (Del.)].

4.21 Deductions from Salary

The income chargeable under the head 'Salaries' is computed after making the following deductions:

- (1) Entertainment allowance [Section 16(ii)]
- (2) Professional tax [Section 16(iii)]

(1) Entertainment allowance - Entertainment allowance received is fully taxable and is first to be included in the salary and thereafter the following deduction is to be made:

However deduction in respect of entertainment allowance is available in case of Government employees. The amount of deduction will be lower of:

- i. One-fifth of his basic salary or
- ii. ₹ 5,000 or
- iii. Entertainment allowance received.

Deduction is permissible even if the amount received as entertainment allowance is not proved to have been spent - *CIT vs. Kamal Devi* [1971] 81 ITR 773 (Delhi).

Amount actually spent by the employee towards entertainment out of the entertainment allowance received by him is not a relevant consideration at all.

(2) **Professional tax on employment** - Professional tax or taxes on employment levied by a State under Article 276 of the Constitution is allowed as deduction only when it is actually paid by the employee during the previous year.

If professional tax is reimbursed or directly paid by the employer on behalf of the employee, the amount so paid is first included as salary income and then allowed as a deduction under section 16.

Illustration 11

Mr. Goyal receives the following emoluments during the previous year ending 31.03.2014.

Basic pay	₹ 40,000
Dearness Allowance	₹ 15,000
Commission	₹ 10,000
Entertainment allowance	₹ 4,000
Medical expenses reimbursed	₹ 25,000
Professional tax paid	₹ 3,000 (₹ 2,000 was paid by his employer)

Mr. Goyal contributes ₹ 5,000 towards recognized provident fund. He has no other income. Determine the income from salary for A.Y. 2014-15, if Mr. Goyal is a State Government employee.

Solution

Computation of salary of Mr. Goyal for the A.Y. 2014-15

Particulars	₹	₹
Basic Salary		40,000
Dearness Allowance		15,000
Commission		10,000
Entertainment Allowance received		4,000
Employee's contribution to RPF [Note]		-
Medical expenses reimbursed	25,000	
Less: Exempt medical expenses	15,000	10,000
Professional tax paid by the employer		2,000
Gross Salary		81,000
Less: Deductions under section 16		
under section 16(ii) Entertainment allowance being lower of :		
(a) Allowance received	4,000	
(b) One fifth of basic salary [$1/5 \times 40,000$]	8,000	

(c) Statutory amount	5,000	4,000
- under section 16(iii) Professional tax paid		3,000
Income from Salary		74,000

Note: Employee's contribution to RPF is not taxable. It is eligible for deduction under section 80C.

4.22 Deduction under Section 80C

Under the provisions of section 80C, an assessee will be entitled to a deduction from gross total income of the amount invested in LIC policies, provident funds, payment of tuition fees, repayment of housing loans, investment in infrastructure bonds etc. subject to a maximum of ₹ 1,00,000.

Students may refer to Chapter 11 on 'Deductions from Gross Total Income' for a detailed discussion.

4.23 Relief under section 89

(1) Where by reason of any portion of an assessee's salary being paid in arrears or in advance or by reason of his having received in any one financial year, salary for more than twelve months or a payment of profit in lieu of salary under section 17(3), his income is assessed at a rate higher than that at which it would otherwise have been assessed, the Assessing Officer shall, on an application made to him in this behalf, grant such relief as prescribed. The procedure for computing the relief is given in Rule 21A.

(2) Similar tax relief is extended to assessee who receive arrears of family pension as defined in the *Explanation* to clause (iia) of section 57. For the purpose of clause (iia) of section 57, "family pension" means a regular monthly amount payable by the employer to a person belonging to the family of an employee in the event of his death.

(3) No relief shall be granted in respect of any amount received or receivable by an assessee on his voluntary retirement or termination of his service, in accordance with any scheme or schemes of voluntary retirement or a scheme of voluntary separation (in the case of a public sector company), if exemption under section 10(10C) in respect of such compensation received on voluntary retirement or termination of his service or voluntary separation has been claimed by the assessee in respect of the same assessment year or any other assessment year.

Illustration 12

In the case of Mr. Hari, aged 61 years, you are informed that the salary for the previous year 2013-14 is ₹ 10,20,000 and arrears of salary received is ₹ 3,45,000. Further, you are given the following details relating to the earlier years to which the arrears of salary received is attributable to:

<i>Previous year</i>	<i>Taxable Salary</i>	<i>Arrears now received (₹)</i>
2010 – 2011	7,10,000	1,03,000
2011 – 2012	8,25,000	1,17,000
2012 – 2013	9,50,000	1,25,000

Compute the relief available under section 89 and the tax payable for the A.Y. 2014-15.

Note : Rates of Taxes:

Assessment Year	Slab rates of income-tax			
	For resident individuals of the age of 60 years or more at any time during the previous year		For other resident individuals	
	Slabs	Rate	Slabs	Rate
2011-12	Upto ₹ 2,40,000	Nil	Upto ₹ 1,60,000	Nil
	₹ 2,40,000 - ₹ 5,00,000	10%	₹ 1,60,000 - ₹ 5,00,000	10%
	₹ 5,00,000 - ₹ 8,00,000	20%	₹ 5,00,000 - ₹ 8,00,000	20%
	Above ₹ 8,00,000	30%	Above ₹ 8,00,000	30%
2012-13	Upto ₹ 2,50,000	Nil	Upto ₹ 1,80,000	Nil
	₹ 2,50,000 - ₹ 5,00,000	10%	₹ 1,80,000 - ₹ 5,00,000	10%
	₹ 5,00,000 - ₹ 8,00,000	20%	₹ 5,00,000 - ₹ 8,00,000	20%
	Above ₹ 8,00,000	30%	Above ₹ 8,00,000	30%
2013-14	Upto ₹ 2,50,000	Nil	Upto ₹ 2,00,000	Nil
	₹ 2,50,000 - ₹ 5,00,000	10%	₹ 2,00,000 - ₹ 5,00,000	10%
	₹ 5,00,000 - ₹ 10,00,000	20%	₹ 5,00,000 - ₹ 10,00,000	20%
	Above ₹ 10,00,000	30%	Above ₹ 10,00,000	30%

Note – Education cess@2% and secondary and higher education cess@1% is attracted on the income-tax for all the years.

Solution

Computation of tax payable by Mr. Hari for the A.Y 2014-15

Particulars	Incl. arrears of salary	Excl. arrears of salary
Current year salary	10,20,000	10,20,000
Add: Arrears of salary	<u>3,45,000</u>	
Taxable Salary	<u>13,65,000</u>	<u>10,20,000</u>
Income-tax thereon	2,34,500	1,31,000
Add : Education cess @2% plus secondary and higher education cess @1%	<u>7,035</u>	<u>3,930</u>
Total payable	<u>2,41,535</u>	<u>1,34,930</u>

Computation of tax payable on arrears of salary if charged to tax in the respective assessment years

Particulars	A.Y. 2011-12		A.Y. 2012-13		A.Y. 2013-14	
	Incl. arrears	Excl. arrears	Incl. arrears	Excl. arrears	Incl. arrears	Excl. arrears
Taxable salary	7,10,000	7,10,000	8,25,000	8,25,000	9,50,000	9,50,000
Add: Arrears of salary	<u>1,03,000</u>	<u>---</u>	<u>1,17,000</u>	<u>---</u>	<u>1,25,000</u>	<u>---</u>
Taxable salary	<u>8,13,000</u>	<u>7,10,000</u>	<u>9,42,000</u>	<u>8,25,000</u>	<u>10,75,000</u>	<u>9,50,000</u>
Tax on the above	97,900	76,000	1,34,600	99,500	1,47,500	1,15,000
Add: Cess@3%	<u>2,937</u>	<u>2,280</u>	<u>4,038</u>	<u>2,985</u>	<u>4,425</u>	<u>3,450</u>
Tax payable	<u>1,00,837</u>	<u>78,280</u>	<u>1,38,638</u>	<u>1,02,485</u>	<u>1,51,925</u>	<u>1,18,450</u>

Computation of relief under section 89

	Particulars	₹	₹
i	Tax payable in A.Y. 2014-15 on arrears :		
	Tax on income including arrears	2,41,535	
	Less : Tax on income excluding arrears	<u>1,34,930</u>	1,06,605
ii	Tax payable in respective years on arrears :		
	Tax on income including arrears (₹ 1,00,837 + ₹ 1,38,638 + ₹ 1,51,925)	3,91,400	
	Less: Tax on income excluding arrears (₹ 78,280 + ₹ 1,02,485 + ₹ 1,18,450)	<u>2,99,215</u>	<u>92,185</u>
	Relief under section 89 - difference between tax on arrears in A.Y 2014-15 and tax on arrears in the respective years		<u>14,420</u>

Tax payable for A.Y 2014-15 after relief under section 89

Particulars	₹
Income-tax payable on total income including arrears of salary	2,41,535
Less : Relief under section 89 as computed above	<u>14,420</u>
Tax payable after claiming relief	<u>2,27,115</u>

Illustration 13

Mr. X is employed with AB Ltd. on a monthly salary of ₹ 25,000 per month and an entertainment allowance and commission of ₹ 1,000 p.m. each. The company provides him with the following benefits:

4.41 Income Tax

1. A company owned accommodation is provided to him in Delhi. Furniture costing ₹ 2,40,000 was provided on 1.8.2013.
2. A personal loan of ₹ 5,00,000 on 1.7.2013 on which it charges interest @ 6.75% p.a. The entire loan is still outstanding. (Assume SBI rate of interest to be 12.75% p.a.)
3. His son is allowed to use a motor cycle belonging to the company. The company had purchased this motor cycle for ₹ 60,000 on 1.5.2010. The motor cycle was finally sold to him on 1.8.2013 for ₹ 30,000.
4. Professional tax paid by Mr. X is ₹ 2,000.

Compute the income from salary of Mr. X for the A.Y.2014-15.

Solution

Computation of Income from Salary of Mr. X for the A.Y.2014-15

Particulars	₹	₹
Basic salary [₹ 25,000 × 12]		3,00,000
Commission [₹ 1,000 × 12]		12,000
Entertainment allowance [₹ 1,000 × 12]		12,000
Rent free accommodation [Note 1]	48,600	
Add : Value of furniture [₹ 2,40,000 × 10% p.a. for 8 months]	16,000	64,600
Interest on personal loan [Note 2]		22,500
Use of motor cycle [₹ 60,000 × 10% p.a. for 4 months]		2,000
Transfer of motor cycle [Note 3]		12,000
Gross Salary		4,25,100
Less : Deduction under section 16(iii)		
Professional tax paid		2,000
Income from Salary		4,23,100

Note 1: Value of rent free unfurnished accommodation

$$= 15\% \text{ of salary for the relevant period}$$

$$= 15\% \text{ of } (\text{₹ } 3,00,000 + \text{₹ } 12,000 + \text{₹ } 12,000) = \text{₹ } 48,600$$

Note 2: Value of perquisite for interest on personal loan

$$= [\text{₹ } 5,00,000 \times (12.75\% - 6.75\%) \text{ for 9 months}] = \text{₹ } 22,500$$

Note 3: Depreciated value of the motor cycle

$$= \text{Original cost} - \text{Depreciation @ } 10\% \text{ p.a. for 3 completed years.}$$

$$= \text{₹ } 60,000 - (\text{₹ } 60,000 \times 10\% \text{ p.a.} \times 3 \text{ years}) = \text{₹ } 42,000.$$

$$\text{Perquisite} = \text{₹ } 42,000 - \text{₹ } 30,000 = \text{₹ } 12,000.$$

Income From House Property

5.1 Chargeability [Section 22]

- (i) The process of computation of income under the head “Income from house property” starts with the determination of annual value of the property. The concept of annual value and the method of determination is laid down in section 23.
- (ii) The annual value of any property comprising of building or land appurtenant thereto, of which the assessee is the owner, is chargeable to tax under the head “Income from house property”.

5.2 Conditions for Chargeability

- (i) Property should consist of any building or land appurtenant thereto.
 - (a) Buildings include not only residential buildings, but also factory buildings, offices, shops, godowns and other commercial premises.
 - (b) Land appurtenant means land connected with the building like garden, garage etc.
 - (c) Income from letting out of vacant land is, however, taxable under the head “Income from other sources”.
- (ii) Assessee must be the owner of the property
 - (a) Owner is the person who is entitled to receive income from the property in his own right.
 - (b) The requirement of registration of the sale deed is not warranted.
 - (c) Ownership includes both free-hold and lease-hold rights.
 - (d) Ownership includes deemed ownership (discussed later in para 2.12)
 - (e) The person who owns the building need not also be the owner of the land upon which it stands.
 - (f) The assessee must be the owner of the house property during the previous year. It is not material whether he is the owner in the assessment year.
 - (g) If the title of the ownership of the property is under dispute in a court of law, the decision as to who will be the owner chargeable to income-tax under section 22 will be of the Income-tax Department till the court gives its decision to the suit filed in respect of such property.
- (iii) The property may be used for any purpose, but it should not be used by the owner for the purpose of any business or profession carried on by him, the profit of which is chargeable to tax.
- (iv) Property held as stock-in-trade etc.: Annual value of house property will be charged under the head “Income from house property” in the following cases also –

- (a) Where it is held by the assessee as stock-in-trade of a business;
- (b) Where the assessee is engaged in the business of letting out of property on rent;

Exceptions

- (a) **Letting out is supplementary to the main business**
 - (i) Where the property is let out with the object of carrying on the business of the assessee in an efficient manner, then the rental income is taxable as business income, provided letting is not the main business but it is supplementary to the main business.
 - (ii) In such a case, the letting out of the property is supplementary to the main business of the assessee and deductions/allowances have to be calculated as relating to profits/gains of business and not relating to house property.
- (b) **Letting out of building along with other facilities**
 - (i) Where income is derived from letting out of building along with other facilities like furniture, the income cannot be said to be derived from mere ownership of house property but also because of facilities and services rendered and hence assessable as income from business.
 - (ii) Where a commercial property is let out along with machinery e.g. a cotton mill including the building and the two lettings are inseparable, the income will either be assessed as business income or as income from other sources, as the case may be.

5.3 Composite Rent

- (i) **Meaning of composite rent:** The owner of a property may sometimes receive rent in respect of building as well as –
 - (1) other assets like say, furniture, plant and machinery.
 - (2) for different services provided in the building, for eg. –
 - (a) Lifts;
 - (b) Security;
 - (c) Power backup;

The amount so received is known as “composite rent”.

- (ii) **Tax treatment of composite rent**
 - (1) Where composite rent includes rent of building and charges for different services (lifts, security etc.), the composite rent is has to be split up in the following manner -
 - (a) the sum attributable to use of property is to be assessed under section 22 as income from house property;
 - (b) the sum attributable to use of services is to charged to tax under the head “Profits and gains of business or profession” or under the head “Income from other sources”.
 - (2) Where composite rent is received from letting out of building and other assets (like furniture) and the two lettings are not separable –

- (a) If the letting out of building and other assets are not separable i.e. the other party does not accept letting out of buildings without other assets, then the rent is taxable either as business income or income from other sources;
- (b) This is applicable even if sum receivable for the two lettings is fixed separately.
- (3) Where composite rent is received from letting out of buildings and other assets and the two lettings are separable –
 - (a) If building is let out along with other assets, but the two lettings are separable i.e. letting out of one is acceptable to the other party without letting out of the other, then income from letting out of building is taxable under “Income from house property”;
 - (b) Income from letting out of other assets is taxable as business income or income from other sources;
 - (c) This is applicable even if a composite rent is received by the assessee from his tenant for the two lettings.

5.4 Income from House Property Situated Outside India

- (i) In case of a resident in India (resident and ordinarily resident in case of individuals and HUF), income from property situated outside India is taxable, whether such income is brought into India or not.
- (ii) In case of a non-resident or resident but not ordinarily resident in India, income from a property situated outside India is taxable only if it is received in India.

5.5 Determination of Annual Value [Section 23]

This involves three steps :

Step 1 - Determination of Gross Annual Value (GAV).

Step 2 – From the gross annual value computed in step 1, deduct municipal tax paid by the owner during the previous year.

Step 3 – The balance will be the Net Annual Value (NAV), which as per the Income-tax Act is the annual value.

- (i) Determination of annual value for different types of house properties

- (1) Where the property is let out throughout the previous year [Section 23(1)(a)/(b)]

Where the property is let out for the whole year, then the GAV would be the higher of -

- (a) Annual Letting Value (ALV) and
- (b) Actual rent received or receivable during the year

- ◆ The ALV is the higher of fair rent (FR) and municipal value (MV), but restricted to standard rent (SR).
For example, let us say the higher of FR and MV is X. Then $ALV = SR$, if $X > SR$. However, if $X < SR$, $ALV = X$.

5.4 Income Tax

- ◆ ALV as per section 23(1)(a) cannot exceed standard rent (SR) but it can be lower than standard rent, in a case where standard rent is more than the higher of MV and FR.
- ◆ Municipal value is the value determined by the municipal authorities for levying municipal taxes on house property.
- ◆ Fair rent means rent which similar property in the same locality would fetch.
- ◆ The standard rent is fixed by the Rent Control Act.
- ◆ From the GAV computed above, municipal taxes paid by the owner during the previous year is to be deducted to arrive at the NAV.

Illustration 1

Jayashree owns five houses in Chennai, all of which are let-out. Compute the GAV of each house from the information given below –

Particulars	House I	House II	House III	House IV	House V
Municipal Value	80,000	55,000	65,000	24,000	75,000
Fair Rent	90,000	60,000	65,000	25,000	80,000
Standard Rent	N.A.	75,000	58,000	N.A.	78,000
Actual rent received/ receivable	72,000	72,000	60,000	30,000	72,000

Solution

GAV	90,000	72,000	60,000	30,000	78,000

(2) Where let out property is vacant for part of the year [Section 23(1)(c)]: Where let out property is vacant for part of the year and owing to vacancy, the actual rent is lower than the ALV, then the actual rent received or receivable will be the GAV of the property.

(3) In case of self-occupied property or unoccupied property [Section 23(2)]: (a) Where the property is self-occupied for own residence or unoccupied throughout the previous year, its Annual Value will be Nil, provided no other benefit is derived by the owner from such property.

(b) The benefit of exemption of one self-occupied house is available only to an individual/HUF.

(c) The expression “Unoccupied property” refers to a property which cannot be occupied by the owner by reason of his employment, business or profession at a different place and he resides at such other place in a building not belonging to him.

(d) No deduction for municipal taxes is allowed in respect of such property.

(4) Where a house property is let-out for part of the year and self-occupied for part of the year [Section 23(3)]: (a) If a single unit of a property is self-occupied for part of the year and let-out for the remaining part of the year, then the ALV for the whole year shall be taken into account for determining the GAV.

(b) The ALV for the whole year shall be compared with the actual rent for the let out period and whichever is higher shall be adopted as the GAV.

(c) However, property taxes for the whole year is allowed as deduction provided it is paid by the owner during the previous year.

(5) In case of deemed to be let out property [Section 23(4)] : (a) Where the assessee owns more than one property for self-occupation, then the income from any one such property, at the option of the assessee, shall be computed under the self-occupied property category and its annual value will be nil. The other self-occupied/unoccupied properties shall be treated as “deemed let out properties”.

(b) This option can be changed year after year in a manner beneficial to the assessee.

(c) In case of deemed let-out property, the ALV shall be taken as the GAV.

(d) The question of considering actual rent received/receivable does not arise. Consequently, no adjustment is necessary on account of property remaining vacant or unrealized rent.

(e) Municipal taxes actually paid by the owner during the previous year can be claimed as deduction.

(6) In case of a house property, a portion let out and a portion self-occupied

(a) Income from any portion or part of a property which is let out shall be computed separately under the “let out property” category and the other portion or part which is self-occupied shall be computed under the “self-occupied property” category.

(b) There is no need to treat the whole property as a single unit for computation of income from house property.

(c) Municipal valuation/fair rent/standard rent, if not given separately, shall be apportioned between the let-out portion and self-occupied portion either on plinth area or built-up floor space or on such other reasonable basis.

(d) Property taxes, if given on a consolidated basis can be bifurcated as attributable to each portion or floor on a reasonable basis.

Notional income instead of real income

Thus, under this head of income, there are circumstances where notional income is charged to tax instead of real income. For example –

- Where the assessee owns more than one house property for the purpose of self-occupation, the annual value of any one of those properties, at the option of the assessee, will be nil and the other properties are deemed to be let-out and income has to be computed on a notional basis by taking the ALV as the GAV.
- In the case of let-out property also, if the ALV exceeds the actual rent, the ALV is taken as the GAV.

(ii) Treatment of unrealised rent [*Explanation* to section 23(1)]

- (1) The Actual rent received/receivable should not include any amount of rent which is not capable of being realised.
- (2) However the conditions prescribed in Rule 4 should be satisfied. They are –
 - (a) the tenancy is *bona fide*;
 - (b) the defaulting tenant has vacated, or steps have been taken to compel him to vacate the property;
 - (c) the defaulting tenant is not in occupation of any other property of the assessee;
 - (d) the assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfies the Assessing Officer that legal proceedings would be useless.

(iii) Property taxes (Municipal taxes)

- (1) Property taxes are allowable as deduction from the GAV subject to the following two conditions:
 - (a) It should be borne by the assessee (owner); and
 - (b) It should be actually paid during the previous year.
- (2) If property taxes levied by a local authority for a particular previous year is not paid during that year, no deduction shall be allowed in the computation of income from house property for that year.
- (3) However, if in any subsequent year the arrears are paid, then the amount so paid is allowed as deduction in computation of income from house property for that year.
- (4) Thus, we find that irrespective of the previous year in which the liability to pay such taxes arise according to the method of accounting regularly employed by the owner, the deduction in respect of such taxes will be allowed only in the year of actual payment.
- (5) In case of property situated outside India, taxes levied by local authority of the country in which the property is situated is deductible. [*CIT v. R. Venugopala Reddiar* (1965) 58 ITR 439 (Mad).]

Illustration 2

Rajesh, a British national, is a resident and ordinarily resident in India during the P.Y.2013-14. He owns a house in London, which he has let out at £ 10,000 p.m. The municipal taxes paid to the Municipal Corporation of London is £ 8,000 during the P.Y.2013-14. The value of one £ in Indian rupee to be taken at ₹ 82.50. Compute Rajesh's taxable income for the A.Y. 2014-15.

Solution

For the P.Y.2013-14, Mr. Rajesh, a British national, is resident and ordinarily resident in India. Therefore, income received by him by way of rent of the house property located in London is to be included in the total income in India. Municipal taxes paid in London is to be allowed as deduction from the gross annual value.

Computation of Income from house property of Mr. Rajesh for A.Y.2014-15

Particulars	₹
Gross Annual Value ($₹ 10,000 \times 12 \times 82.50$)	99,00,000
Less: Municipal taxes paid ($₹ 8,000 \times 82.50$)	6,60,000
Net Annual Value (NAV)	92,40,000
Less: Deduction under section 24	
(a) 30% of NAV = 30% of ₹ 92,40,000	27,72,000
Income from house property	64,68,000

5.6 Deductions from Annual Value [Section 24]

- (i) There are two deductions from annual value. They are –
- (1) 30% of NAV; and
 - (2) interest on borrowed capital
- (1) 30% of NAV is allowed as deduction under section 24(a)
- (a) This is a flat deduction and is allowed irrespective of the actual expenditure incurred.
 - (b) In case of self-occupied property where the annual value is nil, the assessee will not be entitled to deduction of 30%, as the annual value itself is nil.
- (2) Interest on borrowed capital is allowed as deduction under section 24(b)
- (a) Interest payable on loans borrowed for the purpose of acquisition, construction, repairs, renewal or reconstruction can be claimed as deduction.
 - (b) Interest payable on a fresh loan taken to repay the original loan raised earlier for the aforesaid purposes is also admissible as a deduction.
 - (c) Interest relating to the year of completion of construction can be fully claimed in that year irrespective of the date of completion.
 - (d) Interest payable on borrowed capital for the period prior to the previous year in which the property has been acquired or constructed, can be claimed as deduction over a period of 5 years in equal annual installments commencing from the year of acquisition or completion of construction.

Illustration 3

Arvind had taken a loan of ₹ 5,00,000 for construction of property on 1.10.2012. Interest was payable @ 10% p.a. The construction was completed on 30.6.2013. No principal repayment has been made up to 31.3.2014. Compute the interest allowable as deduction under section 24 for the A.Y.2014-15.

Solution

Interest for the year (1.4.2013 to 31.3.2014) = 10% of ₹ 5,00,000 = ₹ 50,000

Pre-construction interest = 10% of ₹ 5,00,000 for 6 months (from 1.10.2012 to 31.3.2013) = ₹ 25,000

5.8 Income Tax

Pre-construction interest to be allowed in 5 equal annual installments of ₹ 5,000 from the year of completion of construction i.e. in this case, P.Y.2013-14.

Therefore, total interest deduction under section 24 = 50,000+5000 = ₹ 55,000.

(ii) Deduction in respect of one self-occupied property where annual value is nil

(1) In this case, the assessee will be allowed a deduction on account of interest (including 1/5th of the accumulated interest of pre-construction period) as under –

(a)	Where the property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital before 1.4.99.	Actual interest payable subject to maximum of ₹ 30,000.
(b)	Where the property is acquired or constructed with capital borrowed on or after 1.4.99 and such acquisition or construction is completed within 3 years from the end of the financial year in which the capital was borrowed.	Actual interest payable subject to maximum of ₹ 1,50,000, if certificate mentioned in (2) below is obtained.
(c)	Where the property is repaired, renewed or reconstructed with capital borrowed on or after 1.4.99.	Actual interest payable subject to a maximum of ₹ 30,000.

(2) For the purpose of claiming deduction of ₹ 1,50,000 as per 1(b) in the table given above, the assessee should furnish a certificate from the person to whom any interest is payable on the capital borrowed, specifying the amount of interest payable by the assessee for the purpose of such acquisition or construction of the property.

(3) The ceiling prescribed for one self-occupied property as above in respect of interest on loan borrowed does not apply to a deemed let-out property.

(4) Deduction under section 24(b) for interest is available on accrual basis. Therefore interest accrued but not paid during the year can also be claimed as deduction.

(5) Where a buyer enters into an arrangement with a seller to pay the sale price in installments along with interest due thereon, the seller becomes the lender in relation to the unpaid purchase price and the buyer becomes the borrower. In such a case, unpaid purchase price can be treated as capital borrowed for acquiring property and interest paid thereon can be allowed as deduction under section 24.

(6) Interest on unpaid interest is not deductible.

5.7 Computation of “Income from house property” for different categories of property

(i) Property let out throughout the previous year

PARTICULARS	Amount
Computation of GAV	
Step 1 Compute ALV	

Step 2	ALV = Higher of MV and FR, but restricted to SR	
	Compute Actual rent received/receivable	
	Actual rent received/receivable less unrealized rent as per Rule 4	
Step 3	Compare ALV and Actual rent received/receivable	
Step 4	GAV is the higher of ALV and Actual rent received/receivable	
	Gross Annual Value (GAV)	A
Less:	Municipal taxes (paid by the owner during the previous year)	B
	Net Annual Value (NAV) = (A-B)	C
Less:	Deductions u/s 24	
	(a) 30% of NAV	D
	(b) Interest on borrowed capital	E
	(actual without any ceiling limit)	
	Income from house property (C-D-E)	F

Illustration 4

Anirudh has a property whose municipal valuation is ₹ 1,30,000 p.a. The fair rent is ₹ 1,10,000 p.a. and the standard rent fixed by the Rent Control Act is ₹ 1,20,000 p.a. The property was let out for a rent of ₹ 11,000 p.m. throughout the previous year. Unrealised rent was ₹ 11,000 and all conditions prescribed by Rule 4 are satisfied. He paid municipal taxes @10% of municipal valuation. Interest on borrowed capital was ₹ 40,000 for the year. Compute the income from house property of Anirudh for A.Y.2014-15.

Solution

Computation of Income from house property of Mr. Anirudh for A.Y. 2014-15

Particulars		Amount in ₹	
Computation of GAV			
Step 1	Compute ALV ALV = Higher of MV of ₹ 1,30,000 p.a. and FR of ₹ 1,10,000 p.a., but restricted to SR of ₹ 1,20,000 p.a.	1,20,000	
Step 2	Compute actual rent received/receivable Actual rent received/receivable less unrealized rent as per Rule 4 = ₹ 1,32,000 - ₹ 11,000	1,21,000	
Step 3	Compare ALV of ₹ 1,20,000 and Actual rent received/receivable of ₹ 1,21,000.		
Step 4	GAV is the higher of ALV and Actual rent received/receivable	1,21,000	
Gross Annual Value (GAV)			1,21,000
Less:	Municipal taxes (paid by the owner during the previous year) = 10% of ₹ 1,30,000		13,000
Net Annual Value (NAV)			1,08,000

5.10 Income Tax

Less:	Deductions under section 24		
	(a) 30% of NAV	32,400	
	(b) Interest on borrowed capital (actual without any ceiling limit)	40,000	72,400
	Income from house property		35,600

(ii) Let out property vacant for part of the year

Particulars		Amount
Computation of GAV		
Step 1	Compute ALV ALV = Higher of MV and FR, but restricted to SR	
Step 2	Compute Actual rent received/receivable Actual rent received/receivable for let out period less unrealized rent as per Rule 4	
Step 3	Compare ALV and Actual rent received/receivable	
Step 4	If Actual rent is lower than ALV owing to vacancy, then Actual rent is the GAV. If Actual rent is lower than ALV due to other reasons, then ALV is the GAV. However, in spite of vacancy, if the actual rent is higher than the ALV, then Actual rent is the GAV.	
Gross Annual Value (GAV)		A
Less:	Municipal taxes (paid by the owner during the previous year)	B
Net Annual Value (NAV) = (A-B)		C
Less:	Deductions under section 24	
	(a) 30% of NAV	D
	(b) Interest on borrowed capital (actual without any ceiling limit)	E
Income from house property (C-D-E)		F

Illustration 5

Ganesh has a property whose municipal valuation is ₹ 2,50,000 p.a. The fair rent is ₹ 2,00,000 p.a. and the standard rent fixed by the Rent Control Act is ₹ 2,10,000 p.a. The property was let out for a rent of ₹ 20,000 p.m. However, the tenant vacated the property on 31.1.2014. Unrealised rent was ₹ 20,000 and all conditions prescribed by Rule 4 are satisfied. He paid municipal taxes @8% of municipal valuation. Interest on borrowed capital was ₹ 65,000 for the year. Compute the income from house property of Ganesh for A.Y.2014-15.

Solution

Computation of income from house property of Ganesh for A.Y.2014-15

Particulars		Amount in ₹	
Computation of GAV			
Step 1	Compute ALV ALV = Higher of MV of ₹ 2,50,000 p.a. and FR of ₹ 2,00,000 p.a., but restricted to SR of ₹ 2,10,000 p.a.	2,10,000	
Step 2	Compute Actual rent received/receivable Actual rent received/receivable for let out period less unrealized rent as per Rule 4 = ₹ 2,00,000 - ₹ 20,000	1,80,000	
Step 3	Compare ALV and Actual rent received/receivable		
Step 4	In this case the actual rent of ₹ 1,80,000 is lower than ALV of ₹ 2,10,000 owing to vacancy, since, had the property not been vacant the actual rent would have been ₹ 2,20,000 (₹ 1,80,000 + ₹ 40,000). Therefore, actual rent is the GAV.	1,80,000	
Gross Annual Value (GAV)			1,80,000
Less:	Municipal taxes (paid by the owner during the previous year) = 8% of ₹ 2,50,000		20,000
Net Annual Value (NAV)			1,60,000
Less:	Deductions under section 24		
	(a) 30% of NAV = 30% of ₹ 1,60,000	48,000	
	(b) Interest on borrowed capital (actual without any ceiling limit)	65,000	1,13,000
Income from house property			47,000

(iii) Self-occupied property or Unoccupied property

Particulars		Amount
Annual value under section 23(2)		Nil
Less:	Deduction under section 24	
	Interest on borrowed capital	E
	Interest on loan taken for acquisition or construction of house on or after 1.4.99 and same was completed within 3 years from the end of the financial year in which capital was borrowed, interest paid or payable subject to a maximum of ₹ 1,50,000 (including apportioned pre-construction interest).	

5.12 Income Tax

(ii) In case of loan for acquisition or construction taken prior to 1.4.99 or loan taken for repair, renovation or reconstruction at any point of time, interest paid or payable subject to a maximum of ₹ 30,000.	
Income from house property	-E

Illustration 6

Poorna has one house property at Indira Nagar in Bangalore. She stays with her family in the house. The rent of similar property in the neighbourhood is ₹ 25,000 p.m. The municipal valuation is ₹ 23,000 p.m. Municipal taxes paid is ₹ 8,000. The house was constructed in the year 2007 with a loan of ₹ 20,00,000 taken from SBI Housing Finance Ltd. The construction was completed on 30.11.2009. The accumulated interest up to 31.3.2009 is ₹ 1,50,000. During the previous year 2013-14, Poorna paid ₹ 1,88,000 which included ₹ 1,44,000 as interest. Compute Poorna's income from house property for A.Y. 2014-15.

Solution

Computation of income from house property of Smt. Poorna for A.Y.2014-15

Particulars	Amount ₹
Annual Value of one house used for self-occupation under section 23(2)	Nil
Less: Deduction under section 24	
Interest on borrowed capital	
Interest on loan was taken for construction of house on or after 1.4.99 and same was completed within 3 years - interest paid or payable subject to a maximum of ₹ 1,50,000 (including apportioned pre-construction interest) will be allowed as deduction.	1,50,000
In this case the total interest is ₹ 1,44,000 + ₹ 30,000 (Being 1/5 th of ₹ 1,50,000) = ₹ 1,74,000. However, the interest deduction is restricted to ₹ 1,50,000.	
Loss from house property	-1,50,000

(iv) House property let-out for part of the year and self-occupied for part of the year

Particulars	Amount
Computation of GAV	
Step 1 Compute ALV for the whole year ALV = Higher of MV and FR, but restricted to SR	
Step 2 Compute Actual rent received/receivable Actual rent received/receivable for the period let out less unrealized rent as per Rule 4	
Step 3 Compare ALV for the whole year with the actual rent received/receivable for the let out period	

Step 4	GAV is the higher of ALV computed for the whole year and Actual rent received/receivable computed for the let-out period.	
Gross Annual Value (GAV)		A
Less: Municipal taxes (paid by the owner during the previous year)		B
Net Annual Value (NAV) = (A-B)		C
Less: Deductions under section 24		
(a) 30% of NAV	D	
(b) Interest on borrowed capital(actual without any ceiling limit)	E	
Income from house property (C-D-E)		F

Illustration 7

Smt. Rajalakshmi owns a house property at Adyar in Chennai. The municipal value of the property is ₹ 5,00,000, fair rent is ₹ 4,20,000 and standard rent is ₹ 4,80,000. The property was let-out for ₹ 50,000 p.m. up to December 2013. Thereafter, the tenant vacated the property and Smt. Rajalakshmi used the house for self-occupation. Rent for the months of November and December 2013 could not be realised in spite of the owner's efforts. All the conditions prescribed under Rule 4 are satisfied. She paid municipal taxes @12% during the year. She had paid interest of ₹ 25,000 during the year for amount borrowed for repairs for the house property. Compute her income from house property for the A.Y. 2014-15.

Solution

Computation of income from house property of Smt. Rajalakshmi for the A.Y.2014-15

Particulars		Amount in ₹	
Computation of GAV			
Step 1	Compute ALV for the whole year ALV = Higher of MV of ₹ 5,00,000 and FR of ₹ 4,20,000, but restricted to SR of ₹ 4,80,000	4,80,000	
Step 2	Compute Actual rent received/receivable Actual rent received/receivable for the period let out less unrealized rent as per Rule 4 = (₹ 50,000×9) - (₹ 50,000 × 2) = ₹ 4,50,000 - ₹ 1,00,000 =	3,50,000	
Step 3	Compare ALV for the whole year with the actual rent received/receivable for the let out period i.e. ₹ 4,80,000 and ₹ 3,50,000		
Step 4	GAV is the higher of ALV computed for the whole year and Actual rent received/receivable computed for the let-out period.	4,80,000	
Gross Annual Value (GAV)			4,80,000
Less:	Municipal taxes (paid by the owner during the previous year) = 12% of ₹ 5,00,000		60,000
Net Annual Value (NAV)			4,20,000

5.14 Income Tax

Less:	Deductions under section 24		
	(a) 30% of NAV = 30% of ₹ 4,20,000	1,26,000	
	(b) Interest on borrowed capital	25,000	1,51,000
	Income from house property		2,69,000

(v) Deemed to be let out property

Particulars	Amount
Gross Annual Value (GAV)	A
ALV is the GAV of house property	
ALV = Higher of MV and FR, but restricted to SR	
Less: Municipal taxes (paid by the owner during the previous year)	B
Net Annual Value (NAV) = (A-B)	C
Less: Deductions under section 24	
(a) 30% of NAV	D
(b) Interest on borrowed capital	E
(actual without any ceiling limit)	
Income from house property (C-D-E)	F

Illustration 8

Ganesh has two houses, both of which are self-occupied. The particulars of the houses for the P.Y.2013-14 are as under:

Particulars	House I	House II
Municipal valuation p.a.	1,00,000	1,50,000
Fair rent p.a.	75,000	1,75,000
Standard rent p.a.	90,000	1,60,000
Date of completion	31.3.1999	31.3.2001
Municipal taxes paid during the year	12%	8%
Interest on money borrowed for repair of property during the current year	-	55,000

Compute Ganesh's income from house property for A.Y.2014-15 and suggest which house should be opted by Ganesh to be assessed as self-occupied so that his tax liability is minimum.

Solution

Computation of income from house property of Ganesh for the A.Y. 2014-15

Let us first calculate the income from each house property assuming that they are deemed to be let out.

Particulars	Amount in ₹	
	House I	House II
Gross Annual Value (GAV) ALV is the GAV of house property ALV = Higher of MV and FR, but restricted to SR	90,000	1,60,000
Less: Municipal taxes (paid by the owner during the previous year)	12,000	12,000
Net Annual Value (NAV)	78,000	1,48,000
Less: Deductions under section 24		
(a) 30% of NAV	23,400	44,400
(b) Interest on borrowed capital	-	55,000
Income from house property	54,600	48,600

OPTION 1 (House I – self-occupied and House II – deemed to be let out)

If House I is opted to be self-occupied, the income from house property shall be –

Particulars	Amount in ₹
House I (Self-occupied)	Nil
House II (Deemed to be let-out)	48,600
Income from house property	48,600

OPTION 2 (House I – deemed to be let out and House II – self-occupied)

If House II is opted to be self-occupied, the income from house property shall be –

Particulars	Amount in ₹
House I (Deemed to be let-out)	54,600
House II (Self-occupied) (interest deduction restricted to ₹ 30,000)	-30,000
Income from house property	24,600

Since Option 2 is more beneficial, Ganesh should opt to treat House II as self-occupied and House I as deemed to be let out. His income from house property would be ₹ 24,600 for the A.Y. 2014-15.

(vi) House property, a portion let out and a portion self-occupied**Illustration 9**

Prem owns a house in Madras. During the previous year 2013-14, 2/3rd portion of the house was self-occupied and 1/3rd portion was let out for residential purposes at a rent of ₹ 8,000 p.m. Municipal value of the property is ₹ 3,00,000 p.a., fair rent is ₹ 2,70,000 p.a. and standard rent is ₹ 3,30,000. He paid municipal taxes @10% of municipal value during the year. A loan of ₹ 25,00,000 was taken by him during the year 2011 for acquiring the property. Interest on loan paid during the previous year 2013-14 was ₹ 1,20,000. Compute Prem's income from house property for the A.Y. 2014-15.

Solution

There are two units of the house. Unit I with 2/3rd area is used by Prem for self-occupation throughout the year and no benefit is derived from that unit, hence it will be treated as self-occupied and its annual value will be Nil. Unit 2 with 1/3rd area is let-out throughout the previous year and its annual value has to be determined as per section 23(1).

Computation of income from house property of Mr. Prem for A.Y.2014-15

Particulars	Amount in ₹	
Unit I (2/3 rd area – self-occupied)		
Annual Value		Nil
Less: Deduction under section 24(b) 2/3 rd of ₹ 1,20,000		80,000
Income from Unit I (self-occupied)		-80,000
Unit II (1/3 rd area – let out)		
Computation of GAV		
Step I – Compute ALV		
ALV = Higher of MV and FR, restricted to SR. However, in this case, SR of ₹ 1,10,000 (1/3 rd of ₹ 3,30,000) is more than the higher of MV of ₹ 1,00,000 (1/3 rd of ₹ 3,00,000) and FR of ₹ 90,000 (1/3 rd of ₹ 2,70,000). Hence the higher of MV and FR is the ALV. In this case, it is the MV.	1,00,000	
Step 2 – Compute actual rent received/ receivable ₹ 8,000 × 12 = ₹ 96,000	96,000	
Step 3 – GAV is the higher of ALV and actual rent received/receivable i.e. higher of ₹ 1,00,000 and ₹ 96,000	1,00,000	
Gross Annual Value (GAV)		1,00,000
Less: Municipal taxes paid by the owner during the previous year relating to let-out portion 1/3 rd of (10% of ₹ 3,00,000) = ₹ 30,000/3 = ₹ 10,000		10,000
Net Annual Value (NAV)		90,000
Less: Deductions under section 24		
(a) 30% of NAV = 30% of ₹ 90,000	27,000	
(b) Interest paid on borrowed capital (relating to let out portion) 1/3 rd of ₹ 1,20,000	40,000	67,000
Income from Unit II (let-out)		23,000
Loss under the head “Income from house property” = ₹ -80,000 + ₹ 23,000 = -57,000		

5.8 Inadmissible deductions [Section 25]

Interest chargeable under this Act which is payable outside India shall not be deducted if –

- (a) tax has not been paid or deducted from such interest and
- (b) there is no person in India who may be treated as an agent under section 163.

5.9 Taxability of recovery of unrealised rent & arrears of rent received

(i) Unrealised rent is deducted from actual rent in determination of annual value under section 23, subject to fulfillment of conditions under Rule 4. Subsequently, when the amount is realized, it gets taxed under section 25AA in the year of receipt.

(ii) If the assessee has increased the rent payable by the tenant and the same has been in dispute and later on the assessee receives the increase in rent as arrears, such arrears is assessable under section 25B.

	Unrealised rent [Section 25AA]	Arrears of rent [Section 25B]
(a)	Taxable in the hands of the assessee whether he is the owner of that property or not.	Taxable in the hands of the assessee whether he is the owner of that property or not.
(b)	Taxable as income of the previous year in which he recovers the unrealized rent.	Taxable as income of the year in which he receives the arrears of rent.
(c)	No deduction shall be allowed.	30% of the amount of arrears shall be allowed as deduction.
(d)	Unrealised rent means the rent which has been deducted from actual rent in any previous year for determining annual value.	Arrears of rent is in respect of rent not charged to income-tax for any previous year.

5.10 Treatment of income from co-owned property [Section 26]

(i) Where property is owned by two or more persons, whose shares are definite and ascertainable, then the income from such property cannot be taxed as income of an AOP.

(ii) The share income of each such co-owner should be determined in accordance with sections 22 to 25 and included in his individual assessment.

(iii) Where the house property owned by co-owners is self occupied by each of the co-owners, the annual value of the property of each co-owner will be Nil and each co-owner shall be entitled to a deduction of ₹ 30,000 / ₹ 1,50,000, as the case may be, under section 24(b) on account of interest on borrowed capital.

(iv) Where the house property owned by co-owners is let out, the income from such property shall be computed as if the property is owned by one owner and thereafter the income so computed shall be apportioned amongst each co-owner as per their specific share.

5.11 Treatment of income from property owned by a partnership firm

- (i) Where an immovable property or properties is included in the assets of a firm, the income from such property should be assessed in the hands of the firm only.
- (ii) Hence, the property income cannot be assessed as income of the individual partner in respect of his share in the firm.

5.12 Deemed Ownership [Section 27]

As per section 27, the following persons, though not legal owners of a property, are deemed to be the owners for the purposes of section 22 to 26.

- (i) **Transfer to a spouse [Section 27(i)]** – In case of transfer of house property by an individual to his or her spouse otherwise than for adequate consideration, the transferor is deemed to be the owner of the transferred property.

Exception – In case of transfer to spouse in connection with an agreement to live apart, the transferor will not be deemed to be the owner. The transferee will be the owner of the house property.

- (ii) **Transfer to a minor child [Section 27(ii)]** – In case of transfer of house property by an individual to his or her minor child otherwise than for adequate consideration, the transferor would be deemed to be owner of the house property transferred.

Exception – In case of transfer to a minor married daughter, the transferor is not deemed to be the owner.

Note - Where cash is transferred to spouse/minor child and the transferee acquires property out of such cash, then the transferor shall not be treated as deemed owner of the house property. However, clubbing provisions will be attracted.

- (iii) **Holder of an impartible estate [Section 27(ii)]** – The impartible estate is a property which is not legally divisible. The holder of an impartible estate shall be deemed to be the individual owner of all properties comprised in the estate.

After enactment of the Hindu Succession Act, 1956, all the properties comprised in an impartible estate by custom is to be assessed in the status of a HUF. However, section 27(ii) will continue to be applicable in relation to impartible estates by grant or covenant,.

- (iv) **Member of a co-operative society etc. [Section 27(iii)]** – A member of a co-operative society, company or other association of persons to whom a building or part thereof is allotted or leased under a House Building Scheme of a society/company/association, shall be deemed to be owner of that building or part thereof allotted to him although the co-operative society/company/ association is the legal owner of that building.

- (v) **Person in possession of a property [Section 27(iiia)]** – A person who is allowed to take or retain the possession of any building or part thereof in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act shall be the deemed owner of that house property. This would include cases where the –

- (1) possession of property has been handed over to the buyer
- (2) sale consideration has been paid or promised to be paid to the seller by the buyer

(3) sale deed has not been executed in favour of the buyer, although certain other documents like power of attorney/agreement to sell/will etc. have been executed.

In all the above cases, the buyer would be deemed to be the owner of the property although it is not registered in his name.

(vi) Person having right in a property for a period not less than 12 years [Section 27(iiib)] – A person who acquires any rights in or with respect to any building or part thereof, by virtue of any transaction as is referred to in section 269UA(f) i.e. transfer by way of lease for not less than 12 years, shall be deemed to be the owner of that building or part thereof.

Exception – Any rights by way of lease from month to month or for a period not exceeding one year.

5.13 Cases where income from house property is exempt from tax

Sl. No.	Section	Particulars
1	10(1)	Income from any farm house forming part of agricultural income.
2	10(19A)	Annual value of any one palace in the occupation of an ex-ruler.
3	10(20)	Income from house property of a local authority.
4	10(21)	Income from house property of an approved scientific research association.
5	10(23C)	Property income of universities, educational institutions, etc.
6	10(24)	Property income of any registered trade union.
7	11	Income from house property held for charitable or religious purpose.
8	13A	Property income of any political party.
9	22	Property used for own business or profession
10	23(2)	One self-occupied property of an individual/HUF

Profits and Gains of Business or Profession

6.1 Meaning of 'Business', 'Profession' and 'Profits'

(i) The tax payable by an assessee on his income under this head is in respect of the profits and gains of any business or profession, carried on by him or on his behalf during the previous year. The term "business" has been defined in section 2(13) to "include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture". But the term "profession" has not been defined in the Act. It means an occupation requiring some degree of learning. Thus, a painter, a sculptor, an author, an auditor, a lawyer, a doctor, an architect and, even an astrologer are persons who can be said to be carrying on a profession but not business. The term 'profession' includes vocation as well [Section 2(36)]. However, it is not material whether a person is carrying on a 'business' or 'profession' or 'vocation' since for purposes of assessment, profits from all these sources are treated and taxed alike.

(ii) Business necessarily means a continuous exercise of an activity; nevertheless, profit from a single venture in the nature of trade would also be assessable under this head if the venture had come to an end or after the entire cost had been recouped. For example, where a person had purchased a piece of land, got it surveyed, laid down a scheme of development, divided it into a number of building plots and sold some of the plots from time to time, though he would not be charged tax on a notional profit made on the individual sale of plots, he would be liable to pay tax on the surplus after all the plots have been sold and the venture has come to an end or after he has recovered the cost of all the plots and expenditure incidental thereto and has a surplus left.

(iii) Profits may be realised in money or in money's worth, i.e., in cash or in kind. Where profit is realised in any form other than cash, the cash equivalent of the receipt on the date of receipt must be taken as the value of the income received in kind. Capital receipts are not generally to be taken into account while computing profits under this head. Payment voluntarily made by persons who were under no obligation to pay anything at all would be income in the hands of the recipient, if they were received in the course of a business or by the exercise of a profession or vocation. Thus, any amount paid to a lawyer by a person who was not a client, but who has been benefited by the lawyer's professional service to another would be assessable as the lawyer's income.

(iv) Application of the gains of trade is immaterial. Gains made even for the benefit of the community by a public body would be liable to tax. To attract the provisions of section 28, it is necessary that the business, profession or vocation should be carried on at least for some time during the accounting year but not necessarily throughout that year and not necessarily

by the assessee-owner personally, but it should be under his direction and control.

(v) The charge is not on the gross receipts but on the profits and gains in their natural and proper sense. Profits are ascertained on ordinary principles of commercial trading and commercial accounting. According to section 145, income has to be computed in accordance with the method of accounting regularly and consistently employed by the assessee. The assessee may account for his receipts on the cash basis or mercantile basis.

(vi) The Act, however, contains certain provisions for determining how the income is to be assessed. These must be followed in every case of business or profession. The illegality of a business, profession or vocation does not exempt its profits from tax: the revenue is not concerned with the taint of illegality in the income or its source. Income is taxable even if the assessee is carrying on the business, profession or vocation without any profit motive. The liability to tax arises once income arises to the assessee; the motive or purpose of earning the income is immaterial. Thus, profit motive is not essential for describing the income from that activity as income from business or profession.

(vii) The profits of each distinct business must be computed separately but the tax chargeable under this section is not on the separate income of every distinct business but on the aggregate profits of all the business carried on by the assessee. Profits should be computed after deducting the losses and expenses incurred for earning the income in the regular course of the business, profession, or vocation unless the loss or expenses is expressly or by necessary implication, disallowed by the Act.

(viii) Income arising from business assets which are temporarily let out e.g., an oil mill, cinema theatre, hotel, ginning or textile factory, rice mill or jute press would be assessable as business income. But if the commercial asset is permanently let the income is taxable as income from house property or income from other sources, depending on the facts and circumstances of the case.

6.2 Income Chargeable under this Head [Section 28]

The various items of income chargeable to tax as income under the head 'profits and gains of business or profession' are as under:

- (i) Income arising to any person by way of profits and gains from the business, profession or vocation carried on by him at any time during the previous year.
- (ii) Any compensation or other payment due to or received by:
 - (a) Any person, by whatever name called, managing the whole or substantially the whole of (i) the affairs of an Indian company or (ii) the affairs in India of any other company at or in connection with the termination of his management or office or the modification of any of the terms and conditions relating thereto;
 - (b) any person, by whatever name called, holding an agency in India for any part of the activities relating to the business of any other person at or in connection with the termination of the agency or the modification of any of the terms and conditions relating thereto ;
 - (c) any person, for or in connection with the vesting in the Government or any corporation

owned or controlled by the Government under any law for the time being in force, of the management of any property or business;

By taxing compensation received on termination of agency or on the takeover of management (which is a capital receipt) as income from business, section 28(ii) provides exception to the general rule that capital receipts are not income taxable in the hands of the recipient.

(iii) Income derived by any trade, professional or similar associations from specific services rendered by them to their members. It may be noted that this forms an exception to the general principle governing the assessment of income of mutual associations such as chambers of commerce, stock brokers' associations etc. As a result a trade, professional or similar association performing specific services for its members is to be deemed as carrying on business in respect of these services and on that assumption the income arising therefrom is to be subjected to tax. For this purpose, it is not necessary that the income received by the association should be definitely or directly related to these services.

(iv) Profits on sale of a licence granted under the Imports (Control) Order, 1955 made under the Imports and Exports (Control) Act, 1947.

(v) Cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India.

(vi) Any Customs duty or Excise duty drawback repaid or repayable to any person against export under the Customs and Central Excise Duties Drawback Rules, 1971.

(vii) Any profit on the transfer of the Duty Entitlement Pass Book Scheme, being Duty Remission Scheme, under the export and import policy formulated and announced under section 5 of the Foreign Trade (Development and Regulation) Act, 1992.

(viii) Any profit on the transfer of Duty Free Replenishment Certificate, being Duty Remission Scheme, under the export and import policy formulated and announced under section 5 of the Foreign Trade (Development and Regulation) Act, 1992.

(ix) The value of any benefit or perquisite whether convertible into money or not, arising from business or the exercise of any profession.

(x) Any interest, salary, bonus, commission or remuneration, by whatever name called, due to or received by a partner of a firm from such firm will be deemed to be income from business. However, where any interest, salary, bonus, commission or remuneration by whatever name called, or any part thereof has not been allowed to be deducted under section 40(b), in the computation of the income of the firm the income to be taxed shall be adjusted to the extent of the amount disallowed. In other words, suppose a firm pays interest to a partner at 20% simple interest p.a. The allowable rate of interest is 12% p.a. Hence the excess 8% paid will be disallowed in the hands of the firm. Since the excess interest has suffered tax in the hands of the firm, the same will not be taxed in the hands of the partner.

(xi) Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy will be taxable as income from business. "Keyman insurance policy" means a life insurance policy taken by a person on the life of another person who is or was the employee of the first mentioned person or is or was connected in any manner whatsoever

with the business of the first mentioned person.

(xii) Any sum received or receivable, in cash or kind, on account of any capital asset (in respect of which deduction has been allowed under section 35AD) being demolished, destroyed, discarded or transferred.

(xiii) any sum whether received or receivable, in cash or kind, under an agreement

(a) for not carrying out any activity in relation to any business; or

(b) not to share 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.

However, the above sub-clause (a) shall not apply to -

(i) any sum, whether received or receivable, in cash or kind, on account of transfer of the right to manufacture, produce or process any article or thing or right to carry on any business, which is chargeable under the head "Capital gains";

(ii) any sum received as compensation, from the multilateral fund of the Montreal Protocol on Substances that Deplete the Ozone layer under the United Nations Environment Programme, in accordance with the terms of agreement entered into with the Government of India.

The *Explanation* for the purposes of this clause provides that

(i) "agreement" includes any arrangement or understanding or action in concert,-

(A) whether or not such arrangement, understanding or action is formal or in writing; or

(B) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings;

(ii) "service" means service of any description which is made available to potential users and includes the provision of services in connection with business of any industrial or commercial nature such as accounting, banking, communication, conveying of news or information, advertising, entertainment, amusement, education, financing, insurance, chit funds, real estate, construction, transport, storage, processing, supply of electrical or other energy, boarding and lodging.

6.3 Speculation Business

Explanation 2 to section 28 specifically provides that where an assessee carries on speculative business, that business of the assessee must be deemed as distinct and separate from any other business. This becomes necessary because section 73 provides that losses in speculation business unlike other business, cannot be set-off against the profits of any business other than a speculation business. Likewise, a loss in speculation business carried forward to a subsequent year can be set-off only against the profit and gains of any speculative business in the subsequent year. Profits and losses resulting from speculative transaction must, therefore, be treated as separate and distinct from other profits and gains of business and profession.

According to section 43(5), the expression “speculative transaction” means a transaction in which a contract for the purchase or sales of any commodity including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips. Further, in view of *Explanation* to section 73, the transaction of purchase and sale of shares by non-banking and non-investment companies must also be deemed to be speculative transactions for tax purposes. However, the following forms of transactions shall not be deemed to be speculative transaction:

- (i) a contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchandising business to guard against loss through future price fluctuations in respect of his contracts for 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 fluctuation; or
- (iii) a contract entered into by a member of a forward market or stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against any loss which may arise in the ordinary course of his business as a member; or
- (iv) an eligible transaction carried out in respect of trading in derivatives in a recognized stock exchange; or

- (a) “eligible transaction” means any transaction,—
 - (A) carried out electronically on screen-based systems through a stock broker or sub-broker or such other intermediary registered under section 12 of the Securities and Exchange Board of India Act, 1992 in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956 or the Securities and Exchange Board of India Act, 1992 or the Depositories Act, 1996 and the rules, regulations or bye-laws made or directions issued under those Acts or by banks or mutual funds on a recognised stock exchange; and
 - (B) which is supported by a time stamped contract note issued by such stock broker or sub-broker or such other intermediary to every client indicating in the contract note the unique client identity number allotted under any Act referred to in sub-clause (A) and permanent account number allotted under this Act;
- (b) “recognised stock exchange” means a recognised stock exchange as referred to in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956 and which fulfils such conditions as may be prescribed and notified by the Central Government for this purpose. The stock exchanges notified as recognized stock exchanges for the purpose of section 43(5) are National Stock Exchange, Bombay Stock Exchange, MCX Stock Exchange and United Stock Exchange.

- (v) *an eligible transaction in respect of trading in commodity derivatives carried out in a recognized association.*

An “eligible transaction” in relation to commodity derivatives has been defined as a transaction -

- (1) *carried out electronically on screen based systems;*
- (2) *carried out through member or an intermediary, registered under the bye-laws, rules and regulations of the recognized association for trading in commodity derivative in accordance with the provisions of Forward Contracts (Regulation) Act, 1952 and the related rules, regulations etc.;*
- (3) *supported by a time stamped contract note issued by such member or intermediary to every client.*

The contract note should indicate the –

- (a) *unique client identity number allotted under FCRA, 1952 and related rules, regulations etc.,*
- (b) *unique trade number; and*
- (c) *permanent account number (PAN) allotted under the Income-tax Act, 1961.*

“Recognised association” means an association to which recognition for the time being has been granted by the Central Government under section 6 of Forward Contracts (Regulation) Act, 1952 in respect of goods or classes of goods specified in such recognition.

The instances stated above constitute the exceptions specifically provided by the Act, whereby certain transactions (e.g., hedging contracts) entered into by manufacturers and merchants in the course of their business to guard against the loss through price fluctuations are excluded from the definition of speculative transactions. This provision should be liberally construed to cover not only hedging forward contracts for purchase of goods but also such contracts for sale.

The Supreme Court held in *CIT v. Shantilal (P) Ltd. [1983] 144 ITR 57 (SC)* that an award of damages for breach of contract is not the same thing as a party to the contract accepting satisfaction of the contract otherwise than in accordance with the original terms thereof. In this view of the matter, the court held that in a case where a company contracted to sell a certain commodity to a party but was unable to effect delivery due to a sharp rise in the price of the commodity and the dispute which arose out of such breach of contract was settled by payment of damages as decided by an arbitrator, the transaction could not be described as a ‘speculative transaction’ within the meaning of section 43(5). This principle has been followed by various High Courts also.

6.4 Computation of income from business [Section 29]

(i) According to section 29, the profits and gains of any business or profession are to be computed in accordance with the provisions contained in sections 30 to 43D. It must, however, be remembered that in addition to the specific allowances and deductions stated in sections 30 to 36, the Act further permits allowance of items of expenses under the residuary section 37(1), which extends the allowance to items of business expenditure not covered by sections 30 to 36, where these are allowable according to accepted commercial practices.

(ii) An item of loss or expenditure not falling within any of the express deductions may be allowed if it is deductible on the basis of common principles of commercial expediency. Thus, in

determining whether a particular item (other than those covered by sections 30 to 36) is deductible from profits, it is necessary first to enquire whether the deduction is expressly or by necessary implication prohibited by the Act and then, if it is not so prohibited, to consider whether it is of such nature that it should be charged against income in the computation of the "profits and gains of business or profession". Accordingly, a loss due to embezzlement or theft of cash by an employee during the course of business is allowable as a deduction in computing the business profit, even though they are not covered by any specific provision of the Act. Losses of non-capital nature which are incidental to the trade and arise unexpectedly in the regular course of the business would be allowed as losses incidental to the trade though there is no specified provision in the Act for allowing such deductions. Examples of such losses are embezzlement, theft, robbery or destruction of assets, overdrawing by employees, loss of stock in trade by damage or by fire or by ravages of white ants or by enemy action during war or by negligence or fraud of employees, etc. However, if a businessman, having business connection with a non-resident, is unable to recover from the non-resident the amount of tax, he cannot claim it as a bad debt or business loss incidental to the trade on principles of commercial accounting as was held in *CIT v. Abdullahhai Abdul Kadar* [1961] 41 ITR 546 (SC).

(iii) Where a trader stands surety for the debt of another and such guarantee is not in the course of or for the purposes of trade, any payment made as a result of such guarantee cannot be deducted as a business loss except in a case where the contract of guarantee is entered into in the course of business pursuant to a trade or custom of which mutual accommodation is the essence e.g., trader standing surety for one another. Loss of cash in a bank on account of robbery by dacoits or loss through burglary of cash which the assessee is under legal obligation or business necessity required to keep in till it would be allowable as loss incidental to the trade. Losses arising from payments made as advances to employees and money lent by the managed company to the managing agents which had become irrecoverable would be incidental to the business provided that the amounts paid in advance or as loan were so made with reasonable business prudence and hence would be deductible.

(iv) Loss caused by embezzlement is allowable as a deduction not necessarily in the year in which the embezzlement takes place, but when there is no reasonable chance of obtaining restitution and the amount is found to be irrecoverable. Normally when a businessman writes off the amount, it is a prima facie evidence of the fact that the amount has become irrecoverable. If embezzled or stolen moneys which are allowed as deduction in any year are subsequently recovered, they should be brought to tax as a revenue receipt from the business in the year of recovery.

(v) In respect of wasting assets or exhaustion of capital, no deduction is allowable from the income derived from such capital or wasting asset. Accordingly, where an annuity is purchased, the entire amount of annuity received is taxable regardless of the capital paid away and exhausted for the purchase of annuity. Likewise, in the case of a lease, the capital cost of the lease is not allowed to be deducted over the life of the lease.

6.5 Admissible Deductions

(i) Rent, rates, repairs and insurance for buildings [Section 30]: Section 30 allows deduction in respect of the rent, rates, taxes, repairs and insurance of buildings used by the

assessee for the purpose of his business or profession. However, where the premises are used partly for business and partly for other purposes, only a proportionate part of the expenses attributable to that part of the premises used for purposes of business will be allowed as a deduction. Where the assessee has sublet a part of the premises, the allowance under the section would be confined to the difference between the rent paid by the assessee and the rent recovered from the sub-tenant. The rent payable would be an allowable deduction under this section even though the income from the property in respect of which it is paid may be exempt from taxation in the hands of the owner. Where the assessee himself is owner of the premises and occupies them for his business purposes, no notional rent would be allowed under this section. However, where a firm runs its business in the premises owned by one of its partners, the rent payable to the partner will be an allowable deduction to the extent it is reasonable and is not excessive.

Apart from rent, this section allows deductions in respect of expenses incurred on account of repairs to building in case where (i) the assessee is the owner of the building or (ii) the assessee is a tenant who has undertaken to bear the cost of repairs to the premises. Even if the assessee occupies the premises otherwise than as a tenant or owner, i.e., as a lessee, licensee or mortgagee with possession, he is entitled to a deduction under the section in respect of current repairs to the premises.

In addition, deductions are allowed in respect of expenses by way of land revenue, local rates, municipal taxes and insurance in respect of the premises used for the purposes of the business or profession. Cesses, rates and taxes levied by a foreign Government are also allowed. Where the premises in respect of which these expenses are incurred are not utilized wholly for the purposes of the business, then, the deduction allowable should be of an amount proportionate to the use of the premises for the purposes of the business.

(ii) **Repairs and insurance of machinery, plant and furniture [Section 31]** : Section 31 allows deduction in respect of the expenses on current repairs and insurance of machinery, plant and furniture in computing the income from business or profession. In order to claim this deduction the assets must have been used for purposes of the assessee's own business the profits of which are being taxed. The word 'used' has to be read in a wide sense so as to include a passive as well as an active user. Thus, insurance and repair charges of assets which have been discarded (though owned by the assessee) or have not been used for the business during the previous year would not be allowed as a deduction. Even if an asset is used for a part of the previous year, the assessee is entitled to the deduction of the full amount of expenses on repair and insurance charges and not merely an amount proportionate to the period of use.

The term 'repairs' will include renewal or renovation of an asset but not its replacement or reconstruction. Also, the deduction allowable under this section is only of current repairs but not arrears of repairs for earlier years even though they may still rank for a deduction under section 37(1).

The deduction allowable in respect of premia paid for insuring the machinery, plant or furniture is subject to the following conditions: (i) The insurance must be against the risk of damage or destruction of the machinery, plant or furniture. (ii) The assets must be used by the assessee for the purposes of his business or profession during the accounting year. (iii) The premium should have been actually paid (or payable under the mercantile system of accounting). The

premium may even take the form of contribution to a trade association which undertakes to indemnify and insure its members against loss; such premium or contribution would be deductible as an allowance under this section even if a part of it is returnable to the insured in certain circumstances. It does not matter if the payment of the claim will enure to the benefit of someone other than the owner.

Cost of repairs and current repairs of capital nature not to be allowed : As per section 30(a), deduction for cost of repairs to the premises occupied by the assessee as a tenant and the amount paid on account of current repairs to the premises occupied by the assessee, otherwise than as a tenant, is allowed.

As per section 31, the amount paid on account of current repairs of machinery, plant or furniture is allowed as deduction in the computation of income under the head “profits and gains of business or profession”

A view has been taken in *Hanuman Motor Service v. CIT* (1967) 66 ITR 88, 91 (Mys.) that in considering a claim for deduction under section 10(2)(v) of the 1922 Act (corresponding to section 30(a)(ii) of the Income-tax Act, 1961), the question whether the expenditure is a capital expenditure or revenue expenditure is irrelevant. Once an expenditure has been established to be cost of repairs or current repairs, the same is allowable whether it is of a revenue or capital nature.

Under the Income-tax Act, 1961, the concept of capital and revenue is of fundamental importance. The Income-tax Act, 1961 is an Act to bring to charge only revenue and not capital. Wherever the legislature has felt that capital receipts have to be charged to income-tax they have specifically included such capital receipts in the definition of income e.g. Capital gains. In the same way, wherever the legislature desired that capital expenditure should be allowed as a deduction, specific provisions have been made for such allowance e.g. capital expenditure on scientific research. While computing income under the Income-tax Act, 1961, only revenue receipts are to be considered against which only revenue expenditure is allowable unless the Act specifically allows the deduction of capital expenditure. Hence it is clear that in respect of cost of repairs and current repairs, as per correct accounting principles, only expenditure of revenue nature can be allowed.

To clarify this, the *Explanation* to section 30 and section 31 provides that the amount paid on account of the cost of repairs and the amount paid on account of current repairs shall not include any expenditure in the nature of capital expenditure.

(iii) Depreciation [Section 32]

(1) Section 32 allows a deduction in respect of depreciation resulting from the diminution or exhaustion in the value of certain capital assets.

The *Explanation* to this section provides that deduction on account of depreciation shall be made compulsorily, whether or not the assessee has claimed the deduction in computing his total income.

(2) The allowance of depreciation which is regulated by Rule 5 of the Income-tax Rules, 1962, is subject to the following conditions which are cumulative in their application.

(a) The assets in respect of which depreciation is claimed must belong to either of the following categories, namely:

- (i) buildings, machinery, plant or furniture, being tangible assets;
- (ii) know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets acquired on or after 1st April, 1998.

The depreciation in the value of any other capital assets cannot be claimed as a deduction from the business income. No depreciation is allowable on the cost of the land on which the building is erected because the term 'building' refers only to superstructure but not the land on which it has been erected. The term 'plant' as defined in section 43(3) includes books, vehicles, scientific apparatus and surgical equipments. The expression 'plant' includes part of a plant (e.g., the engine of a vehicle); machinery includes part of a machinery and building includes a part of the building. However, the word 'plant' does not include an animal, human body or stock-in-trade. Thus plant includes all goods and chattels, fixed or movable, which a businessman keeps for employment in his business with some degree of durability. Similarly the term 'buildings' includes within its scope roads, bridges, culverts, wells and tubewells.

(b) The assets should be actually used by the assessee for purposes of his business during the previous year - The asset must be put to use at any time during the previous year. The amount of depreciation allowance is not proportionate to the period of use during the previous year.

Asset used for less than 180 days - However, it has been provided that where any asset is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period of less than 180 days, depreciation shall be allowed at 50 per cent of the allowable depreciation according to the percentage prescribed in respect of the block of assets comprising such asset. It is significant to note that this restriction applies only to the year of acquisition and not for subsequent years.

If the assets are not used exclusively for the business of the assessee but for other purposes as well, the depreciation allowable would be a proportionate part of the depreciation allowance to which the assessee would be otherwise entitled. This is provided in section 38.

Depreciation would be allowable to the owner even in respect of assets which are actually worked or utilized by another person e.g., a lessee or licensee. The deduction on account of depreciation would be allowed under this section to the owner who has let on hire his building, machinery, plant or furniture provided that letting out of such assets is the business of the assessee. In other cases where the letting out of such assets does not constitute the business of the assessee, the deduction on account of depreciation would still be allowable under section 57(ii).

Use includes passive use in certain circumstances: One of the conditions for claim of depreciation is that the asset must be "used for the purpose of business or profession". 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.

However, such passive use should also be for business purposes.

The Delhi High Court, in *CIT v. Insilco Ltd.* (2009) 179 Taxman 55, 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.

(c) **The assessee must own the assets, wholly or partly** - In the case of buildings, the assessee must own the superstructure and not necessarily the land on which the building is constructed. In such cases, the assessee should be a lessee of the land on which the building stands and the lease deed must provide that the building will belong to the lessor of the land upon the expiry of the period of lease. Thus, no depreciation will be allowed to an assessee in respect of an asset which he does not own but only uses or hires for purposes of his business.

However, in this connection, students may note that the *Explanation 1* to section 32 provides that where the business or profession of the assessee is carried on in a building not owned by him but in respect of which the assessee holds a lease or other right of occupancy, and any capital expenditure is incurred by the assessee for the purposes of the business or profession or the construction of any structure or doing of any work by way of renovation, extension or improvement to the building, then depreciation will be allowed as if the said structure or work is a building owned by the assessee.

Depreciation is allowable not only in respect of assets “wholly” owned by the assessee but also in respect of assets “partly” owned by him and used for the purposes of his business or profession.

(3) **In case of succession of firm/sole proprietary concern by a company or amalgamation or demerger of companies** - In order to restrict the double allowance under the proviso to section 32, in the cases of succession or amalgamation or demerger, the aggregate deduction in respect of depreciation allowable in the hands of the predecessor and the successor or in the case of amalgamating company and the amalgamated company or in the case of the demerged company and the resulting company, as the case may be, shall not exceed the amount of depreciation calculated at the prescribed rates as if the succession/amalgamation, demerger had not taken place. It is also provided that such deduction shall be apportioned between the two entities in the ratio of the number of days for which the assets were used by them.

In case of conversion of a private company or an unlisted public company into an LLP, fulfilling the conditions mentioned in section 47(xiii b), the aggregate depreciation allowable to the predecessor company and successor LLP shall not exceed, in any previous year, the depreciation calculated at the prescribed rates as if the conversion had not taken place. Such depreciation shall be apportioned between the predecessor company and the successor LLP in the ratio of the number of days for which the assets were used by them.

(4) Hire purchase - In the case of assets under the hire purchase system the allowance for depreciation would under *Circular No. 9 of 1943 R. Dis. No. 27(4) I.T. 43 dated 23-3-1943*, be granted as follows :

1. In every case of payment purporting to be for hire purchase, production of the agreement under which the payment is made would be insisted upon by the department.
2. Where the effect of an agreement is that the ownership of the asset is at once transferred on the lessee the transaction should be regarded as one of purchase by instalments and consequently no deduction in respect of the hire amount should be made. This principle will be applicable in a case where the lessor obtains a right to sue for arrears of instalments but has no right to recover the asset back from the lessee. Depreciation in such cases should be allowed to the lessee on the hire purchase price determined in accordance with the terms of hire purchase agreement.
3. Where the terms of an agreement provide that the asset shall eventually become the property of the hirer or confer on the hirer an option to purchase an asset, the transaction should be regarded as one of hire purchase. In such case, periodical payments made by the hirer should for all tax purposes be regarded as made up of (i) the consideration for hirer which will be allowed as a deduction in assessment, and (ii) payment on account of the purchase price, to be treated as capital outlay and depreciation being allowed to the lessee on the initial value namely, the amount for which the hired assets would have been sold for cash at the date of the agreement. The allowance to be made in respect of the hire should be the amount of the difference between the aggregate amount of the periodical payments under the agreement and the initial value as stated above. The amount of this allowance should be spread over the duration of the agreement evenly. If, however, agreement is terminated either by outright purchase of the asset or by its return to the seller, the deduction should cease as from the date of termination of agreement.

For the purpose of allowing depreciation an assessee claiming deduction in respect of the assets acquired on hire purchase would be required to furnish a certificate from the seller or any other suitable documentary evidence in respect of the initial value or the cash price of the asset. In cases where no such certificate or other evidence is furnished the initial value of the assets should be arrived at by computing the present value of the amount payable under the agreement at an appropriate per centum. For the purpose of allowing depreciation the question whether in a particular case the assessee is the owner of the hired asset or not is to be decided on a consideration of all the facts and circumstances of each case and the terms of the hire purchase agreement. Where the hired asset is originally purchased by the assessee and is registered in his name, the mere fact that the payment of the price is spread over the specified period and is made in installments to suit the needs of the purchaser does not disentitle the assessee from claiming depreciation in respect of the asset, since the assessee would be the real owner although the payment of purchase price is made subsequent to the date of acquisition of the asset itself.

(5) Computation of Depreciation Allowance - Depreciation allowance will be calculated on the following basis:

- (i) In the case of assets of an undertaking engaged in generation or generation and

distribution of power, such percentage on the actual cost to the assessee as prescribed by Rule 5(1A).

Rule 5(1A) - As per this rule, the depreciation on the abovementioned assets shall be calculated at the percentage of the actual cost at rates specified in Appendix IA of these rules. However, the aggregate depreciation allowed in respect of any asset for different assessment years shall not exceed the actual cost of the asset. It is further provided that such an undertaking as mentioned above has the option of being allowed depreciation on the written down value of such block of assets as are used for its business at rates specified in Appendix I to these rules.

However, such option must be exercised before the due date for furnishing return under section 139(1) for the assessment year relevant to the previous year in which it begins to generate power. It is further provided that any such option once exercised shall be final and shall apply to all subsequent assessment years.

- (ii) In the case of any block of assets, at such percentage of the written down value of the block, as may be prescribed by Rule 5(1).

Block of Assets - 1. A "block of assets" is defined in clause (11) of section 2, as a group of assets falling within a class of assets comprising—

- (a) tangible assets, being buildings, machinery, plant or furniture;
- (b) intangible assets, being know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature,

in respect of which the same percentage of depreciation is prescribed.

Know-how - In this context, 'know-how' means any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil-well or other sources of mineral deposits (including searching for discovery or testing of deposits for the winning of access thereto).

- (iii) **Additional depreciation on Plant & Machinery acquired by an Industrial Undertaking:** Additional depreciation is allowed on any new machinery or plant (other than ships and aircraft) acquired and installed after 31.3.2005 by an assessee engaged in the business of manufacture or production of any article or thing or in the business of generation or generation and distribution of power at the rate of 20% of the actual cost of such machinery or plant.

Such additional depreciation will not be available in respect of:

- (i) any machinery or plant which, before its installation by the assessee, was used within or outside India by any other person; or
- (ii) any machinery or plant installed in office premises, residential accommodation, or in any guest house; or
- (iii) office appliances or road transport vehicles; or
- (iv) any machinery or plant, the whole or part of the actual cost of which is allowed as a

deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head “Profits and Gains of Business or Profession” of any one previous year.

- (iv) **Terminal depreciation:** In case of a power concern as covered under clause (i) above, if any asset is sold, discarded, demolished or otherwise destroyed in the previous year, the depreciation amount will be the amount by which the monies payable in respect of such building, machinery, plant or furniture, together with the amount of scrap value, if any, falls short of the written down value thereof. The depreciation will be available only if the deficiency is actually written off in the books of the assessee.

“Moneys payable” in respect of any building, machinery, plant or furniture includes—

- (a) any insurance, salvage or compensation moneys payable in respect thereof;
- (b) where the building, machinery, plant or furniture is sold, the price for which it is sold, so, however, that where the actual cost of a motor-car is, in accordance with the proviso to clause (1) of section 43, taken to be ₹ 25,000, the moneys payable in respect of such motor-car shall be taken to be a sum which bears to the amount for which the motor-car is sold or, as the case may be, the amount of any insurance, salvage or compensation moneys payable in respect thereof (including the amount of scrap value, if any) the same proportion as the amount of ₹ 25,000 bears to the actual cost of the motor-car to the assessee as it would have been computed before applying the said proviso;

“Sold” includes a transfer by way of exchange or a compulsory acquisition under any law for the time being in force but does not include a transfer, in a scheme of amalgamation, of any asset by the amalgamating company to the amalgamated company where the amalgamated company is an Indian company or a transfer of any asset by a banking company to a banking institution in a scheme of amalgamation of such banking company with the banking institution, sanctioned and brought into force by the Central Government.

- (6) **Actual Cost [Section 43(1)]** :The expression “actual cost” means the actual cost of the asset to the assessee as reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority.

Actual cost in certain special situations [Explanations to section 43(1)]

- (i) Where an asset is used for the purposes of business after it ceases to be used for scientific research related to that business, the actual cost to the assessee for depreciation purposes shall be the actual cost to the assessee as reduced by any deduction allowed under section 35(1)(iv) [*Explanation 1*].
- (ii) Where an asset is acquired by way of gift or inheritance, its actual cost shall be the written down value to the previous owner [*Explanation 2*].
- (iii) Where, before the date of its acquisition by the assessee, the asset was at any time used by any other person for the purposes of his business or profession, and the Assessing Officer is satisfied that the main purpose of the transfer of the asset directly or indirectly to the assessee was the reduction of liability of income-tax directly or indirectly to the assessee (by claiming depreciation with reference to an enhanced cost) the actual cost to the assessee

shall be taken to be such an amount which the Assessing Officer may, with the previous approval of the Joint Commissioner, determine, having regard to all the circumstances of the case [*Explanation 3*].

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

- (a) the written down value at the time of original transfer; or
- (b) the actual price for which the asset is re-acquired by him

whichever is less [*Explanation 4*].

(v) Where before the date of acquisition by the assessee say, Mr.A, the assets were at any time used by any other person, say Mr.B, for the purposes of his business or profession and depreciation allowance has been claimed in respect of such assets in the case of Mr.B and such person acquires on lease, hire or otherwise, assets from Mr.A, then, the actual cost of the transferred assets, in the case of Mr.A, shall be the same as the written down value of the said assets at the time of transfer thereof by Mr.B [*Explanation 4A*].

We can explain the above as follows—

A person (say “A”) owns an asset and uses it for the purposes of his business or profession. A has claimed depreciation in respect of such asset. The said asset is transferred by A to another person (say “B”). A then acquires the same asset back from B on lease, hire or otherwise. B being the new owner will be entitled to depreciation. In the above situation, the cost of acquisition of the transferred assets in the hands of B shall be the same as the written down value of the said assets at the time of transfer.

Explanation 4A overrides Explanation 3 - Explanation 3 to section 43(1) deals with a situation where a transfer of any asset is made with the main purpose of reduction of tax liability (by claiming depreciation on enhanced cost), and the Assessing Officer, having satisfied himself about such purpose of transfer, may determine the actual cost having regard to all the circumstances of the case.

In the Explanation 4A, a *non-obstante* clause has been included to the effect that Explanation 4A will have an overriding effect over Explanation 3. The result of this is that there is no necessity of finding out whether the main purpose of the transaction is reduction of tax liability. Explanation 4A is activated in every situation described above without inquiring about the main purpose.

(vi) Where a building which was previously the property of the assessee is brought into use for the purposes of the business or profession, its actual cost to the assessee shall be the actual cost of the building to the assessee, as reduced by an amount equal to the depreciation calculated at the rates in force on that date that would have been allowable had the building been used for the purposes of the business or profession since the date of its acquisition by the assessee [*Explanation 5*].

(vii) When any capital asset is transferred by a holding company to its subsidiary company or by a subsidiary company to its holding company then, if the conditions specified in section

47(iv) or (v) are satisfied, the transaction not being regarded as a transfer of a capital asset, the actual cost of the transferred capital asset to the transferee company shall be taken to be the same as it would have been if the transferor company had continued to hold the capital asset for the purposes of its own business [*Explanation 6*].

(viii) In a scheme of amalgamation, if any capital asset is transferred by the amalgamating company to the amalgamated company, the actual cost of the transferred capital assets to the amalgamated company will be taken at the same amount as it would have been taken in the case of the amalgamating company had it continued to hold it for the purposes of its own business [*Explanation 7*].

In the case of a demerger, where any capital asset is transferred by the demerged company to the resulting company, the actual cost of the transferred asset to the resulting company shall be taken to be the same as it would have been if the demerged company had continued to hold the asset. However, the actual cost shall not exceed the WDV of the asset in the hands of the demerged company [*Explanation 7A*].

(ix) Certain taxpayers have, with a view to obtain more tax benefits and reduce the tax outflow, resorted to the method of capitalising interest paid or payable in connection with acquisition of an asset relatable to the period after such asset is first put to use. Certain judicial rulings also favoured this approach. This capitalisation implies inclusion of such interest in the 'Actual Cost' of the asset for the purposes of claiming depreciation, investment allowance etc. under the Income-tax Act. This was never the legislative intent nor was it in accordance with recognised accounting practices. Therefore, with a view to counter-acting tax avoidance through this method and placing the matter beyond doubt, Explanation 8 to section 43(1) provides that any amount paid or payable as interest in connection with the acquisition of an asset and relatable to period after asset is first put to use shall not be included and shall be deemed to have never been included in the actual cost of the asset [*Explanation 8*].

(x) Where an asset is or has been acquired by an assessee, the actual cost of asset shall be reduced by the amount of duty of excise or the additional duty leviable under section 3 of the Customs Tariff Act, 1975 in respect of which a claim of credit has been made and allowed under the Central Excise Rules, 1944 [*Explanation 9*].

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

However, where such subsidy or grant or reimbursement is of such nature that it cannot be directly relatable to the asset acquired, so much of the amount which bears to the total subsidy or reimbursement or grant the same proportion as such asset bears to all the assets in respect of or with reference to which the subsidy or grant or reimbursement is so received, shall not be included in the actual cost of the asset to the assessee [*Explanation 10*].

(xii) Where an asset is acquired outside India by an assessee, being a non-resident and such asset is brought by him to India and used for the purposes of his business or profession,

the actual cost of asset to the assessee shall be the actual cost the asset to the assessee, as reduced by an amount equal to the amount of depreciation calculated at the rate in force that would have been allowable had the asset been used in India for the said purposes since the date of its acquisition by the assessee [*Explanation 11*].

(xiii) Where any capital asset is acquired under a scheme for corporatisation of a recognised stock exchange in India approved by the SEBI, the actual cost shall be deemed to be the amount which would have been regarded as actual cost had there been no such corporatization[*Explanation 12*].

(xiv) *Explanation 13* has been inserted in section 43(1) to provide that the actual cost of any capital asset, on which deduction has been allowed or is allowable to the assessee under section 35AD, shall be nil. This would be applicable in the case of transfer of asset by the assessee where -

- (1) the assessee himself has claimed deduction under section 35AD; or
- (2) the previous owner has claimed deduction under section 35AD. This would be applicable where the capital asset is acquired by the assessee by way of -
 - (a) gift, will or an irrevocable trust;
 - (b) any distribution on liquidation of the company;
 - (c) any distribution of capital assets on total or partial partition of a HUF;
 - (d) any transfer of a capital asset by a holding company to its 100% subsidiary company, being an Indian company;
 - (e) any transfer of a capital asset by a subsidiary company to its 100% holding company, being an Indian company;
 - (f) any transfer of a capital asset by the amalgamating company to an amalgamated company in a scheme of amalgamation, if the amalgamated company is an Indian company;
 - (g) any transfer of a capital asset by the demerged company to the resulting company in a scheme of demerger, if the resulting company is an Indian company;
 - (h) any transfer of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm, or any transfer of a capital asset to a company in the course of demutualization or corporatisation of a recognized stock exchange in India as a result of which an association of persons or body of individuals is succeeded by such company (fulfilling the conditions specified);
 - (i) any transfer of a capital asset or intangible asset by a sole proprietary concern to a company, where the sole proprietary concern is succeeded by a company (fulfilling the conditions specified) which would have been regarded as actual cost had there been no such corporatisation.
 - (j) any transfer of a capital asset by a company to an LLP as a result of conversion of

the company into LLP (fulfilling the conditions prescribed).

Definition of plant [Section 43(3)] – “Plant” includes ships, vehicles, books, scientific apparatus and surgical equipment used for the purposes of business or profession but does not include tea bushes or livestock or buildings or furniture and fittings.

(7) **Written down value [Section 43(6)]** - (i) In the case of assets acquired by the assessee during the previous year, the written down value means the actual cost to the assessee.

(ii) In the case of assets acquired before the previous year, the written down value would be the actual cost to the assessee less the aggregate of all deductions actually allowed in respect of depreciation. For this purpose, any depreciation carried forward is deemed to be depreciation actually allowed [Section 43(6)(c)(i) read with *Explanation 3*].

The written down value of any asset shall be worked out as under in accordance with section 43(6)(c) -

- (1) The aggregate of the written down value of the block of assets at the beginning of the previous year.
- (2) The sum arrived at as above shall be increased by the actual cost of any asset falling within that block which is acquired by the assessee during the previous year.
- (3) The sum so arrived at shall be reduced by the sale proceeds and other amounts receivable by the assessee with regard to any asset falling within that block which is sold, discarded, demolished or destroyed during that previous year.

(iii) When in the case of a succession to business or profession, an assessment is made on the successor under section 170(2), the written down value of an asset or block of assets shall be the amount which would have been taken as the written down value if the assessment had been made directly on the person succeeded to [*Explanation 1* to section 43(6)].

(iv) Where in any previous year any block of assets is transferred by a holding company to a subsidiary company or vice versa and the conditions of clause 47(iv) or (v) are satisfied or by an amalgamating company to an amalgamated company the latter being an Indian company then the actual cost of the block of assets in the case of transferee-company or amalgamated company as the case may be, shall be the written down value of the block of assets as in the case of the transferor company or amalgamating company, as the case may be, for the immediately preceding year as reduced by depreciation actually allowed in relation to the said previous year [*Explanation 2* to section 43(6)].

(v) Where in any previous year any asset forming part of a block of assets is transferred by demerged company to the resulting company, the written down value of the block of assets of the demerged company for the immediately preceding year shall be reduced by the written down value of the assets transferred to the resulting company [*Explanation 2A* to section 43(6)].

(vi) Where any asset forming part of a block of assets is transferred by a demerged company to the resulting company, the written down value of the block of assets in the case of resulting company shall be the written down value of the transferred assets of the demerged company immediately before the demerger [*Explanation 2B* to section 43(6)].

(vii) The actual cost of the block of assets in the case of the successor LLP shall be the written down value of the block of assets as in the case of the predecessor company on the date of conversion [*Explanation 2C* to section 43(6)].

(viii) Where any asset forming part of a block of assets is transferred in any previous year by a recognised stock exchange in India to a company under a scheme for corporatisation approved by SEBI, the written down value of the block shall be the written down value of the transferred assets immediately before the transfer [*Explanation 5* to section 43(6)].

(ix) Depreciation provided in the books of account deemed to be depreciation actually allowed [*Explanation 6* to section 43(6)]

Section 32(1)(ii) provides that depreciation shall be allowed at the prescribed percentage on the written down value (WDV) of any block of assets. Section 43(6)(b) provides that written down value in the case of assets acquired before the previous year means the actual cost to the assessee less all depreciation actually allowed to him under the Income-tax Act, 1961.

Persons who were exempt from tax were not required to compute their income under the head "Profits and gains of business or profession". However, when the exemption is withdrawn subsequently, such persons became liable to income-tax and hence, were required to compute their income for income-tax purposes. In this regard, a question arises as to the basis on which depreciation is to be allowed under the Income-tax Act, 1961 in respect of assets acquired during the years when the person was exempt from tax.

Explanation 6 to section 43(6) provides that,-

- (a) the actual cost of an asset has to be adjusted by the amount attributable to the revaluation of such asset, if any, in the books of account;
- (b) the total amount of depreciation on such asset provided in the books of account of the assessee in respect of such previous year or years preceding the previous year relevant to the assessment year under consideration shall be deemed to be the depreciation actually allowed under the Income-tax Act, 1961 for the purposes of section 43(6);
- (c) the depreciation actually allowed as above has to be adjusted by the amount of depreciation attributable to such revaluation.

(x) *Explanation 7* 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 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.

For instance, Rule 8 prescribes the taxability of income from the manufacture of tea. Under the said rule, income derived from the sale of tea grown and manufactured by seller shall be computed as if it were income derived from business, and 40% of such income shall be deemed to be income liable to tax. If the turnover is, say, ₹ 20 lakh, the depreciation ₹ 1 lakh and other expenses ₹ 4 lakh, then the income would be ₹ 15 lakh. Business income would be ₹ 6 lakh (being 40% of ₹ 15 lakh). As per earlier Court decisions, only the depreciation "actually allowed" i.e., ₹ 40,000, being 40% of ₹ 1 lakh, has to be deducted to arrive at the

written down value. The ambiguity in this case has arisen on account of the interpretation of the meaning of the phrase “actually allowed” used in section 43(6)(b). However, the correct legislative intent is that the WDV is required to be computed by deducting the full depreciation attributable to composite income i.e. ₹ 1 lakh in this case. Explanation 7 clarifies this legislative intent.

(xi) The written down value of any block of assets, may be reduced to nil for any of the following reasons:

(a) The moneys receivable by the assessee in regard to the assets sold or otherwise transferred during the previous year together with the amount of scrap value may exceed the written down value at the beginning of the year as increased by the actual cost of any new asset acquired, or

(b) All the assets in the relevant block may be transferred during the year.

(8) Rates of depreciation - All assets have been divided into four main categories and rates of depreciation as prescribed by Rule 5(1) are given below:

PART A TANGIBLE ASSETS

I Buildings

Block 1.	Buildings (other than covered by sub-item (3) below) which are used mainly for residential purposes	5%
Block 2.	Buildings which are not used mainly for residential purposes and not covered by sub-items (1) above and (3) below	10%
Block 3.	Buildings acquired on or after the 1st September, 2002 For installing machinery and plant forming part of water supply project or water treatment system and which is put to use for the purpose of business of providing infrastructure facilities under clause (i) of sub-section (4) of section 80-IA	100%
Block 4.	Purely temporary erections such as wooden structures	100%

II Furniture and Fittings

Block 1.	Furniture and fittings including electrical fittings	10%

III Plant & Machinery

Block 1.	Motors buses, motor lorries, motor taxis used in the business of running them on hire	30%
Block 2	Aeroplanes, aeroengines	40%
Block 3.	Specified air, water pollution control equipments, solid waste control equipment and solidwaste recycling and resource recovery systems	100%

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Block 4.	Energy Saving Devices (as specified)	80%
Block 5.	Motor cars other than those used in a business of running them on hire, acquired or put to use on or after 1-4-1990.	15%
Block 6	Computers including computer software	60%
Block 7.	Annual publications owned by assesseees carrying on a profession	100%
Block 8.	Books owned by assesseees carrying on business in running lending libraries	100%
Block 9.	Books, other than annual publications, owned by assesseees carrying on a profession	60%
Block 10.	Plant & machinery (General rate)	15%
IV Ships		
Block 1.	Ocean-going ships	20%
Block 2.	Vessels ordinarily operating on inland waters not covered by sub-item (3) below	20%
Block 3.	Speed boats operating on inland water	20%
PART B INTANGIBLE ASSETS		
	Know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature	25%

Students should refer to Income-tax Rules for the detailed classification of assets under Rule 5(1) and the rates applicable thereto.

Note - New commercial vehicles acquired on or after 1.1.2009 but before 1.10.2009 and put to use before 1.10.2009 for the purposes of business or profession" would be classified under the head MACHINERY AND PLANT and would be eligible for depreciation at the rate of 50%.

(9) Increased rate of depreciation for certain assets - Rule 5(2) - Any new machinery or plant installed to manufacture or produce any article or thing by using any technology or other know-how developed in a laboratory owned or financed by the Government or a laboratory owned by a public sector company or a University or an institution recognized by the Secretary, Department of Scientific and Industrial Research, Government of India shall be treated as a part of the block of assets qualifying for depreciation@ 40%.

Conditions to be fulfilled

1. The right to use such technology to manufacture such article has been acquired from the owner of such laboratory or any person deriving title from such owner.
2. The return filed by the assessee for any previous year in which the said machinery is acquired, should be accompanied by a certificate from the Secretary, Department of Scientific and

Industrial Research, Government of India to the effect that such article is manufactured by using such technology developed in such laboratory or such article has been invented in that laboratory.

3. The machinery or plant is not used for the purpose of business of manufacture or production of any article or thing specified in the Eleventh schedule.

The depreciation ordinarily allowable to an assessee in respect of any block of assets shall be calculated at the above specified rates on the WDV of such block of assets as are used for the purposes of the business or profession of the assessee at any time during the previous year.

(10) Carry forward and set off of depreciation [Section 32(2)] - Section 32(2) provides for carry forward of unabsorbed depreciation. Where, in any previous year the profits or gains chargeable are not sufficient to give full effect to the depreciation allowance, the unabsorbed depreciation shall be added to the depreciation allowance for the following previous year and shall be deemed to be part of that allowance. If no depreciation allowance is available for that previous year, the unabsorbed depreciation of the earlier previous year shall become the depreciation allowance of that year. The effect of this provision is that the unabsorbed depreciation shall be carried forward indefinitely till it is fully set off.

However, in the order of set-off of losses under different heads of income, effect shall first be given to business losses and then to unabsorbed depreciation.

The provisions in effect are as follows:

- Since the unabsorbed depreciation now falls part of the current year's depreciation, it can be set off against any other head of income.
- The unabsorbed depreciation can be carried forward for indefinite number of previous years.
- Set off will be allowed even if the same business to which it relates is no longer in existence in the year in which the set off takes place.

Current depreciation to be deducted first - The Supreme Court, in *CIT v. Mother India Refrigeration (P.) Ltd.* [1985] 23 Taxman 8, has categorically held that current depreciation must be deducted first before deducting the unabsorbed carried forward business losses of the earlier years in giving set off while computing the total income of any particular year.

Illustration 1

A newly qualified Chartered Accountant Mr. Dhaval, commenced practice and has acquired the following assets in his office during F.Y. 2013-14 at the cost shown against each item. Calculate the amount of depreciation that can be claimed from his professional income for A.Y. 2014-15:

Sl. No.	Description	Date of acquisition	Date when put to use	Amount ₹
1.	Computer	27 Sept., 13	1 Oct., 13	35,000
2.	Computer software	2 Oct., 13	4 Oct., 13	8,500

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3.	Computer printer	2 Oct., 13	1 Oct., 13	12,500
4.	Books (of which books being annual publications are of ₹ 12,000)	1 Apr., 13	1 Apr., 13	13,000
5.	Office furniture (Acquired from a practising C.A.)	1 Apr., 13	1 Apr., 13	3,00,000
6.	Laptop	26 Sep., 13	4 Oct., 13	43,000

Solution

Computation of depreciation allowable for A.Y.2014-15

	Asset	Rate	Depreciation
Block 1	Furniture	10%	30,000
Block 2	Plant (Computer, computer software, laptop & books)	60%	37,050
Block 3	Plant (Books)	100%	12,000
Block 4	Plant (Printer)	15%	1,875
	Total depreciation allowable		80,925

Notes:

1. Computation of depreciation

Block of Assets	₹
Block 1: Furniture – rate 10%	
Put to use for more than 180 days [₹ 3,00,000@10%]	30,000
Block 2: Plant – rate 60%	
(a) Computer (put to use for more than 180 days) [₹ 35,000 @ 60%]	21,000
(b) Laptop (put to use for less than 180 days) [₹ 43,000 @ 30%]	12,900
(c) Computer Software (put to use for less than 180 days) [₹ 8,500@ 30%]	2,550
(d) Books (other than annual publications) (Put to use for more than 180 days) [₹ 1,000 @ 60%]	600
	37,050
Block 3: Plant – Rate 100%	
Books (being annual publications) put to use for more than 180 days [₹ 12,000@100%]	12,000

Block 4: Plant – Rate 15%	
Computer printer (Put to use for more than 180 days) [₹ 12,500 @15%]	1,875

2. Where an asset is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period of less than 180 days, the deduction on account of depreciation would be restricted to 50% of the prescribed rate. In this case, since Mr. Dhaval commenced his practice in the P.Y.2013-14 and acquired the assets during the same year, the restriction of depreciation to 50% of the prescribed rate would apply to those assets which have been put to use for less than 180 days in that year, namely, laptop and computer software.

Illustration 2

Gamma Ltd. was incorporated on 1.1.2013 for manufacture of tyres and tubes for motor vehicles. The manufacturing unit was set up on 1.5.2013. The company commenced its manufacturing operations on 1.6.2013. The total cost of the plant and machinery installed in the unit is ₹ 120 crore. The said plant and machinery included second hand plant and machinery bought for ₹ 20 crore and new plant and machinery for scientific research relating to the business of the assessee acquired at a cost of ₹ 15 crore.

Compute the amount of depreciation allowable under section 32 of the Income-tax Act, 1961 in respect of the assessment year 2014-15.

Solution

Computation of depreciation allowable for the A.Y. 2014-15 in the hands of Gamma Ltd.

Particulars	₹ in crore	
Total cost of plant and machinery	120.00	
Less: Used for Scientific Research (Note 1)	<u>15.00</u>	
	<u>105.00</u>	
Normal Depreciation at 15% on ₹ 105 crore		15.75
Additional Depreciation:		
Cost of plant and machinery	120.00	
Less: Second hand plant and machinery (Note 2) 20.00		
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>15.00</u>	<u>35.00</u>	
	85.00	
Additional Depreciation at 20%		<u>17.00</u>
Depreciation allowable for A.Y.2014-15		<u>32.75</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 deduction is allowable under section 35 in respect of such capital expenditure.
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, *inter alia*, 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;
- (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).

Illustration 3

Lights and Power Ltd. engaged in the business of generation of power, furnishes the following particulars pertaining to P.Y. 2013-14. Compute the depreciation allowable under section 32 for A.Y.2014-15, while computing its income under the head "Profits and gains of business or profession". The company has opted for the depreciation allowance on the basis of written down value.

	Particulars	₹
1.	Opening Written down value of Plant and Machinery (15% block) as on 01.04.2013 (Purchase value ₹ 8,00,000)	5,78,000
2.	Purchase of second hand machinery (15% block) on 29.12.2013 for business purpose	2,00,000
3.	Machinery Y (15% block) purchased and installed on 12.07.2013 for the purpose of power generation	8,00,000
4.	Acquired and installed for use a new air pollution control equipment on 31.07.2013	2,50,000
5.	New air conditioner purchased and installed in office premises on 08.09.2013	3,00,000
6.	New machinery Z (15% block) acquired and installed on 23.11.2013 for the purpose of generation of power	3,25,000

7.	Sale value of an old machinery X, sold during the year (Purchase value ₹ 4,80,000, WDV as on 01.04.2013 ₹ 3,46,800)	3,10,000

Answer

Computation of depreciation allowance under section 32 for the A.Y. 2014-15

Particulars	₹	Plant and Machinery (15%) (₹)	Plant and Machinery (100%) (₹)
Opening WDV as on 01.04.2013		5,78,000	-
Add: Plant and Machinery acquired during the year			
- Second hand machinery	2,00,000		
- Machinery Y	8,00,000		
- Air conditioner for office	3,00,000		
- Machinery Z	<u>3,25,000</u>	16,25,000	
- Air pollution control equipment		-	<u>2,50,000</u>
		22,03,000	2,50,000
Less: Asset sold during the year		<u>3,10,000</u>	<u>Nil</u>
Written down value before charging depreciation		<u>18,93,000</u>	<u>2,50,000</u>
Normal depreciation			
100% on air pollution control equipment		-	2,50,000
Depreciation on plant and machinery put to use for less than 180 days @ 7.5% (i.e., 50% of 15%)			
- Second hand machinery (₹ 2,00,000 × 7.5%)	15,000		
- Machinery Z (₹ 3,25,000 × 7.5%)	<u>24,375</u>	39,375	
15% on the balance WDV being put to use for more than 180 days (₹ 13,68,000 × 15%)		2,05,200	
Additional depreciation			
- Machinery Y (₹ 8,00,000 × 20%)	1,60,000		
- Machinery Z (₹ 3,25,000 × 10%)	<u>32,500</u>	<u>1,92,500</u>	<u>Nil</u>
Total depreciation		<u>4,37,075</u>	<u>2,50,000</u>

Notes:

- (1) Power generation equipments qualify for claiming additional depreciation in respect of new plant and machinery from A.Y. 2014-15.

- (2) Additional depreciation is not allowed in respect of second hand machinery.
- (3) No additional depreciation is allowed in respect of office appliances. Hence, no depreciation is allowed in respect of air conditioner installed in office premises.
- (4) Additional depreciation is not allowed in respect of an asset whose actual cost is allowed as deduction in computing the income chargeable under the head "Profit and Gains of business or profession". It is presumed that the new air pollution control equipment installed is eligible for 100% depreciation. Therefore, no additional depreciation is allowed in respect of the same.

(11) Building, machinery, plant and furniture not exclusively used for business purpose [Section 38(2)] – Where any building, plant and machinery, furniture is not exclusively used for the purposes of business or profession, the deduction on account of expenses on account of current repairs to the premises, insurance premium of the premises, current repairs and insurance premium of machinery, plant and furniture and depreciation in respect of these assets shall be restricted to a fair proportionate part thereof, which the Assessing Officer may determine having regard to the user of such asset for the purposes of the business or profession.

(12) **Balancing Charge** – Section 41(2) provides for the manner of calculation of the amount which shall be chargeable to income-tax as income of the business of the previous year in which the monies payable for the building, machinery, plant or furniture on which depreciation has been claimed under section 32(1)(i), i.e. in the case of power undertakings, is sold, discarded, demolished or destroyed. The balancing charge will be the amount by which the moneys payable in respect of such building, machinery, plant or furniture, together with the amount of scrap value, if any, exceeds the written down value. However, the amount of balancing charge should not exceed the difference between the actual cost and the WDV. The tax shall be levied in the year in which the moneys payable become due.

The *Explanation* below section 41(2) makes it clear that where the moneys payable in respect of the building, machinery, plant or furniture referred to in section 41(2) become due in a previous year in which the business, for the purpose of which the building, machinery, plant or furniture was being used, is no longer in existence, these provisions will apply as if the business is in existence in that previous year.

(iv) **Investment in new plant and machinery [New Section 32AC]**

(1) *New section 32AC has been inserted by the Finance Act, 2013 to provide a tax incentive by way of investment allowance to encourage huge investment in plant or machinery.*

(2) *Under new section 32AC, a manufacturing company is entitled to an investment allowance@15% of the aggregate amount of actual cost of new plant and machinery acquired and installed during the financial years 2013-14 & 2014-15, if the same exceeds ₹100 crore.*

(3) *As per section 32AC, a company assessee would be entitled to deduction@15% of aggregate investment in new plant and machinery if it is –*

- (a) *engaged in the business of manufacture of an article or thing; and*

(b) *invests a sum of more than ₹ 100 crore in new plant or machinery during the period beginning from 1st April, 2013 and ending on 31st March, 2015.*

(4) *For A.Y. 2014-15, a manufacturing company would be entitled to deduction of 15% of aggregate amount of actual cost of new assets acquired and installed during the financial year 2013-14, if the aggregate cost of such assets exceeds ₹ 100 crore.*

For A.Y. 2015-16, a deduction of 15% of aggregate amount of actual cost of new assets, acquired and installed during the period beginning on 1st April, 2013 and ending on 31st March, 2015, as reduced by the deduction allowed, if any, for A.Y. 2014-15.

(5) *The investment allowance@15% under this section is in addition to the depreciation and additional depreciation allowable under section 32(1). Further, the investment allowance would not be reduced to arrive at the written down value of plant and machinery.*

(6) *“New plant or machinery” does not include—*

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

(7) *The new plant and machinery in respect of which investment allowance has been claimed under section 32AC cannot be sold or otherwise transferred for a period of 5 years from the date of installation. If it is sold or transferred within this period, the deduction allowed earlier would be deemed as income chargeable to tax under the head “Profits and gains of business or profession” of the previous year in which such new plant and machinery is sold or otherwise transferred. This would be in addition to the taxability of gains on transfer of such plant and machinery.*

In case of amalgamation or demerger, this restriction would continue to apply to the amalgamated company or resulting company, as the case may be, as it would have applied to the amalgamating or demerged company.

Illustration 4

Compute the admissible investment allowance under section 32AC for A.Y.2014-15 and A.Y.2015-16 in each of the following cases -

Company	Investment in new plant and machinery (₹ in crore)	
	P.Y.2013-14	P.Y.2014-15
A Ltd.	80	10
B Ltd.	75	35
C Ltd.	110	40
D Ltd.	0	98
E Ltd.	105	0
F Ltd.	0	110

Solution

Company	Investment in new plant and machinery (₹ in crore)		Investment allowance under section 32AC (₹ in crore)	
	P.Y.2013-14	P.Y.2014-15	A.Y.2014-15	A.Y.2015-16
A Ltd.	80	10	Nil	Nil
B Ltd.	75	35	Nil	16.50
C Ltd.	110	40	16.50	6.00
D Ltd.	0	98	Nil	Nil
E Ltd.	105	0	15.75	Nil
F Ltd.	0	110	Nil	16.50

Illustration 5

B Ltd., a company engaged in the business of manufacture of sports equipments, furnishes the following particulars pertaining to P.Y.2013-14 and P.Y.2014-15. Compute the depreciation allowable under section 32 as well as the investment allowance allowable under section 32AC for A.Y.2014-15 and A.Y.2015-16, while computing its income under the head "Profits and gains of business or profession". Also, compute the written down value of plant and machinery as on 1.4.2014 and 1.4.2015.

	Particulars	₹ in crore
1.	Written down value of plant and machinery (15% block) as on 01.04.2013	25.00
2.	Sold plant and machinery on 20.5.2013 (15% block)	4.00
3.	Purchase of second hand machinery (15% block) on 29.5.2013 for business purpose (the machinery was put to use immediately)	12.00
4.	Purchased new computers (60% block) on 8.11.2013 for office	0.40

5.	Acquired and installed new plant and machinery (15% block) on 31.7.2013 (₹ 50 crore) and on 31.10.2013 (₹ 40 crore)	90.00
6.	New air conditioners purchased and installed in office premises on 30.6.2013	0.15
7.	Acquired and installed new plant and machinery (15% block) on 2.4.2014	15.00

Solution**Computation of depreciation allowance under section 32 for the A.Y. 2014-15**

Particulars	Plant and Machinery (15%)	Plant and Machinery (60%)
	(₹ in crore)	
WDV as on 01.04.2013	25.00	-
Add: Plant and Machinery acquired during the year		
- Second hand machinery	12.00	
- New plant and machinery	90.00	
- Air conditioner installed in office	<u>0.15</u>	
	102.15	
Computers acquired during the year	-	<u>0.40</u>
	127.15	0.40
Less: Asset sold during the year	<u>4.00</u>	<u>Nil</u>
Written down value before charging depreciation	123.15	0.40
Less: Depreciation for the P.Y.2013-14 (See Note 1 below)	<u>29.47</u>	<u>0.12</u>
WDV as on 1.4.2014	<u>93.68</u>	<u>0.28</u>
Note 1 : Computation of depreciation for the P.Y.2013-14		
Normal depreciation		
Depreciation@30% on computers put to use for less than 180 days (50% of 60% × 0.40 crore)	-	0.12
Depreciation on plant and machinery (15% block) (40 × 7.5%) + [(123.15-40) × 15%]	15.47	
Additional depreciation		
- New plant and machinery installed on 31.7.2013 (₹ 50 crore × 20%)	10	
- on 31.10.2013 (₹ 40 crore × 10%)	4	
	<u>14.00</u>	<u>Nil</u>
Total depreciation	<u>29.47</u>	<u>0.12</u>

Note – For the A.Y.2014-15, the company would not be entitled for investment allowance under section 32AC since the investment in new plant and machinery acquired and installed during the year is only ₹ 90 crores (i.e., less than ₹ 100 crores). Investment in second hand plant and machinery and air-conditioners and computers installed in office would not be eligible for investment allowance under section 32AC or additional depreciation under section 32(1)(ia).

Computation of depreciation allowance under section 32 for the A.Y. 2015-16

Particulars	Plant and Machinery (15%)	Plant and Machinery (60%)
	(₹ in crore)	
WDV as on 1.4.2014	93.68	0.28
Add: Plant and Machinery acquired during the year	<u>15.00</u>	<u>-</u>
	108.68	0.28
Less: Asset sold during the year	<u>Nil</u>	<u>Nil</u>
Written down value (before charging depreciation)	108.68	0.28
Less: Depreciation for the P.Y.2014-15 @15% and 60%, respectively	16.30	0.17
Additional depreciation@20% on 15 crore	<u>3.00</u>	<u>-</u>
WDV as on 1.4.2015	<u>89.38</u>	<u>0.11</u>

Computation of investment allowance under section 32AC for the A.Y.2015-16

Particulars	(₹ in crore)
New plant and machinery acquired and installed during the P.Y.2013-14	90
New plant and machinery acquired and installed during the P.Y.2014-15	<u>15</u>
Aggregate investment in new plant and machinery during the period from 1.4.2013 to 31.3.2015	<u>105</u>
Investment allowance@15% of ₹ 105 crore	15.75
Less: Deduction allowed in respect investment allowance during the A.Y.2014-15	<u>Nil</u>
Deduction under section 32AC for the A.Y.2015-16	<u>15.75</u>

Note - The company would be eligible for investment allowance under section 32AC in the P.Y.2014-15, since the aggregate investment in new plant and machinery from 1.4.2013 to 31.3.2015 has exceeded ₹ 100 crore.

(v) Tea Development Account/Coffee Development Account/Rubber Development Account [Section 33AB]

(1) Where an assessee carrying on the business of growing and manufacturing tea or coffee or rubber in India has, before the expiry of six months from the end of the previous year or before the due date of furnishing the return of income, whichever is earlier, (i) deposited with a National Bank any amount in a special account maintained by the assessee with that Bank in accordance with a scheme approved by Tea Board or Coffee Board or Rubber Board, or (ii) deposited any amount to be known as Deposit Account opened by the assessee in accordance with the scheme framed by the Tea Board or Coffee Board or Rubber Board, as the case may be, with the previous approval of the Central Government, the assessee shall be allowed a deduction of :

- (a) A sum equal to the aggregate of the deposits made or
- (b) 40% of the profits of such business computed under the head 'Profits and gains of business or profession' before making any deduction under this section,

whichever is less.

(2) The above deduction will be allowed before the setting off of brought-forward loss under section 72.

(3) Where the assessee is a firm or any association of persons or any body of individuals the deduction under this section shall not be allowed in the computation of the income of any partner or member of such firm, AOP or BOI.

(4) This deduction shall not be allowed unless the accounts of such business of the assessee for the previous year have been audited by a chartered accountant and the assessee furnishes along with his return of income the report of such audit in the prescribed form duly signed and verified by such accountant.

(5) However, where the assessee is required by any other law to get his accounts audited it shall be sufficient compliance with the provision of this section if such assessee gets the accounts of such business audited under any such law and furnishes the report of the audit and a further report in the prescribed form under this section.

(6) Any amount standing to the credit of the assessee in the special account cannot be withdrawn except for the purposes specified in the scheme, or, as the case may be, in the deposit scheme.

The above amount can also be withdrawn in the following circumstances:

- (a) Closure of business
- (b) Death of an assessee
- (c) Partition of HUF
- (d) Dissolution of a firm
- (e) Liquidation of a company.

(7) Where the sum standing to the credit of the assessee in the Special account or in the Deposit account is released by the National Bank or is withdrawn by the assessee from the

Deposit account and is utilised for the purchase of:

- (a) Any machinery or plant installed in any office premises or residential accommodation including a guest house.
- (b) Any office appliances (other than computers)
- (c) Any machinery or plant the whole of whose actual cost is allowed as deduction by way of depreciation or otherwise in computing the business income.
- (d) Any new machinery or plant installed for production of any XI Schedule item, the whole of such amount so utilised will be treated as taxable profits of that year and taxed accordingly.
- (8) Where any amount is withdrawn by the assessee from the special account during any previous year on the closure of his business or dissolution of a firm, the whole of such withdrawal shall be deemed to be the profits and gains of business of that previous year and shall be chargeable to tax as the income of that previous year, as if the business had not closed or the firm had not been dissolved.
- (9) Where any amount standing to the credit of the assessee in the special account is utilised by the assessee for the purpose of any expenditure in connection with such business in accordance with the scheme, such expenditure shall not be allowed in computing the business income.
- (10) Where any amount in the special account which is released during any previous year by the National Bank for being utilised by the assessee for the purposes of such business in accordance with the scheme is not so utilised within that previous year, the unutilised amount shall be deemed to be profits and gains and chargeable to income-tax as the income of that previous year.

However, where such amount is released during the previous year at the closing of the account on the death of the assessee, partition of a HUF or liquidation of a company, the above restriction will not apply.

- (11) Where an asset acquired in accordance with the scheme is sold or otherwise transferred in any previous year by the assessee to any person at any time before the expiry of 8 years from the end of the previous year in which it was acquired, such portion of the cost equal to the deduction allowed under this section shall be deemed to be profits of the previous year in which the asset is sold or transferred and shall be chargeable to income-tax as the income of that previous year.

However, the above restriction will not apply in the following cases :

- (i) Where the asset is sold or otherwise transferred to Government, local authority, statutory corporation or a Government company.
- (ii) Where the sale or transfer is made in connection with the succession of a firm by a company in the business or profession carried on by the firm as result of which the firm sells or otherwise transfers any asset to the company and the scheme continues to apply to the company in the same manner as applicable to the firm. Further, all the properties of the firm relating to the business or profession immediately before the succession should become the liabilities of the company and all the shareholders of the company

should have been partners of the firm immediately before the succession.

(12) The Central Government has the power to direct that the deduction allowable under this section shall not be allowed after a specified date.

(13) "National Bank" means the National Bank for Agricultural and Rural Development (NABARD).

(vi) **Site Restoration Fund [Section 33ABA] – (1)** This section provides for a deduction in the computation of the taxable profits in the case of an assessee carrying on business of prospecting for, or extraction or production, of petroleum or natural gas or both in India and in relation to which the Central Government has entered into an agreement with such assessee for such business.

(2) It provides that where the assessee has during the previous year -

- (i) deposited any sum with the State Bank of India in a special account maintained by the assessee with that bank in accordance with the scheme approved in this behalf by the Government of India in the Ministry of Petroleum and Natural Gas (hereinafter referred to as the Site Restoration Account), or
- (ii) deposited any amount in an account opened by the assessee for the purposes specified in a scheme framed by the said Ministry,

the assessee shall be entitled to a deduction of —

- a sum equal to the sum deposited; or
- a sum equal to twenty per cent of its profits (as computed under the head "Profits and gains of business or profession" before making any deduction under the new section),

whichever is less.

(3) For this purpose, it is provided that any amount credited in the special account or Site Restoration Account by way of interest shall also be deemed to be a deposit.

(4) **Non-eligibility - (i)** Where such assessee is a firm or AOP or BOI, the deduction under this section will not be available in the computation of the income of any partner of the firm or the member of the AOP or BOI.

(ii) Where any deduction in respect of any amount deposited in the special account or Site Restoration Account has been allowed in any previous year, no deduction shall be allowed in respect of such amount in any other previous year.

(5) **Audit - (i)** Section 33ABA(2) provides that deduction under sub-section (1) shall not be admissible unless the accounts of the said business of the assessee for the previous year relevant to the assessment year have been audited by a chartered accountant and the assessee furnishes the report of such audit in the prescribed form along with the return.

(ii) Where the assessee is required by or under any other law to get his accounts audited, it will be sufficient compliance with the provisions of this sub-section if the assessee gets the accounts of the aforesaid business audited under any such law and furnishes the report of the audit and a further report in the prescribed form.

(6) **Withdrawal of deduction** - Any amount standing to the credit in the special account or the Site Restoration Account will not be allowed to be withdrawn except for the purposes specified in the scheme or in the deposit scheme.

No deduction shall be allowed in respect of any amount utilised for the purchase of the following items:

- (a) any machinery or plant to be installed in any office premises or residential accommodation, including any accommodation in the nature of a guest house;
- (b) any office appliances (not being computers);
- (c) any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head 'Profits and gains of business or profession' of any one previous year;
- (d) any new machinery or plant to be installed in an industrial undertaking for the purpose of the business of construction, manufacture or production of any article or thing specified in the list in the Eleventh Schedule.

(7) **Withdrawal on closure of account** - (i) Where any amount standing to the credit of the assessee in the special account or in the Site Restoration Account is withdrawn on closure of the account during any previous year by the assessee, the amount so withdrawn from the account as reduced by the amount, if any, payable to the Central Government by way of profit or production share as provided in the agreement referred to in section 42, shall be deemed to be the profits and gains of business or profession of that previous year and shall accordingly be chargeable to income-tax as the income of that previous year.

(ii) Where any amount is withdrawn on closure of the account in a previous year in which the business carried on by the assessee is no longer in existence, these provisions will apply as if the business is in existence in that previous year.

(8) **Utilisation from scheme not available as a deduction** - When any amount standing to the credit of the assessee in the special account or in the Site Restoration Account business is utilised by the assessee for the purpose of any expenditure in connection with such business in accordance with the scheme or the deposit scheme such expenditure will not be allowed in computing the income chargeable under the head 'Profits and gains of business or profession'.

(9) **Consequences of non-utilisation** - Where any amount is released in the previous year by the State Bank of India or is withdrawn from the Site Restoration Account and is not utilised in accordance with the scheme or the deposit scheme, the whole of such amount or the part thereof shall be deemed to be the profits and gains of business and accordingly chargeable to income-tax as income of that previous year. This sub-section will not apply in a case where such amount is released in the event of death of an assessee, partition of a Hindu undivided family or liquidation of a company. These circumstances are provided in clauses (b), (c) and (e) of section 33AB(3).

(10) **Consequences of sale or transfer** - Where any asset acquired in accordance with the scheme or the deposit scheme is sold or otherwise transferred in any previous year by the assessee before the expiry of eight years from the end of the previous year in which such

assets were acquired, such part of the cost of such asset as is relatable to the deduction allowed under section 33ABA(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 and shall accordingly be chargeable to income-tax as the income of that previous year.

This sub-section will not apply in the following cases:

- (a) where the asset is sold or otherwise transferred by the assessee to the Government, a local authority, a corporation established by or under a Central, State or Provincial Act or a Government company as defined in section 617 of the Companies Act, 1956¹; or
- (b) where the sale or transfer of the asset is made in connection with the succession of a firm by a company in the business or profession carried on by the firm as a result of which the firm sells or otherwise transfers to the company any asset and the scheme or the deposit scheme continues to apply to the company in the manner applicable to the firm, if the following conditions are satisfied;
 - (i) all the properties of the firm relating to the business or profession immediately before the succession become the properties of the company;
 - (ii) all the liabilities of the firm relating to the business or profession immediately before the succession become the liabilities of the company; and
 - (iii) all the shareholders of the company were partners of the firm immediately before the succession.

Specified period - The Central Government may, by notification in the Official Gazette, direct that the deduction allowable under this section will not be allowed after such date as may be specified in such notification.

(vii) Reserves for Shipping Business [Section 33AC]: The tonnage tax scheme, introduced by insertion of Chapter XII-G in the Income-tax Act, 1961, provides for special provisions relating to taxation of income of shipping companies. Consequently, no deduction under section 33AC is allowable from. A.Y. 2005-06, where a shipping company has opted for the tonnage tax scheme.

(viii) Expenditure on Scientific Research [Section 35]: This section allows a deduction in respect of any expenditure on scientific research related to the business of assessee. The expression 'scientific research' as defined in section 43(4)(i) means activities for the extension of knowledge in the fields of natural or applied science including agriculture, animal husbandry or fisheries. A reference to expenditure incurred on scientific research would include all expenditure incurred for the prosecution or the provision of facilities for the prosecution of scientific research but does not include any expenditure incurred in the acquisition of rights in or arising out of scientific research. In particular, a reference to scientific research related to a business or a class of business would include (i) any scientific research which may lead to or facilitate an extension of that business or all the business of that class, as the case may be;

¹ Section 2(45) of the Companies Act, 2013

(ii) any scientific research of a medical nature which has a special relation to the welfare of the workers employed in that business or all the business of that class, as the case may be.

(1) The deduction allowable under this section consists of -

(i) Revenue Expenditure:

(a) Any revenue expenditure incurred by the assessee himself on scientific research related to his business. Expenditure incurred within 3 years immediately preceding the commencement of the business on payment of salary to research personnel engaged in scientific research related to his business carried on by the taxpayer or on material inputs for such scientific research will be allowed as deduction in the year in which the business is commenced. The deduction will be limited to the amount certified by the prescribed authority.

(b) An amount equal to $1\frac{1}{4}$ times of any sum paid to a university, college or other institution or research association which has as its object, the undertaking of scientific research to be used for scientific research provided that the university, college, institution or association is approved for this purpose by the Central Government by notification in the Official Gazette.

The scope of the above deduction has been extended to cover expenditure on sponsored research carried out in the in-house research and development facilities of public companies. For the purpose, the expression "public sector company" means Government company as defined in section 617 of the Companies Act, 1956.

The payments so made to such institutions would be allowable irrespective of whether (i) the field of scientific research is related to the assessee's business or not, and (ii) the payment is of a revenue nature or of a capital nature.

(c) A sum equal to $1\frac{1}{4}$ times of any amount paid to a company to be used by it for scientific research [Clause (iia) of section 35(1)]

However, such deduction would be available only if the company is registered in India and has as its main object the scientific research and development. Further, it should be approved by the prescribed authority and should fulfill the other prescribed conditions.

A company approved under section 35(1)(iia) will not be entitled to claim weighted deduction of 200% under section 35(2AB). However, it can continue to claim deduction under section 35(1)(i) in respect of the revenue expenditure incurred on scientific research.

(d) A sum equal to $1\frac{1}{4}$ times of any amount paid to a research association which has as its object the undertaking of research in social science or statistical research or to a university, college or other institution approved by the Central Government by notification in the Official Gazette to be used for research in any social science or statistical research.

(e) The applicant association, university, college or other institution shall be approved in accordance with the guidelines, in the manner and subject to such conditions as may be prescribed. Such association, university, college or other institution should be notified in the Official Gazette by the Central Government.

(f) The deduction would be available only if such association, university, college or other institution is for the time being approved in accordance with the guidelines, in the manner and subject to such conditions as may be prescribed.

(g) Further, it has been clarified that the deduction to which an assessee (i.e. donor) is entitled on account of payment of any sum to a research association or university or college or other institution, shall not be denied merely on the ground that subsequent to payment of such sum by the assessee, the approval granted to any of the aforesaid entities is withdrawn.

(ii) **Capital Expenditure:** Any expenditure of a capital nature related to the business carried on by the assessee would be deductible in full in the previous year in which it is incurred.

Capital expenditure prior to commencement of business - The *Explanation* added to sub-section (2) specifically provides that where any capital expenditure has been incurred prior to the commencement of the business the aggregate of the expenditure so incurred within the three years immediately preceding the commencement of the business shall be deemed to have been incurred in the previous year in which the business is commenced. Consequently, any capital expenditure incurred within three years before the commencement of business will rank for deduction as expenditure for scientific research incurred during the previous year.

Expenditure on land disallowed - No deduction will be allowed in respect of capital expenditure incurred on the acquisition of any land after 29-2-1984 whether the land is acquired as such or as part of any property.

For the above purpose the expression 'land' would include any interest in land and it shall be deemed to be acquired on the date on which the document purporting to transfer the land is registered under the Registration Act, 1908 and where the possession of any land has been obtained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882, on the date on which such possession was obtained.

(2) If any question arises under this section as to whether, and if so, to what extent, any activity constitutes, or any asset is being used, for scientific research, the Board shall refer the question to—

- (a) the Central Government, when such question relates to any activity under clauses (ii) and (iii) of sub-section (1) i.e. any scientific research, or any research in social science or statistical research carried on by a university, college or institution approved for this purpose, and its decision shall be final;
- (b) the prescribed authority, when such question relates to any activity other than the activity specified in clause (a) above whose decision shall be final.

(3) **Carry forward of deficiency** - Capital expenditure incurred on scientific research which cannot be absorbed by the business profits of the relevant previous year can be carried forward to the immediately succeeding previous year and shall be treated as the allowance for that year. In effect, this means that there is no time bar on the period of carry forward. It shall be accordingly allowable for that previous year.

(4) **No depreciation** - Section 35(2)(iv) clarifies that no depreciation will be admissible on any capital asset represented by expenditure which has been allowed as a deduction under section 35 whether in the year in which deduction under section 35 was allowed or in any other previous year.

(5) **Approval by Central Government** - The Central Government by notification in the Official Gazette will approve such research association, university, college or institution for the purpose of sections 35(1)(ii) and 35(1)(iii).

The research association, university or college or other institution referred to in section 35(1)(ii) or (iii) shall make an application in the prescribed form and manner to the Central Government for the purpose of grant of approval or continuance thereof under these clauses.

The Central Government may call for such documents (including audited annual accounts) or information from the research association etc. in order to satisfy itself about the genuineness of the activities of the research association.

Notification issued by the Central Government under these clauses shall at any time have effect for not more than three assessment years (including an assessment year or years commencing before the date on which such notification is issued), as may be specified in the Notification. This time limit is applicable in respect of a notification issued by the Central Government under clause (ii) or clause (iii) before 13.7.2006. Consequently, any notification issued on or after 13.7.2006 shall remain in force until approval granted to such entity is withdrawn.

In respect of an application received on or after 13.7.2006, every notification under clause (ii) or clause (iii) shall be issued or an order rejecting the application shall be passed before expiry of 12 months from the end of the month in which the application for approval was received by the Central Government.

(6) **Application of section 41** - Section 41, *inter alia*, seeks to tax the profits arising on the sale of an asset representing expenditure of a capital nature on scientific research. Such an asset might be sold, discarded, demolished or destroyed, either after having been used for the purposes of business on the cessation of its use for the purpose of scientific research related to the business or without having been used for other purposes. In either case, tax liability could arise. In the first case, where the asset is sold, etc., after having been used for the purposes of the business, the moneys payable in respect of such asset together with the amount of scrap value, if any, could be brought to charge under section 41(1) the provisions of which are wide enough to cover such situations and to bring to tax that amount of deductions allowed in earlier years. It may be noted that in such cases, the actual cost of the concerned asset under section 43(1) read with explanation would be nil and no depreciation would be allowed by virtue of section 35(2)(iv).

Where the asset representing expenditure of a capital nature on Scientific Research is sold without having been used for other purposes, then the case would come under section 41(3) and if the proceeds of sale together with the total amount of the deductions made under section 35 exceed the amount of capital expenditure, the excess or the amount of deduction so made, whichever is less, will be charged to tax as income of the business of the previous year in which the sale took place.

(7) **Sum paid to National Laboratory, etc. [Section 35(2AA)]**- Sub-section (2AA) of section 35 provides that any sum paid by an assessee to a National Laboratory or University or Indian Institute of Technology or a specified person for carrying out programmes of scientific research approved by the prescribed authority will be eligible for weighted deduction of 200% of the amount so paid.

No contribution which qualifies for weighted deduction under this clause will be entitled to deduction under any other provision of the Act.

The authority which will approve the National Laboratory will also approve the programmes and procedure. Such programmes and procedure will be specified in rules.

The prescribed authority can call for each document or information as it considers necessary to satisfy itself about the genuineness of scientific research activities of the National Laboratory applying for approval. The prescribed authority under Rules 6(3) to (7) is Secretary, Department of Scientific & Industrial Research/Director General (Income-tax Exemptions).

It has been clarified that the deduction to which an assessee is entitled on account of payment of any sum by him to a National Laboratory, University, Indian Institute of Technology or a specified person for the approved programme [referred to in sub-section (2AA) of section 35] shall not be denied to the donor-assessee merely on the ground that after payment of such sum by him, the approval granted to any of the aforesaid done-entities has been withdrawn.

'National Laboratory' means a scientific laboratory functioning at the national level under the aegis of the Indian Council of Agricultural Research, Indian Council of Medical Research or the Council of Scientific and Industrial Research, the Defence Research and Development Organisation, the Department of Electronics, the Department of Bio-Technology, or the Department of Atomic Energy and which is approved as a National Laboratory by the prescribed authority in the prescribed manner. 'Specified person' means a person who is approved by the prescribed authority.

(8) **Company engaged in Business of Drugs, Electronic Equipments, etc.** [Section 35(2AB)] : Where 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 list of the Eleventh Schedule incurs any expenditure on scientific research on inhouse research and development facility as approved by the prescribed authority, a deduction of a sum equal to 200% of the expenditure will be allowed. Such expenditure should not be in the nature of cost of any land or building.

For this clause, "expenditure on scientific research" in relation to drugs and pharmaceuticals shall include expenditure incurred on clinical drug trial, obtaining approval from any state regulatory authority, and filing an application for a patent under the Patents Act, 1970.

No deduction will be allowed in respect of the above expenditure under any other provision of this Act.

No company will be entitled to this deduction unless it enters into an agreement with the prescribed authority for co-operation in such research and development facility and for audit of accounts maintained for that facility.

The prescribed authority shall submit its report in relation to the approval of the said facility to the Director General in such form and within such time as may be prescribed.

No deduction shall be allowed in respect of such expenditure incurred after 31-3-2017.

Illustration 6

A Ltd. furnishes the following particulars for the P.Y.2013-14. Compute the deduction allowable under section 35 for A.Y.2014-15, while computing its income under the head "Profits and gains of business or profession".

	Particulars	₹
1.	Amount paid to Indian Institute of Science, Bangalore, for scientific research	1,00,000
2.	Amount paid to IIT, Delhi for an approved scientific research programme	2,50,000
3.	Amount paid to X Ltd., a company registered in India which has as its main object scientific research and development, as is approved by the prescribed authority	4,00,000
4.	Expenditure incurred on in-house research and development facility as approved by the prescribed authority	
(a)	Revenue expenditure on scientific research	3,00,000
(b)	Capital expenditure (including cost of acquisition of land ₹ 5,00,000) on scientific research	7,50,000

Solution**Computation of deduction under section 35 for the A.Y.2014-15**

Particulars	₹	Section	% of weighted deduction	Amount of deduction (₹)
Payment for scientific research				
Indian Institute of Science	1,00,000	35(1)(ii)	175%	1,75,000
IIT, Delhi	2,50,000	35(2AA)	200%	5,00,000
X Ltd.	4,00,000	35(1)(iia)	125%	5,00,000
Expenditure incurred on in-house research and development facility				
Revenue expenditure	3,00,000	35(2AB)	200%	6,00,000
Capital expenditure (excluding cost of acquisition of land ₹ 5,00,000)	2,50,000	35(2AB)	200%	<u>5,00,000</u>
Deduction allowable under section 35				<u>22,75,000</u>

(ix) Expenditure for obtaining licence to operate telecommunication services [Section 35ABB] - (1) Where any capital expenditure has been incurred for acquiring any right to operate telecommunication services and for which payment has actually been made to obtain a licence, a deduction will be allowed in equal annual instalments over the relevant previous years.

“Relevant previous years” means—

- (a) in a case where the licence fee is actually paid before the commencement of the business to operate telecommunication services, the previous years beginning with the previous year in which such business commenced;

- (b) in any other case, the previous years beginning with the previous year in which the licence fee is actually paid, and the subsequent previous year or years during which the licence, for which the fee is paid, shall be in force.

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

- (2) Moreover, any capital expenditure so incurred before the actual commencement of the business shall also be eligible for deduction under sub-section (1).

(3) Where the licence is transferred and the proceeds of the transfer (so far as they consist of capital sums) are less than the expenditure incurred remaining unallowed, a deduction equal to such expenditure remaining unallowed, as reduced by the proceeds of the transfer, shall be allowed in respect of the previous year in which the licence is transferred.

(4) Where the whole or any part of the licence is transferred and the proceeds of the transfer (so far as they consist of capital sums) exceed the amount of the expenditure incurred remaining unallowed, so much of the excess as does not exceed the difference between the expenditure incurred to obtain the licence and the amount of such expenditure remaining unallowed shall be chargeable to income-tax as profits and gains of the business in the previous year in which the licence has been transferred.

Where the licence is transferred in a previous year in which the business is no longer in existence, the above provisions will apply as if the business is in existence in that previous year.

(5) Where the whole or any part of the licence is transferred and the proceeds of the transfer (so far as they consist of capital sums) are not less than the amount of expenditure incurred remaining unallowed, no deduction for such expenditure shall be allowed in respect of the previous year in which the licence is transferred or in any subsequent previous year.

(6) Where a part of the licence is transferred in a previous year, the proceeds of transfer will be subtracted from the expenditure remaining unallowed. Such remainder will be divided by the number of relevant previous years which have not expired at the beginning of the previous year during which the licence is transferred.

(7) Where in a scheme of amalgamation the amalgamating company sells or otherwise transfers the license to the amalgamated company being an Indian company, the above provisions with regard to the chargeability of the surplus will not apply to the amalgamating company. Further, the provisions will apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not transferred the license.

(8) The said provisions relating to transfer of license given in (iii), (iv) and (v) above shall not be applicable in the case of demerged company where the demerged company sells or transfers the license to the resulting company (being an Indian company) and the provisions of the section allowing deduction of expenditure incurred for obtaining the licence shall be applicable to the resulting company as it would have applied to demerged company.

(9) Where a deduction is claimed and allowed for any previous year under sub-section (1) of the section 35ABB, then, no deduction on the capital expenditure so incurred shall be allowed

by way of depreciation under sub-section (1) of section 32 in respect of acquiring any right to operate telecommunication services.

(x) **Promotion of social and economic welfare [Section 35AC]** – (1) Under this section, deduction will be allowed in computing profits of business or profession chargeable to tax, in respect of the expenditure incurred for an eligible project or scheme for promoting social and economic welfare or uplift of the public as may be specified by the Central Government on the recommendations of the “National Committee”. For this purpose, ‘National Committee’ will be the committee constituted by the Central Government from amongst persons of eminence in public life. Rules 11-F to 11-O deal with the National Committee for Promotion of Social and Economic Welfare and the guidelines for granting approval of associations and institutions and for recommending projects or schemes, for the purposes of this provision.

(2) The deduction will be allowed in case where the qualifying expenditure is either incurred by way of payment to a public sector company, a local authority or to an approved association or institution for carrying out any eligible project or scheme.

(3) However, companies will be allowed the deduction also in cases where expenditure is incurred by them directly on an eligible project or scheme.

(4) The claim for deduction under this section should be supported by a certificate obtained from the public sector company, local authority or approved association or institution as the case may be. Where the claim is in respect of expenditure directly incurred by a company on an eligible project or scheme, a certificate should be obtained from a Chartered Accountant.

(5) The deduction to which an assessee (i.e. the donor) is entitled on account of payment of any sum by him to a public sector company or a local authority or to an association or institution shall not be denied to the assessee merely on the ground that after payment of such sum by him, the approval granted to such association or institution has been withdrawn or the notification notifying the eligible project or scheme referred to in section 35AC has been withdrawn.

(6) The Committee can withdraw the approval to an association or institution if it is satisfied that the project or the scheme is not being carried on in accordance with all or any of the conditions subject to which approval was granted or if the association/institution has failed to furnish to the National Committee, after the end of each financial year, a progress report within the prescribed time in the prescribed form. The National Committee, should however, give a reasonable opportunity to the concerned association or institution of showing cause against the proposed withdrawal. Further, a copy of the order withdrawing the approval or notification should be forwarded to the Assessing Officer having jurisdiction over the concerned association or institution.

(7) Similarly, the Committee can withdraw a notification regarding an eligible project or scheme if it is satisfied that the project or the scheme is not being carried out in accordance with all or any of the conditions subject to which such project or scheme was notified or a report in respect of such eligible project or scheme has not been furnished after the end of each financial year, in the prescribed form within the prescribed time. The National Committee should however, give a reasonable opportunity of showing cause against the proposed withdrawal.

(8) Further, a copy of the notification by which the eligible project or scheme is withdrawn should be forwarded to the Assessing Officer having jurisdiction over the concerned association, institution, public sector company or local authority, as the case may be, carrying on such eligible project or scheme.

(i) Where the approval of the National Committee or the notification in respect of eligible project or scheme is withdrawn in case of a public sector company or local authority, etc; or

(ii) Where a company has claimed deduction in respect of any expenditure incurred directly on the eligible project or scheme and the approval for such project or scheme is withdrawn by the National Committee,

the total amount of payment received by the public sector company or the local authority, etc., as case may be, in respect of which it has furnished to certificate, or the deduction claimed by the company shall be deemed to be the income of such company/authority, etc. for previous year in which the approval or notification is withdrawn. Further, tax will be charged on such income at the maximum marginal rate in force.

(xi) “Investment-linked tax incentives” for specified businesses [Section 35AD]

(i) Although there are a plethora of tax incentives available under the Income-tax Act, 1961 they do not fulfill the intended purpose of creating infrastructure since these incentives are linked to profits and consequently have the effect of diverting profits from the taxable sector to the tax-free sector. Therefore, with the specific objective of creating rural infrastructure and environment friendly alternate means for transportation of bulk goods, investment-linked tax incentives have been introduced for specified businesses, namely–

- setting-up and operating ‘cold chain’ facilities for specified products;
- setting-up and operating warehousing facilities for storing agricultural produce;
- 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;
- building and operating a hotel of two-star or above category, anywhere in India;
- building and operating a hospital, anywhere in India, with at least 100 beds for patients;
- developing and building a housing project under a scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government, as the case may be, and notified by the CBDT in accordance with the prescribed guidelines.
- developing and building a housing project under a notified scheme for affordable housing framed by the Central Government or State Government;
- production of fertilizer in India;
- setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962;
- bee-keeping and production of honey and beeswax; and
- setting up and operating a warehousing facility for storage of sugar.

(ii) 100% of the capital expenditure incurred during the previous year, wholly and exclusively for the above businesses 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.

(iii) 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.

(iv) Weighted “investment-linked” tax deduction for certain specified businesses [Section 35AD(1A)]

The following “specified businesses” would be eligible for weighted deduction@150% of the capital expenditure (including capital expenditure incurred before commencement of operations and capitalized in the books of account on the date of commencement of operations) under section 35AD(1A), if they commence operations on or after 1st April, 2012 –

- (1) setting up and operating a cold chain facility;
 - (2) setting up and operating a warehousing facility for storage of agricultural produce;
 - (3) building and operating, anywhere in India, a hospital with at least 100 beds for patients;
 - (4) developing and building a housing project under a scheme for affordable housing framed by the Central Government or a State Government. Such scheme should be notified by the CBDT in accordance with the prescribed guidelines; and
 - (5) production of fertilizer in India.
- (v) For claiming deduction (whether 100% or 150%) under section 35AD, the specified business should fulfill the following conditions -

- (1) it should not be set up by splitting up, or the reconstruction, of a business already in existence;
- (2) it should not be set up by the transfer to the specified business of machinery or plant previously used for any purpose;

In order to satisfy this condition, the total value of the plant or machinery so transferred should not exceed 20% of the value of the total plant or machinery used in the new business.

For the purpose of this condition, machinery or plant would not be regarded as previously used if it had been used outside India by any person other than the assessee provided the following conditions are satisfied:

- (a) such plant or machinery was not used in India at any time prior to the date of its installation by the assessee;
- (b) the plant or machinery was imported into India from a foreign country;

- (c) no deduction in respect of depreciation of such plant or machinery has been allowed to any person at any time prior to the date of installation by the assessee.
 - (3) In respect of the business of laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network, such business,—
 - (a) should be owned by a company formed and registered in India under the Companies Act, 1956 or by a consortium of such companies or by an authority or a board or a corporation established or constituted under any Central or State Act;
 - (b) should have been approved by the Petroleum and Natural Gas Regulatory Board and notified by the Central Government in the Official Gazette.
 - (c) should have made not less than such proportion of its total pipeline capacity available for use on common carrier basis by any person other than the assessee or an associated person. The common carrier capacity condition prescribed by the regulations of the Petroleum & Natural Gas Regulatory Board is –
 - (1) “one-third” for natural gas pipeline network; and
 - (2) “one-fourth” for petroleum product pipeline network.
 - (d) should fulfill any other prescribed condition.
 - (vi) where a deduction under this section is claimed and allowed in respect of the specified business for any assessment year, no deduction under the provisions of Chapter VI-A under the heading “C.-Deductions in respect of certain incomes” is permissible in relation to such specified business for the same or any other assessment year.
- Correspondingly, section 80A has been amended to provide that where a deduction under any provision of this Chapter under the heading “C – Deductions in respect of certain incomes” is claimed and allowed in respect of the profits of such specified business for any assessment year, no deduction under section 35AD is permissible in relation to such specified business for the same or any other assessment year.
- In short, once the assessee has claimed the benefit of deduction under section 35AD for a particular year in respect of a specified business, he cannot claim benefit under Chapter VI-A under the heading “C.-Deductions in respect of certain incomes” for the same or any other year and vice versa.
- (vii) The assessee cannot claim deduction in respect of such expenditure incurred for specified business under any other provision of the Income-tax Act, 1961 in the current year or under this section for any other year.
 - (viii) The benefit will be available –
 - (a) 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;
 - (b) in a case where the business relates to setting and operating “cold-chain” facilities

- for specified products or warehousing facilities for storing agricultural produce, if such business commences its operation on or after 1st April, 2009;
- (c) in the case of the business of affordable housing projects and production of fertilizer in a new plant or in a newly installed capacity in an existing plant, if such business commences operation on or after 1st April, 2011;
- (d) in the case of business of setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962, bee-keeping and production of honey and beeswax and setting up and operating a warehousing facility for storage of sugar, if such business commences operation on or after 1st April, 2012;
- (e) in any other case, if such business commences its operation on or after 1st April, 2010.

Consequently, profit-linked deduction provided under section 80-IA to the business of laying and operating a cross country natural gas distribution network has been discontinued. As a result, any person availing of this incentive can now avail of the benefit under section 35AD.

Illustration 7

Mr. A commenced operations of the businesses of setting up a warehousing facility for storage of food grains, sugar and edible oil on 1.4.2013. He incurred capital expenditure of ₹ 80 lakh, ₹ 60 lakh and ₹ 50 lakh, respectively, on purchase of land and building during the period January, 2013 to March, 2013 exclusively for the above businesses, and capitalized the same in its books of account as on 1st April, 2013. The cost of land included in the above figures are ₹ 50 lakh, ₹ 40 lakh and ₹ 30 lakh, respectively. Further, during the P.Y.2013-14, it incurred capital expenditure of ₹ 20 lakh, ₹ 15 lakh & ₹ 10 lakh, respectively, for extension/reconstruction of the building purchased and used exclusively for the above businesses. Compute the income under the head "Profits and gains of business or profession" for the A.Y.2014-15 and the loss to be carried forward, assuming that Mr. A has fulfilled all the conditions specified for claim of deduction under section 35AD and has not claimed any deduction under Chapter VI-A under the heading "C. – Deductions in respect of certain incomes". The profits from the business of setting up a warehousing facility (before claiming deduction under section 35AD and section 32) for the A.Y. 2014-15 is ₹ 16 lakhs, ₹ 14 lakhs and ₹ 31 lakhs, respectively.

Answer

Computation of profits and gains of business or profession for A.Y.2014-15

Particulars	₹ (in lakhs)
Profit from business of setting up of warehouse for storage of edible oil (before providing for depreciation under section 32)	31
Less: Depreciation under section 32	

10% of ₹ 30 lakh, being (₹ 50 lakh – ₹ 30 lakh + ₹ 10 lakh)	<u>3</u>
Income chargeable under “Profits and gains from business or profession”	<u>28</u>

Computation of income/loss from specified business under section 35AD

	Particulars	Food Grains	Sugar	Total
		₹ (in lakhs)		
(A)	Profits from the specified business of setting up a warehousing facility (before providing deduction under section 35AD)	16	14	30
	Less: Deduction under section 35AD			
(B)	Capital expenditure incurred prior to 1.4.2013 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2013 (excluding the expenditure incurred on acquisition of land) = ₹ 30 lakh (₹ 80 lakh – ₹ 50 lakh) and ₹ 20 lakh (₹ 60 lakh – ₹ 40 lakh)	30	20	50
(C)	Capital expenditure incurred during the P.Y.2013-14	20	15	35
(D)	Total capital expenditure (B + C)	50	35	85
(E)	Deduction under section 35AD			
	150% of capital expenditure (food grains)	75		
	100% of capital expenditure (sugar)		35	
	Total deduction u/s 35AD for A.Y.2014-15	75	35	110
(F)	Loss from the specified business of setting up and operating a warehousing facility (after providing for deduction under section 35AD) to be carried forward as per section 73A (A-E)	(59)	(21)	(80)

Notes:

- (1) Weighted deduction@150% of the capital expenditure is available under section 35AD for A.Y.2014-15 in respect of specified business of setting up and operating a warehousing facility for storage of agricultural produce which commences operation on or after 01.04.2012. Food grains constitute agricultural produce and therefore, the capital expenditure incurred for setting up a warehousing facility for storage of food grains is eligible for weighted deduction@150% under section 35AD.

- (2) Deduction of 100% of the capital expenditure is available under section 35AD for A.Y.2014-15 in respect of specified business of setting up and operating a warehousing facility for storage of sugar, where operations are commenced on or after 01.04.2012.
- (3) However, since setting up and operating a warehousing facility for storage of edible oils is not a specified business, Mr. A is not eligible for deduction under section 35AD in respect of capital expenditure incurred in respect of such business.
- (4) Mr. A can, however, claim depreciation@10% under section 32 in respect of the capital expenditure incurred on buildings. It is presumed that the buildings were put to use for more than 180 days during the P.Y.2013-14.
- (5) Loss from a specified business can be set-off only against profits from another specified business. Therefore, the loss of ₹ 80 lakh from the specified businesses of setting up and operating a warehousing facility for storage of food grains and sugar cannot be set-off against the profits of ₹ 28 lakh from the business of setting and operating a warehousing facility for storage of edible oils, since the same is not a specified business. Such loss can, however, be carried forward indefinitely for set-off against profits of the same or any other specified business.
- (ix) "Cold chain facility" means a chain of facilities for storage or transportation of agricultural and forest produce, meat and meat products, poultry, marine and dairy products, products of horticulture, floriculture and apiculture and processed food items under scientifically controlled conditions including refrigeration and other facilities necessary for the preservation of such produce.

An "associated person" in relation to the assessee means a person—

- (1) who participates directly or indirectly or through one or more intermediaries in the management or control or capital of the assessee;
- (2) who holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the capital of the assessee;
- (3) who appoints more than half of the Board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of the assessee; or
- (4) who guarantees not less than 10% of the total borrowings of the assessee.
- (x) In respect of the business of hotels and hospitals, the word "new" has been removed from the definition of "specified business". Therefore, "specified business" means the business of building and operating, anywhere in India, -
 - (1) a hotel of two-star or above category as classified by the Central Government;
 - (2) a hospital with at least one hundred beds for patients.

Consequently, 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.

Illustration 8

XYZ Ltd. commenced operations of the business of a new three-star hotel in Madurai, Tamil Nadu on 1.4.2013. The company incurred capital expenditure of ₹ 50 lakh during the period January, 2013 to March, 2013 exclusively for the above business, and capitalized the same in its books of account as on 1st April, 2013. Further, during the P.Y.2013-14, it incurred capital expenditure of ₹ 2 crore (out of which ₹ 1.50 crore was for acquisition of land) exclusively for the above business. Compute the income under the head "Profits and gains of business or profession" for the A.Y.2014-15, assuming that XYZ Ltd. has fulfilled all the conditions specified for claim of deduction under section 35AD and has not claimed any deduction under Chapter VI-A under the heading "C. – Deductions in respect of certain incomes". The profits from the business of running this hotel (before claiming deduction under section 35AD) for the A.Y.2014-15 is ₹ 25 lakhs. Assume that the company also has another existing business of running a four-star hotel in Coimbatore, which commenced operations 5 years back, the profits from which are ₹ 120 lakhs for the A.Y.2014-15.

Solution

Particulars	₹
Profits from the specified business of new hotel in Madurai (before providing deduction under section 35AD)	25 lakh
Less: Deduction under section 35AD	
Capital expenditure incurred during the P.Y.2013-14 (excluding the expenditure incurred on acquisition of land) = ₹ 200 lakh – ₹ 150 lakh (See point no. (ii) above)	50 lakh
Capital expenditure incurred prior to 1.4.2013 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2013 (See point no. (iii) above)	<u>50 lakh</u>
Total deduction under section 35AD for A.Y.2014-15	<u>100 lakh</u>
Loss from the specified business of new hotel in Madurai	(75 lakh)
Profit from the existing business of running a hotel in Coimbatore	<u>120 lakh</u>
Net profit from business after set-off of loss of specified business against profits of another specified business under section 73A	<u>45 lakh</u>

(xi) Where the assessee builds a hotel of two-star or above category as classified by the Central Government and subsequently, while continuing to own the hotel, transfers the operation of the said hotel to another person, the assessee shall be deemed to be carrying on

the specified business of building and operating a hotel. Therefore, he would be eligible to claim investment-linked tax deduction under section 35AD.

Therefore, in effect, the assessee shall be deemed to be carrying on the specified business of building and operating hotel if –

- (1) The assessee builds a hotel of two-star or above category;
- (2) Thereafter, he transfers the operation of the hotel to another person;
- (3) He, however, should continue to own the hotel.

(xii) Where any goods or services held for the purposes of the specified business are transferred to any other business carried on by the assessee, or vice versa, and if the consideration for such transfer does not correspond with the market value of the goods or services then the profits and gains of the specified business shall be computed as if the transfer was made at market value.

For the above purpose, “market value” means the price such goods or services would ordinarily fetch in the open market, subject to statutory or regulatory restrictions, if any.

(xiii) The deduction shall be allowed to the assessee only if the accounts of the assessee for the relevant previous year have been audited by a chartered accountant and the assessee furnishes the audit report in the prescribed form, duly signed and verified by such accountant along with his return of income.

(xiv) Where it appears to the Assessing Officer that the assessee derives more than ordinary profits from the specified business due to close connection between the assessee and any other person, or due to any other reason, the Assessing Officer may consider such profits as may be reasonably deemed to have been derived from the specified business for the purpose of computing deduction under this section.

(xii) **Contributions for Rural Development [Section 35CCA]:** This section allows a deduction of the following expenditure incurred by the assessee during the previous year:

- (1) Payment to an association or institution, having the objective of undertaking programmes of rural development. Such payment must be used for carrying out any programme of rural development approved by the prescribed authority.

Conditions for allowance:

- (a) The assessee must furnish a certificate from such association (which should be authorised by the prescribed authority to issue such a certificate) that the programme of rural development had been approved by the prescribed authority before 1-3-1983 and
 - (b) Where such payment is made after 28-2-1983, the programme should involve work by way of (i) construction of any building, or other structure (to be used for dispensary, school, training or welfare centre, workshop, etc.) or (ii) the laying of any road or (iii) the construction or boring of a well or tube well or (iv) the installation of any plant or machinery and such work must have commenced before 1-3-1983.
- (2) Payment to an association or institution having as its object the training of persons for implementing rural development programme.

Conditions:

- (a) Assessee must furnish a certificate from such association (which should be authorised by the prescribed authority to issue such a certificate) that it has been approved by the prescribed authority before 1-3-1983.
- (b) Such training of persons must have started before 1-3-1983.

The deduction to which an assessee is entitled on account of payment of any sum by him to an association or institution for carrying out the programme of rural development shall not be denied to the assessee merely on the ground that after payment of such sum by him, the approval granted to such programme or, as the case may be, to the association or institution has been withdrawn.

- (3) Payment to a rural development fund set up and notified by the Central Government.

The expression 'programme of rural development' for this purpose have the same meaning as has been assigned to it under Explanation to section 35CC(i).

- (4) Payments made to "National Urban Poverty Eradication Fund" (NUPEF) set up and notified by the Central Government.

It has been specifically provided that in every case where any deduction in respect of contribution for rural development is claimed by the assessee and allowed to him for any assessment year in respect of any expenditure incurred by way of payment of contribution to the approved association or institution, no deduction in respect of the same expenditure can again be claimed by the assessee under any other relevant provision.

(xiii) Weighted deduction in respect of expenditure incurred on notified agricultural extension project [Section 35CCC]

- (1) In order to incentivize the business entities to provide better and effective agriculture extensive services, section 35CCC provides a weighted deduction of a sum equal to 150% of expenditure incurred by an assessee on agricultural extension project in accordance with the prescribed guidelines.
- (2) The agricultural extension project eligible for this weighted deduction shall be notified by the Board.
- (3) In case deduction in respect of such expenditure is allowed under this section then, no deduction in respect of such expenditure shall be allowed under any other provisions of the Act in the same or any other assessment year.

(xiv) Weighted deduction in respect of expenditure incurred by companies on notified skill development project [Section 35CCD]

- (1) The National Manufacturing Policy (NMP) has been notified by the Department of Industrial Policy & Promotion (DIPP) vide Press Note dated 4th November, 2011. As per the notified NMP, the government will provide weighted standard deduction of 150% of the expenditure (other than land or building) incurred on Public Private Partnership (PPP) project for skill development in the ITIs in manufacturing sector. This is to encourage

private sector to set up their own institution in coordination with National Skill Development Corporation.

- (2) In order to encourage companies to invest on skill development projects in the manufacturing sector, section 35CCD provides for a weighted deduction of a sum equal to 150% of the expenditure (not being expenditure in the nature of cost of any land or building) on skill development project incurred by the company in accordance with the prescribed guidelines.
- (3) The skill development project eligible for this weighted deduction shall be notified by the Board.
- (4) In case deduction in respect of such expenditure is allowed under this section then, no deduction of such expenditure shall be allowed under any other provisions of the Act in the same or any other assessment year.

(xv) **Amortisation of Preliminary Expenses [Section 35D]**– (1) Section 35D provides for the amortisation of preliminary expenses incurred by Indian companies and other resident non-corporate taxpayers for the establishment of business concerns or the expansion of the business of existing concerns.

(2) This section applies (a) only to Indian companies and resident non-corporate assessees; (b) in the case of new companies to expenses incurred before the commencement of the business; (c) in the case of extension of an existing undertaking to expenses incurred till the extension is completed, i.e., in the case of the setting up of a new unit - to expenses incurred till the new unit commences production or operation.

(3) Such preliminary expenditure incurred shall be amortised over a period of 5 years. In other words, 1/5th of such expenditure is allowable as a deduction for each of the five successive previous years beginning with the previous year in which the business commences or, the previous year in which the extension of the undertaking is completed or the new unit commences production or operation, as the case may be.

(4) **Eligible expenses** - The following expenditure are eligible for amortisation:

(i) Expenditure in connection with - (a) the preparation of feasibility report (b) the preparation of project report; (c) conducting market survey or any other survey necessary for the business of the assessee; (d) engineering services relating to the assessee's business; (e) 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.

(ii) Where the assessee is a company, in addition to the above, expenditure incurred - (f) by way of legal charges for drafting the Memorandum and Articles of Association of the company; (g) on printing the Memorandum and Articles of Association; (h) by way of fees for registering the company under the Companies Act, 1956, (i) 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

(iii) Such other items of expenditure (not being expenditure qualifying for any allowance or deduction under any other provision of the Act) as may be prescribed by the Board for the

purpose of amortisation. However, the Board, so far, has not prescribed any specific item of expense as qualifying for amortisation under this clause.

In the case of expenditure specified in items (a) to (e) 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.

(5) **Overall Limits** - The maximum aggregate amount of the qualifying expenses that can be amortised has been fixed at 5% of the cost of the project or in the case of an Indian company, or, at the option of the company, 5% of the capital employed in the business of the company, whichever is higher. The excess, if any, of the qualifying expenses shall be ignored.

The assessee is entitled to a deduction of an amount equal to one-fifth of the qualifying amount of the expenditure for each of the five successive accounting years beginning with the year in which the business commences, or as the case may be, the previous year in which the business commences or as the case may be, the previous year in which extension of the undertaking is completed or the new unit commences production or operation.

(6) For purpose of amortisation, the expression, 'cost of the project' means -

(i) In the case of expenses incurred before the commencement of business the actual cost of the fixed assets, being land, buildings, leaseholds, plant, machinery, furniture, fittings, railway sidings (including expenditure on the development of land, buildings) which are shown in the books of the assessee as on the last day of the previous year in which the business of the assessee commences;

(ii) in case of extension of the business or setting up of a new unit, the cost of the fixed assets being land, buildings, leaseholds, plant, machinery, furniture, fittings, and railway sidings (including expenditure on the development of land and buildings) which are shown in the books of the assessee as on the last day of the previous year in which the extension of the undertaking is completed or, as the case may be, the new unit commences production or operation, insofar as such assets have been acquired or developed in connection with the extension of the undertaking or the setting up of the new unit.

(7) The expression "capital employed in the business of the company" means -

(i) in the case of new company, the aggregate of the issued share capital, debentures and long-term borrowings as on the last day of the previous year in which the business of the company commences;

(ii) in the case of extension of the business or the setting up of a new unit, the aggregate of the issued share capital, debentures, and long-term borrowings as on the last day of the accounting year in which the extension of the undertaking is completed or, as the case may be, the unit commences production or operation insofar as such capital, debentures and long-term borrowings have been issued or obtained in connection with the extension of the undertaking or the setting up of the new undertaking or the setting up of the new unit of the company.

(8) The expression "long-term borrowing," mentioned above, means any moneys borrowed in

India by the company from the Government or the Industrial Finance Corporation of India or the Industrial Credit and Investment Corporation of India or any other financial institution eligible for deduction under section 36(1)(iii) or any banking institution, or any moneys borrowed or debt incurred by it in a foreign country in respect of the purchase outside India of plant and machinery where the terms under which such moneys are borrowed or the debt is incurred provide for the repayment thereof during a period of not less than seven years.

(9) In cases where the assessee is a person other than a company or a co-operative society, the deduction would be allowable only if the accounts of the assessee for the year or years in which the expenditure is incurred have been audited by a Chartered Accountant and the assessee furnishes, along with his return of income for the first year in respect of which the deduction is claimed, the report of such audit in the prescribed form duly signed and verified by the auditor and setting forth such other particulars as may be prescribed.

(10) **Special provisions for amalgamation and demerger-** Where the undertaking of an Indian company is transferred, before the expiry of the period of ten years, to another Indian company under a scheme of amalgamation as defined in section 2(IA) the aforesaid provisions will apply to the amalgamated company as if the amalgamation had not taken place. But no deduction will be admissible in the case of the amalgamating company for the previous year in which the amalgamation takes place.

Sub-section (5A) provides similar provisions for the scheme of demerger where the resulting company will be able to claim amortisation of preliminary expenses as if demerger had not taken place, and no deduction shall be allowed to the demerged company in the year of demerger.

It has been clarified that in case where a deduction under this section is claimed and allowed for any assessment year in respect of any item of expenditure, the expenditure in respect of which deduction is so allowed shall not qualify for deduction under any other provision of the Act for the same or any other assessment year.

(xvi) Amortisation of Expenses for Amalgamation/Demerger [Section 35DD]

(1) Where an assessee, being an Indian company, incurs expenditure on or after 1st April, 1999, wholly and exclusively for the purpose of amalgamation or demerger, the assessee shall be allowed a deduction equal to one-fifth of such expenditure for five successive previous years beginning with the previous year in which amalgamation or demerger takes place.

(2) No deduction shall be allowed in respect of the above expenditure under any other provisions of the Act.

(xvii) Amortisation of expenditure incurred under voluntary retirement scheme [Section 35DDA]- (1) This section applies to an assessee who has incurred expenditure in any previous year in the form of payment to any employee in connection with his voluntary retirement, in accordance with any scheme or schemes of voluntary retirement.

(2) The amount of deduction allowable is one-fifth of the amount paid for that previous year, and the balance in four equal installments in the four immediately succeeding previous years.

(3) In case of amalgamation, demerger, reorganisation or succession of business during the intervening period of the said 5 years, the benefit of deduction will be available to the "new

company” for the balance period including the year in which such amalgamation/demerger/reorganisation or succession takes place.

(4) This will be applicable in the following situations:

- (i) where an Indian company is transferred to another Indian company in a scheme of amalgamation;
- (ii) where the undertaking of an Indian company is transferred to another company in a scheme of demerger;
- (iii) where due to a re-organisation of business, a firm is succeeded by a company fulfilling the conditions in section 47(xiii) or a proprietary concern is succeeded by a company fulfilling the conditions in section 47(xiv);
- (iv) where a company has converted into a LLP fulfilling the conditions laid down in section 47(xiiib).

(5) In the above cases, the deduction shall be available to the successor company as such deduction would have applied to the original entity if such transfer had not taken place at all.

(6) It is further provided that no deduction shall be available to the original entity being the amalgamating company, or the demerged company or the firm or proprietary concern (as the case may be) for the previous year in which the amalgamation, demerger or succession takes place.

(7) No deduction shall be allowed in respect of the above expenditure under any other provision of the Act.

(xviii) Amortisation of expenses for prospecting and development of certain minerals [Section 35E] – (1) This provision applies only to expenditure incurred by an Indian company or any other person who is resident in India. Thus, foreign companies or foreign concerns and non-resident assesseees are not entitled for the benefits of deduction under section 35E. In order to qualify for amortisation, the assessee should be engaged in any operations relating to prospecting for or the extraction or production of any mineral.

(2) Eligible expenses - The nature and kind of expenditure qualifying for amortisation are -
 (i) It must have been incurred during the year of commercial production or any one or more of the four years immediately preceding that year, (ii) It must be an expenditure incurred wholly and exclusively on any operations relating to the prospecting for or extraction of certain minerals listed in the Seventh Schedule of the Income-tax Act, 1961.

(3) Expenditure not allowed for deduction - However, any portion of the expenditure which is met directly or indirectly by any other persons or authority and the sale, salvage, compensation or insurance moneys realised by the assessee in respect of any property or rights brought into existence as a result of the expenditure should be excluded from the amount of expenditure qualifying for amortisation. Further, specific provision has been made to the effect that the following items of expenses do not qualify for amortisation at all viz.:

- (i) Expenditure incurred on the acquisition of the site of the source of any minerals or group of associated minerals stated above or of any right in or over such site;

- (ii) Expenditure on the acquisition of the deposits of minerals or group of associated minerals referred to above or to any rights in or over such deposits; or
- (iii) Expenditure of a capital nature in respect of any building, machinery, plant or furniture for which depreciation allowance is permissible under section 32.

(4) **Amount of deduction** - The assessee will be allowed for each of ten relevant previous years, a deduction of an amount equal to one-tenth of the aggregate amount of the qualifying expenditure. Thus, the deduction to be allowed for any relevant previous year is (i) one-tenth of the expenditure or (ii) such amount as will reduce to nil the income of the previous year arising from the commercial exploration of any minerals or other natural deposit of the mineral or minerals in a group of associated minerals in respect of which the expenditure was incurred, whichever figure is less. The amount of the deduction admissible in respect of any relevant previous year to the extent to which it remains unallowed, shall be carried forward and added to the installment relating to the previous year next following and shall be deemed to be a part of the installment and so on, for ten previous years beginning from the year of commercial production.

(5) For purposes of this amortisation, the expression "operation relating to prospecting" means any operation undertaken for the purpose of exploiting, locating or proving deposits of any minerals and includes any such operation which proves to be infructuous or abortive. The expression 'year of commercial production' means the previous year in which as a result of any operation relating to prospecting or commercial production of any material or one or more of the minerals in a group of associated minerals specified in Part A or Part B, respectively, of the Seventh Schedule to Act actually commences. The relevant previous year in which the deduction would be allowed to the assessee are those ten previous years beginning with the year of commercial production.

(6) In the case of amalgamation, such deduction would continue to be admissible to the amalgamated company as if the amalgamation had not taken place.

Sub-section (7A) provides for similar provisions in cases of demerger where such deduction can be availed of by the resulting company as if the demerger had not taken place.

Further, no deduction will be admissible to the amalgamating/demerged company in the year of amalgamation/demergers.

(7) Where a deduction is claimed and allowed on account of amortisation of the expenses under section 35E in any year in respect of any expenditure, the expenditure in respect of which deduction is so allowed shall not again qualify for deduction from the profits and gains under any other provisions of the Act for the same or any other assessment year. The provisions with regard to audit of accounts relating to the qualifying expenditure are similar to those applicable for amortisation of preliminary expenses discussed earlier.

(xix) **Other Deductions [Section 36]** - This section authorises deduction of certain specific expenses. The items of expenditure and the conditions under which such expenditures are deductible are:

(1) **Insurance premia paid [Section 36(1)(i)]** - If insurance policy has been taken out against risk, damage or destruction of the stock or stores of the business or profession, the

premium paid is deductible. But the premium in respect of any insurance undertaken for any other purpose is not allowable under the clause.

(2) **Insurance premia paid by a Federal Milk Co-operative Society [Section 36(1)(ia)]** - Deduction is allowed in respect of the amount of premium paid by a Federal Milk Co-operative Society to effect or to keep in force an insurance on the life of the cattle owned by a member of a co-operative society being a primary society engaged in supply of milk raised by its members to such Federal Milk Co-operative Society. The deduction is admissible without any monetary or other limits.

(3) **Premia paid by employer for health insurance of employees [Section 36(1)(ib)]** - This clause seeks to allow a deduction to an employer in respect of premia paid by him by any mode of payment other than cash to effect or to keep in force an insurance on the health of his employees in accordance with a scheme framed by (i) the General Insurance Corporation of India and approved by the Central Government; or (ii) any other insurer and approved by the IRDA.

(4) **Bonus and Commission [Section 36(1)(ii)]** - These are deductible in full provided the sum paid to the employees as bonus or commission shall not be payable to them as profits or dividends if it had not been paid as bonus or commission. It is a provision intended to safeguard against a private company or an association escaping tax by distributing a part of its profits by way of bonus amongst the members, or employees of their own concern instead of distributing the money as dividends or profits.

(5) **Interest on borrowed capital [Section 36(1)(iii)]** - In the case of genuine business borrowings, the department cannot disallow any part of the interest on the ground that the rate of interest is unreasonably high except in cases falling under section 40A.

Under section 36(1), deduction of interest is allowed in respect of capital borrowed for the purposes of business or profession in the computation of income under the head "Profits and gains of business or profession".

Capital may be borrowed for several purposes like for acquiring a capital asset, or to pay off a trading debt or loss etc. The scope of the expression 'for the purposes of business' is very wide. Capital may be borrowed in the course of the existing business as well as for acquiring assets for extension of existing business. *Explanation 8* to section 43(1) clarifies that interest relating to a period after the asset is first put to use cannot be capitalised. Interest in respect of capital borrowed for any period from the date of borrowing to the date on which the asset was first put to use should normally be capitalised. However, there was scope for the assessee to claim it as a revenue expenditure.

It has now been provided that no such deduction shall be allowed in respect of any amount of interest paid, in respect of capital borrowed for acquisition of new asset for extension of existing business or profession (whether capitalised in the books of account or not) for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use. It is significant to note here that even after the amendment the scope for claiming such interest as revenue expenditure in respect of existing business still exists.

(6) **Discount on Zero Coupon Bonds(ZCBs) [Section 36(1)(iiia)]** - Section 36(1)(iiia) provides deduction for the discount on ZCB on pro rata basis having regard to the period of

life of the bond to be calculated in the manner prescribed. The Explanation seeks to provide the meaning of the expression 'discount' as a difference of the amount received or receivable by an infrastructure capital company/infrastructure capital fund/public sector company/scheduled bank on issue of the bond and the amount payable by such company or fund or bank on maturity or redemption of the bond. The expression 'period of life of the bond' has been defined to mean the period commencing from the date of issue of the bond and ending on the date of the maturity or redemption.

For definitions of "infrastructure capital company" and "infrastructure capital fund", refer sections 2(26A) and 2(26B) in Chapter 1 of this study material – Basic Concepts.

(7) Contributions to provident and other funds [Section 36(1)(iv) and (v)] - Contribution to the employees' provident and other funds are allowable subject to the following conditions:

- (a) The fund should be settled upon a trust.
- (b) In case of Provident or a superannuation or a Gratuity Fund, it should be one recognised or approved under the Fourth Schedule to the Income-tax Act, 1961.
- (c) The amount contributed should be periodic payment and not an adhoc payment to start the fund.
- (d) The fund should be for exclusive benefit of the employees.

The nature of the benefit available to the employees from the fund is not material; it may be pension, gratuity or provident fund.

(8) Employer's contribution to the account of the employee under a Pension Scheme referred to in section 80CCD [Section 36(1)(iva)]

- (i) Section 36(1)(iva) 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).

Illustration 9

X Ltd. contributes 20% of basic salary to the account of each employee under a pension scheme referred to in section 80CCD. Dearness Allowance is 40% of basic salary and it forms part of pay of the employees. Compute the amount of deduction allowable under section 36(1)(iva), if the basic salary of the employees aggregate to ₹ 10 lakh. Would disallowance under section 40A(9) be attracted, and if so, to what extent?

Solution

Computation of deduction allowable under section 36(1)(iva) and disallowance under section 40A(9)

Particulars	₹
Basic Salary	10,00,000
Dearness Allowance@40% of basic salary [DA forms part of pay]	<u>4,00,000</u>
Salary for the purpose of section 36(1)(iva) (Basic Salary + DA)	<u>14,00,000</u>
Actual contribution (20% of basic salary i.e., 20% of ₹ 10 lakh)	2,00,000
Less: Permissible deduction under section 36(1)(iva) (10% of basic salary plus dearness pay = 10% of ₹ 14,00,000 = ₹ 1,40,000)	<u>1,40,000</u>
Excess contribution disallowed under section 40A(9)	<u>60,000</u>

(9) Amount received by assessee as contribution from his employees towards their welfare fund to be allowed only if such amount is credited on or before due date - Clause (va) of section 36(1) and clause (ia) of section 57 provide that deduction in respect of any sum received by the taxpayer as contribution from his employees towards any welfare fund of such employees will be allowed only if such sum is credited by the taxpayer to the employee's account in the relevant fund on or before the due date. For the purposes of this section, "due date" will mean the date by which the assessee is required as an employer to credit such contribution to the employee's account in the relevant fund under the provisions of any law on term of contract of service or otherwise.

As per the Employees Provident Funds Scheme, 1952, the amounts under consideration in respect of wages of the employees for any particular month shall be paid within 15 days of the close of every month. A further grace period of 5 days is allowed.

(10) Allowance for animals [Section 36(1)(vi)] - This clause grants an allowance in respect of animals which have died or become permanently useless. The amount of the allowance is the difference between the actual cost of the animals and the price realised on the sale of the animals themselves or their carcasses. The allowance under the clause would thus recoup to the assessee the entire capital expenditure in respect of animal.

(11) Bad debts [Section 36(1)(vii) and section 36(2)] - These can be deducted subject to the following conditions:

- The debts or loans should be in respect of a business which was carried on by the assessee during the relevant previous year.
- The debt should have been taken into account in computing the income of the assessee of the previous year in which such debt is written off or of an earlier previous year or should represent money lent by the assessee in the ordinary course of his business of banking or money lending.

Deduction under section 36(1)(vii) for bad debts limited to the amount by which bad debts exceed credit balance in the provision for doubtful debts account under section 36(1)(viia)

Under section 36(1)(vii), bad debt actually written off as irrecoverable in the books of account of the

assessee is deductible. However, in the case of entities for which provision for bad and doubtful debts is allowable under section 36(1)(viia), deduction for bad debts written off under said clause (vii) shall be limited to the amount by which the bad debt written off exceeds the credit balance in the provision for bad and doubtful debts account made under section 36(1)(viia). This is provided in the proviso to section 36(1)(vii).

Further, the provisions of section 36(1)(vii) are subject to the provisions of section 36(2). Section 36(2)(v) provides that where the debt or part thereof relates to advances made by an assessee, to which section 36(1)(viia) applies, no deduction shall be allowed unless the assessee has debited the amount of such debt or part of such debt in that previous year to the provision for bad and doubtful debts account made under section 36(1)(viia).

Explanation 2 to section 36(1)(vii) states that for the purposes of the proviso to section 36(1)(vii) and section 36(2)(v), only one account as referred to therein shall be made in respect of provision for bad and doubtful debts under section 36(1)(viia) and such account shall relate to all types of advances, including advances made by rural branches.

Therefore, in the case of an assessee to which section 36(1)(viia) applies, the amount of deduction in respect of the bad debts actually written off under section 36(1)(vii) shall be limited to the amount by which such bad debts exceeds the credit balance in the provision for bad and doubtful debts account made under section 36(1)(viia) without any distinction between rural advances and other advances.

Illustration 10

The following are the particulars in respect of a scheduled bank incorporated in India -

	Particulars	₹ in lakh
(i)	Provision for bad and doubtful debts under section 36(1)(viia) upto A.Y.2013-14	100
(ii)	Gross Total Income of A.Y.2014-15 [before deduction under section 36(1)(viia)]	800
(iii)	Aggregate average advances made by rural branches of the bank	300
(iv)	Bad debts written off (for the first time) in the books of account (in respect of urban advances only) during the previous year 2013-14	210

Compute the deduction allowable under section 36(1)(vii) for the A.Y.2014-15.

Solution

Particulars	₹ in lakh	
Bad debts written off (for the first time) in the books of account		210
Less: Credit balance in the "Provision for bad and doubtful debts" under section 36(1)(viia) as on 31.3.2014		
(i) Provision for bad and doubtful debts u/s 36(1)(viia) upto A.Y.2013-14	100	
(ii) Current year provision for bad and doubtful debts under section 36(1)(viia) [7.5% of ₹ 800 lakhs + 10% of ₹ 300 lakhs]	90	190
Deduction under section 36(1)(vii) in respect of bad debts written off for A.Y.2014-15		20

Deduction of differential amount of debts due as bad debts in the year of recovery, to the extent of deficiency in recovery

Further, if on the final settlement the amount recovered in respect of any debt, where deduction had already been allowed, falls short of the difference between the debt due and the amount of debt allowed, the deficiency can be claimed as a deduction from the income of the previous year in which the ultimate recovery out of the debt is made. It is permissible for the Assessing Officer to allow deduction in respect of a bad debt or any part thereof in the assessment of a particular year and subsequently to allow the balance of the amount, if any, in the year in which the ultimate recovery is made, that is to say, when the final result of the process of recovery comes to be known.

Recovery of a bad debt subsequently [Section 41(4)] - If a deduction has been allowed in respect of a bad debt under section 36, and subsequently the amount recovered in respect of such debt is more than the amount due after the allowance had been made, the excess shall be deemed to be the profits and gains of business or profession and will be chargeable as income of the previous year in which it is recovered, whether or not the business or profession in respect of which the deduction has been allowed is in existence at the time.

For example, let us assume that a debt of ₹ 10,000 was claimed as a bad debt in the previous year 2012-13. However, the Assessing Officer allowed only a sum of ₹ 5,000 as bad debt. If in the previous year 2013-14, a sum of ₹ 4,000 is recovered ultimately in respect of the debt, then the Assessing Officer should allow a deduction in respect of the deficiency namely, ₹ 1,000 i.e., the difference between the amount ultimately recovered and the amount disallowed earlier under Section 36(1)(vii). If on the other hand, the sum ultimately recovered is ₹ 6,000 then there will be a liability, under section 41(4) in respect of sum of ₹ 1,000, which would be deemed to be the profits and gains of business or profession. Such a liability under section 41(4) would arise even if the business or profession in respect of which deduction has been allowed is not in existence at that time.

(12) Special provision for bad and doubtful debts in cases of Rural Branches of Scheduled Banks [Section 36(1)(viii)]

- (a) In the case of a scheduled bank which is not a bank incorporated by or under the laws of a country outside India or a non-scheduled bank, the following deductions will be allowed:
- (i) an amount not exceeding 7.5% of the total income (computed before making any deduction under this clause and Chapter VI-A), and
 - (ii) an amount not exceeding 10% of the aggregate average advances made by the rural branches of such bank computed in the manner prescribed by the CBDT.
- (b) A scheduled bank or a non-scheduled bank referred to in (a) above or a co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank shall, at its option, be allowed a further deduction in excess of the limits specified in the foregoing provisions, for an amount not exceeding the income derived from redemption of securities in accordance with a scheme framed by the Central Government. It is also provided that this deduction shall not be allowed unless such income has been disclosed in the return of income under the head "Profits and gains of business or profession".

Scheduled Bank: It refers to the State Bank of India or any of its subsidiaries or any of the nationalised banks and would also include any other bank which is listed in the Second Schedule to the Reserve Bank of India Act, 1935.

Non-Scheduled Bank: This refers to a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 which is not a scheduled bank.

Rural branch: This means a branch of a scheduled bank or a non-scheduled bank situated in a place which has a population of not more than 10,000 according to the last preceding census of which the relevant figures have been published before the first day of the previous year.

(c) **Foreign Banks:** In the case of foreign banks the deduction will be an amount not exceeding 5% of the total income (computed before making any deduction under this clause and Chapter VI-A).

(d) A public financial institution, a State Financial Corporation and a State Industrial Investment Corporation will be entitled to a deduction in respect of provision for bad and doubtful debts made out of profits. The maximum amount to be allowed as a deduction will be limited to 5% of its total income before making any deduction in respect of the provision for bad and doubtful debt or in respect of any deduction in Chapter VI-A.

"Public Financial Institution" shall have the meaning assigned to it in section 4A of the Companies Act, 1956².

"State Financial Corporation" means a financial corporation established under section 3 or section 3A or an institution notified under section 46 of the State Financial Corporations Act, 1951.

"State Industrial Investment Corporation" means a Government company within the meaning of Section 617 of the Companies Act, 1956 engaged in the business of providing long-term finance for industrial projects and eligible for deduction under clause (viii) of this sub-section.

Co-operative bank, primary agricultural credit society and primary co-operative agricultural and rural development bank have the same meanings assigned in *Explanation* to section 80P(4).

(13) Special deduction to Specified Entities engaged in eligible business [Section 36(1)(viii)]

(a) This section provides deduction in respect of any special reserve created and maintained by a specified entity.

(b) 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 such reserve account.

(c) The eligible business for different entities specified are given in the table below –

	Specified entity	Eligible business
1.	Financial Corporation specified in section 4A of the Companies Act, 1956	Business of providing long-term finance for -

² Section 2(72) of the Companies Act, 2013

	Financial corporation which is a public sector company Banking company Co-operative bank (other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank)	(i) industrial or agricultural development or (ii) development of infrastructure facility in India; or (iii) development of housing in India.
2.	A housing finance company	Business of providing long-term finance for the construction or purchase of houses in India for residential purposes.
3.	Any other financial corporation including a public company	Business of providing long-term finance for development of infrastructure facility in India.

(d) 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.

(e) Infrastructure facility has been defined to mean -

- (a) (1) an infrastructure facility as defined in the Explanation to clause (i) of sub-section (4) of section 80-IA i.e.
 - (i) a road including toll road, a bridge or a rail system;
 - (ii) a highway project including housing or other activities being an integral part of the highway project;
 - (iii) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system; and
 - (iv) a port, airport, inland waterway or inland port or a navigational channel in the sea
- (2) any other public facility of a similar nature as may be notified by the CBDT in this behalf in the Official Gazette and which fulfils the prescribed conditions;
- (b) an undertaking referred to in clause (ii) or clause (iii) or clause (iv) of sub-section (4) of section 80-IA (i.e. an undertaking providing telecommunication services, an undertaking developing, developing and operating, maintaining and operating an industrial park or SEZ notified by the Central Government, an undertaking generating, distributing or transmitting power); and
- (c) an undertaking referred to in sub-section (10) of section 80-IB i.e. an undertaking developing and building housing projects approved by a local authority.

Conditions to be fulfilled by a public facility to be eligible to be notified as an infrastructure facility [Notification No.187/2006 dated 20.7.2006]: Rule 6ABAA specifies the conditions to be fulfilled by a public facility to be eligible to be notified as an infrastructure facility in accordance with the provisions of clause (d) of the Explanation to clause (viii) of sub-section (1) of section 36. The conditions specified therein are -

- (a) it is owned by a company registered in India or by a consortium of such companies or by an authority or a board or a corporation or any other body established or constituted under any Central or State Act;
- (b) it has entered into an agreement with the Central Government or a State Government or a local authority or any other statutory body for (i) developing or (ii) operating and maintaining or (iii) developing, operating and maintaining a new infrastructure facility similar in nature to an infrastructure facility referred to in the *Explanation* to section 80-IA(4)(i);
- (c) it has started or starts operating and maintaining such infrastructure facility on or after 1st April, 1995.

Notification of public facilities as infrastructure facility for the purpose of section 36(1)(viii) [Notification No. 188/2006, dated 20.7.2006]

The following public facilities have been notified by the CBDT as infrastructure facility for purposes 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.

Deduction in respect of income from long-term finance for development of infrastructure facilities - The deduction will now be available also to approved financial corporations providing long-term finance for development of infrastructure facilities in India. For this purpose, the expression "infrastructure facility" shall have the meaning assigned to it in section 80-IA.

(14) **Expenses on family planning** [Section 36(1)(ix)] - Any expenditure of revenue nature bona fide incurred by a company for the purpose of promoting family planning amongst its

employees will be allowed as a deduction in computing the company's business income; where, the expenditure is of a capital nature, one-fifth of such expenditure will be deducted in the previous year in which it was incurred and in each of the four immediately succeeding previous years. This deduction is allowable only to companies and not to other assessees. The assessee would be entitled to carry forward and set off the unabsorbed part of the allowance in the same way as unabsorbed depreciation. The capital expenditure on promoting family planning will be treated in the same way as capital expenditure for scientific research for purposes of dealing with the profit or loss on the sale or transfer of the asset including a transfer on amalgamation.

(15) Deduction for expenditure incurred by entities established under any Central, State or Provincial Act [Section 36(1)(xii)]

Any expenditure (not being in the nature of capital expenditure) incurred by a corporation or a body corporate, by whatever name called, if –

- (a) it is constituted or established by a Central, State or Provincial Act;
- (b) such corporation or body corporate is notified by the Central Government in the Official Gazette for this purpose having regard to the objects and purposes of the Act;
- (c) the expenditure is incurred for the objects and purposes authorised by the Act under which it is constituted and established.

Accordingly, the Central Government has notified the Oil Industry Development Board for the purpose of deduction under section 36(1)(xii).

(16) Deduction in respect of banking cash transaction tax [Section 36(1)(xiii)]

- (a) The Finance Act, 2005 had, through Chapter VII, introduced a tax called banking cash transaction tax, as an anti tax-evasion measure, in respect of every taxable banking transaction entered into on or after 1.6.2005.
- (b) Section 36(1)(xiii) provides for deduction of any amount of banking cash transaction tax paid by the assessee during the previous year on the taxable banking transactions entered into by him.

Note – Banking Cash Transaction Tax is not chargeable in respect of any taxable banking transaction entered into on or after 1.4.2009.

(17) Deduction of contribution by a public financial institution to Credit guarantee fund trust for small industries [Section 36(1)(xiv)]

- (i) Section 36(1)(xiv) provides for deduction of any sum paid by a public financial institution by way of contribution to such credit guarantee fund trust for small industries notified by the Central Government in the Official Gazette.
- (ii) Public financial institution has the meaning assigned to it in section 4A of the Companies Act, 1956.

(18) Deduction of securities transaction tax paid [Section 36(1)(xv)]: The amount of securities transaction tax paid by the assessee during the year in respect of taxable securities transactions entered into in the course of business shall be allowed as deduction under section 36 subject to the condition that such income from taxable securities transactions is included under the head 'Profits and gains of business or profession'. Thus, securities transaction tax paid would be allowed as a deduction like any other business expenditure.

(19) Deduction for commodities transaction tax paid in respect of taxable commodities transactions [Section 36(1)(xvi)]

(a) *The Finance Act, 2013 has introduced a new tax called Commodities Transaction Tax (CTT) to be levied on taxable commodities transactions entered into in a recognised association, vide Chapter VII of the Finance Act, 2013.*

(b) *For this purpose, a 'taxable commodities transaction' means a transaction of sale of commodity derivatives in respect of commodities, other than agricultural commodities, traded in recognised associations.*

(c) *CTT is to be levied at 0.01% on sale of commodity derivative from the date on which Chapter VII of the Finance Bill, 2013 comes into force by way of notification in the Official Gazette by the Central Government. CTT is to be paid by the seller.*

(d) *A "commodity derivative" means –*

- (1) A contract for delivery of goods which is not a ready delivery contract*
- (2) A contract for differences which derives its value from prices or indices of prices -
 - (i) of such underlying goods; or*
 - (ii) of related services and rights, such as warehousing and freight; or*
 - (iii) with reference to weather and similar events and activities having a bearing on the commodity sector.**

(e) *Consequently, new clause (xvi) has been inserted in section 36(1) to provide that an amount equal to the CTT paid by the assessee in respect of the taxable commodities transactions entered into in the course of his business during the previous year shall be allowable as deduction, if the income arising from such taxable commodities transactions is included in the income computed under the head "Profits and gains of business or profession".*

(xix) Residuary Expenses [Section 37]

(1) Revenue expenditure incurred for purposes of carrying on the business, profession or vocation - This is a residuary section under which only business expenditure is allowable but not the business losses, e.g., those arising out of embezzlement, theft, destruction of assets, misappropriation by employees etc. (These are allowable under section 29 as losses incidental to the business). The deduction is limited only to the amount actually expended and does not extend to a reserve created against a contingent liability.

(2) **Conditions for allowance** - The following conditions should be fulfilled in order that a particular item of expenditure may be deductible under this section:

- (a) The expenditure should not be of the nature described in sections 30 to 36.
- (b) It should have been incurred by the assessee in the accounting year.
- (c) It should be in respect of a business carried on by the assessee the profits of which are being computed and assessed.
- (d) It must have been incurred after the business was set up.
- (e) It should not be in the nature of any personal expenses of the assessee.
- (f) It should have been laid out or expended wholly and exclusively for the purposes of such business.
- (g) It should not be in the nature of capital expenditure. (The principles to be followed for distinguishing capital expenditure from revenue are discussed below.)
- (h) The expenditure should not have been incurred by the assessee for any purpose which is an offence or is prohibited by law.

This section is thus limited in scope. It does not permit an assessee to make all deductions which a prudent trader would make in ascertaining his own profit. It might be observed that the section requires that the expenditure should be wholly and exclusively laid out for purpose of the business but not that it should have been necessarily laid out for such purpose. There fore, expenses wholly and exclusively laid out for the purpose of trade are, subject to the fulfilment of other conditions, allowed under this section even though the outlay is unnecessary.

(3) For determining whether an expenditure is of the nature contemplated by the foregoing provisions of law the following tests should be applied:

- (i) **'Character as a trader'**: The expenditure should be incurred by the assessee in his character as a trader.
- (ii) **'Voluntarily expended on grounds of commercial expediency'** : A sum of money expended, not out of necessity but with a view to getting a direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency and in order indirectly to facilitate the carrying on of the business may yet be expended wholly and exclusively for purposes of the trade [*Atherton v British Insulated and Helsby Ltd.* 10 LTC. 115 (H.L.)].
- (iii) **'Direct concern and direct purpose'** : In order to ascertain whether the expenditure has been incurred wholly and exclusively for the purpose of the business one must look to the direct concern and direct purpose for which the money is laid out and not the remote or indirect result which may possibly motivate or flow from the expenditure.
- (iv) **'Purpose of the assessee's own business'** : The expenditure should be primarily incurred for the assessee's own business. Notwithstanding this proposition so long as the expenditure is for the whole and exclusive purpose of the assessee's trade the mere fact that the expenditure incidentally obtains some advantage to the assessee in some

character other than that of a trader, would not detract the effect of the finding that the expenditure was wholly and exclusively incurred for purpose of the assessee's business.

- (v) 'Unremunerative expenditure' : The expenditure need not be incurred solely for the purpose of earning profit in the year of account. For example, the cost of repairs or advertisement or expenses on a foreign tour by the managing directors would be deductible even though the income therefrom would be earned in future years.
- (vi) 'Treatment in assessee's accounts' : The way in which an item of expenditure is treated in the assessee's accounts is not a conclusive evidence against or in favour of the assessee.

Payment out of profits and payments ascertained by reference to profits : When a trader makes a payment which is computed in relation to profits the question that arises is : Does the payment represent a mere division of profit with another person or is it an item of expenditure the amount of which is ascertained by reference to the profits? The payment would be allowable in the second case but not in the first.

(4) Distinction between capital and revenue expenditure: The line of demarcation between capital and revenue expenditure is very thin and the ultimate conclusion on the nature of the expenditure is always a mixed question of law and fact. In deciding whether an expenditure is of a revenue or a capital nature, one must take into consideration the nature and ordinary course of the business of the assessee and the object for which the expenditure had been incurred.

Whether a particular item of expenditure is incurred for the purpose of the business or not must be viewed in the larger context of business necessity and expediency. For this purpose, one must look not to the documents but also the surrounding circumstances so as to arrive at a decision as to what exactly is the real nature of the transaction from the commercial point of view.

It is often very difficult to lay down a test of a comprehensive nature which would be of universal application. Different tests have to be applied from the business point of view and then conclusions must be arrived at on the question whether, on a fair consideration of the whole situation as evident from the facts, the expenditure in question incurred in a particular case is of revenue nature or of a capital nature. The following broad principles have been evolved by the decisions of the various courts from time to time. These principles are neither exhaustive nor are they intended to be. They would serve only as guidelines to decide any problem arising in regard to the determination of the capital or revenue of a particular item [*Hylam Ltd. v CIT* [1913] 87 ITR 310 (A.P.)].

- (i) If the expenditure is for the initial outlay or for acquiring or bringing into existence any asset or advantage of an enduring benefit to the business of the assessee or for extension of the business which is already in existence or for substantial replacement of any existing business asset it must be treated as capital expenditure. The Supreme Court has reiterated the above principle in *CIT v. Jalan Trading Co. (P) Ltd.* [1985] 23 Taxman (SC).
- (ii) If, however, the expenditure, although incurred for the purpose of the business that too for acquiring an asset or advantage, is for running the business or for working out that asset with a view to producing profits, it would be a revenue expenditure. The expenditure incurred for the purpose of carrying on the business undertaking would be of

a revenue nature. The expenditure which has to be incurred by an assessee in the ordinary course of his business, to enable him to carry on his trading operations is normally to be considered to be of a revenue nature. The expenditure by the assessee cannot be considered to be capital in nature merely because of the fact that the amount involved is large. The quantum of the expenditure cannot go to affect or alter the real nature and character of expenditure.

- (iii) In cases where the outgoing of money spent by the assessee is so related to the carrying on or the conduct of the business that it may be regarded as an integral part of the profit-earning process of operations and not for the acquisition of any asset of a permanent character the possession of which is a condition precedent to the running of the business, then such an item of payment would constitute an expenditure of a revenue nature.
- (iv) Any special knowledge, technical know-how or patent or trade mark constitutes an asset and if such an asset is acquired on payment for its use and exploitation for a limited period in the business and the acquisition is not of an asset or advantage of an enduring nature and at the end of the stipulated period the asset or advantage reverts back intact to the giver of the special knowledge or the owner of the patent, trade mark or copyright, it would constitute an expenditure of a revenue nature. In this context, it may be noted that a payment made to ward off competition in business to a rival would constitute a capital expenditure if the object of making that payment is to derive an advantage by eliminating competition over some length of time. The same result would not follow if there is no certainty of the duration of the advantage and the same can be put to an end at any point of time. How long the period of contemplated advantage or the benefit should be in order to constitute benefit of an enduring nature would depend upon the facts and circumstances of each individual case. Although enduring benefit need not be of an everlasting character, it should not be so transitory and ephemeral that it may be terminated at any time at the volition of any of the parties to the contract.
- (v) In cases of acquisition of a capital asset, it is immaterial whether the price for it is paid by the assessee once and for all in lumpsum or periodically and also whether it is paid out of capital or income or is linked with the total sales or the turnover of the business. In such a case, the expenditure or outgoing would constitute payment of a capital nature although it may indirectly be linked to or is paid out of revenue profit or sales.
- (vi) In cases where the amount paid for acquisition of an asset of an enduring nature is settled, by the mere fact that the amount so settled is chalked out into various small amounts or periodical instalments the capital nature of the transaction or expenditure would not in any way be affected nor the fact that the payment is made in instalments or in small amounts would in any way alter the nature of the expenditure from capital to revenue. In other words, the magnitude of the payment and its periodicity would not be deciding factors for determining the capital or revenue nature of any particular payment.
- (vii) A lumpsum amount paid for liquidating recurring claims would generally be of a revenue nature; it would not cease to be a revenue expenditure or get converted into capital expenditure merely because its payment is spread over a number of years. In such a case it is the intention and the object for which the assets are acquired that determine the nature of the expenditure incurred over it, and not the mode and the manner in which the payment

is made nor is it in any way related to or determined by the source of such payment.

- (viii) If the expenditure in question is recurring and is incurred by the assessee during the ordinary course of the business or manufacture, it would normally constitute a revenue expenditure.
- (ix) An asset or advantage of an enduring nature resulting in capital expenditure does not mean that such an asset should last forever; if the capital asset is, by its very nature, a short lived one, the expenditure incurred over it does not on that account cease to be a capital expenditure.
- (x) It is nowhere stipulated in the law that if a benefit of enduring nature is obtained, the expenditure for securing it must be treated as a capital expenditure. If the advantage or the benefit acquired by the assessee is to get stock-in-trade of a business it would constitute a revenue; but if what is acquired by the assessee is not the advantage of getting his current or trading assets directly but of something which requires to be processed before it is converted into stock-in-trade, the expenditure incurred over it would constitute a capital expenditure.
- (xi) Further, an item of disbursement may be regarded as capital expenditure when it is referable to fixed capital or a capital asset; it is a revenue expenditure when it is referable to circulating capital or stock in trade. Expenditure which relates to the framework of the taxpayer's business is a capital expenditure. Expenditure incurred for the termination of trading relationship in order to avoid losses occurring in future though that relationship, whether pecuniary loss or commercial inconvenience, is a revenue expenditure. Expenditure incurred for the initial starting of the business before its setting up for substantial expansion and also expenditure incurred after the discontinuance of the business would be of a capital nature.

The capital or revenue character of a particular item must be decided from the facts and circumstances of each case and must be based upon the principles of law applicable to those facts. The fact that a particular transaction is treated by the parties as capital or revenue in nature or is called a sale, instead of being an agreement to use or let out the particular asset would not convert the capital or revenue character of the transaction. Similarly, the entries made by the parties concerned in their books of account or other documents would not always be indicative or conclusive, as to what the real nature of the transaction is based upon the above principles, the capital or revenue character of a particular expenditure will have to be decided in every case.

Instances of revenue expenditure: Payment made for the use of goodwill, use of quota rights or in the case of a hotel or restaurant business the cost of table linen, crockery, pots is of a revenue expenditure. The cost of dredging carried on by a harbor authority for the purpose of keeping the channels clear for shipping is also of revenue expenditure. Expenditure incurred by a surgeon or businessman on a study tour abroad to acquire knowledge of the latest techniques would be on revenue account.

Circular No.6/2007 dated 11.10.2007 clarifies the issue of allowability of the claim of harvesting and transportation expenses incurred by the Co-operative sugar mills for procuring sugarcane from farmers, who are members of such Co-operative Sugar Mills and who are bound under an agreement to supply the sugarcane exclusively to the concerned sugar Mill.

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

Instances of capital expenditure: Expenditure on improvement to property as distinguished from mere repairs or that which is incurred by a company in raising loans or issuing debentures for capital outlay would be capital expenditure if they are incurred before the business is set up. Legal expenses incurred in connection with the mortgages of the premises belonging to the assessee in which the assessee carries on his business are also capital expenditure.

(5) **Advertisements in souvenirs of political parties:** Section 37(2B) disallows any deduction on account of advertisement expenses representing contributions made by any person carrying on business or profession in computing the profits and gains of the business or profession. It has specifically been provided that this provision for disallowance would apply notwithstanding anything to the contrary contained in section 37(1). In other words, the expenditure representing contribution for political purposes would become disallowable even in those cases where the expenditure is otherwise incurred by the assessee in his character as a trader and the amount is wholly and exclusively incurred for the purpose of the business. Accordingly, a taxpayer would not be entitled to any deduction in respect of expenses incurred by him on advertisement in any souvenir, brochure, tract or the like published by any political party, whether it is registered with the Election Commission of India or not.

(6) **Explanation to section 37(1) -** This *Explanation* provides that any expenditure incurred by the assessee for any purpose which is an offence or is prohibited by law shall not be allowed as a deduction or allowance.

Inadmissibility of expenses incurred in providing freebees to medical practitioner by pharmaceutical and allied health sector industry [Circular No. 5/2012 dated 1-8-2012]

Section 37(1) provides for deduction of any revenue expenditure (other than those falling under sections 30 to 36) from the business income if such expense is laid out or expended wholly or exclusively for the purpose of business or profession. However, the Explanation below section 37(1) denies claim of any such expenses, if the same has been incurred for a purpose which is either an offence or prohibited by law.

The CBDT, considering the fact that the claim of any expense incurred in providing freebees to medical practitioner is in violation of the provisions of Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, has clarified that the expenditure so incurred shall be inadmissible under section 37(1) of the Income-tax Act, 1961, being an expense prohibited by the law. The disallowance shall be made in the hands of such pharmaceutical or allied health sector industry or other assessee which has provided aforesaid freebees and claimed it as a deductible expense in its accounts against income.

This circular has also clarified that a sum equivalent to value of freebees enjoyed by the

aforesaid medical practitioner or professional associations is also taxable as business income or income from other sources, as the case may be, depending on the facts of each case.

Illustration 11

Isac limited is a company engaged in the business of biotechnology. The net profit of the company for the financial year ended 31.03.2014 is ₹15,25,890 after debiting the following items:

S.No.	Particulars	₹
1.	Purchase price of raw material used for the purpose of in-house research and development	1,80,000
2.	Purchase price of asset used for in-house research and development wrongly debited to profit and loss account:	
	(1) Land	5,00,000
	(2) Building	3,00,000
3.	Expenditure incurred on notified agricultural extension project	1,50,000
4.	Expenditure on notified skill development project:	
	(1) Purchase of land	2,00,000
	(2) Expenditure on training for skill development	2,50,000
5.	Expenditure incurred on advertisement in the souvenir published by a political party	75,000

Compute the income under the head "Profits and gains of business or profession" for the A.Y. 2014-15 of Isac Ltd.

Answer

Computation of income under the head "Profits and gains of business or profession" for the A.Y.2014-15

Particulars	₹	₹
Net profit as per profit and loss account		15,25,890
Add: Items debited to profit and loss account, but to be disallowed		
Purchase price of Land used in in-house research and development - being capital expenditure not allowable as deduction under section 35	5,00,000	
Purchase price of building used in in-house research and development - being capital expenditure, 100% of which is allowable as deduction u/s 35(1)(iv) read with section 35(2)	-	
Expenditure incurred on notified agricultural extension project (to be treated separately)	1,50,000	
Expenditure incurred on notified skill development project - Purchase of land - being capital expenditure not qualifying for deduction under section 35CCD	2,00,000	

	Expenditure incurred on notified skill development project - Expenditure on training for skill development (to be treated separately)	2,50,000	
	Expenditure incurred on advertisement in the souvenir published by a political party not allowed as deduction as per section 37(2B)	<u>75,000</u>	<u>11,75,000</u>
			27,00,890
Less:	Purchase price of raw material used for in-house research and development qualifies for 200% deduction under section 35(2AB). Since, it is already debited to profit and loss account balance 100% is allowed.	1,80,000	
Less:	Expenditure incurred on notified agricultural extension project qualifies for 150% deduction under section 35CCC.	2,25,000	
Less:	Expenditure incurred on training for skill development in a notified skill development project qualifies for 150% deduction under section 35CCD.	<u>3,75,000</u>	<u>7,80,000</u>
	Profit and gains from business		<u>19,20,890</u>

Note : The expenditure incurred on advertisement in the souvenir published by a political party is disallowed as per section 37(2B) while computing income under the head "Profit and Gains of Business or Profession" but the same would be allowed as deduction under section 80GGB from the gross total income of the company.

3.6 Inadmissible Deductions [Section 40]

By dividing the assessees into distinct groups, this section places absolute restraint on the deductibility of certain expenses as follows:

(i) Section 40(a) - In the case of any assessee, the following expenses are not deductible:

(1) Any interest (not being interest on loan issued for public subscription before the 1st day of April, 1938), royalty, fees for technical services or other sum chargeable under this Act, which is payable, -

(a) outside India;

(b) in India to a non-resident, not being a company or to a foreign company,

on which tax is deductible at source under Chapter XVIIIB and such tax has not been deducted or, after deduction, has not been paid during the previous year, or in the subsequent year before the expiry of the time prescribed under section 200(1). It is also provided that where in respect of any such sum, where tax has been deducted in any subsequent year, or has been deducted in the previous year but paid in any subsequent year after the expiry of the time prescribed under section 200(1), such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

(2) Section 40(a)(ia) provides that interest, commission, brokerage, rent, royalty, fees for technical/professional services payable to a resident or amounts payable (for carrying out any

work contract) to a resident contractor/sub-contractor, on which tax is deductible at source, shall be disallowed if –

- (i) such tax has not been deducted; or
- (ii) such tax, after deduction, has not been paid on or before the due date specified in section 139(1).

In case the tax is deducted in any subsequent year or has been deducted during the previous year but paid after the due date specified in section 139(1), such sum shall be allowed as deduction in computing the income of the previous year in which such tax has been paid.

If, for instance, tax on royalty paid to Mr. A, a resident, has been deducted during the previous year 2013-14, the same has to be paid by 31st July/30th September 2014, as the case may be. Otherwise, the expenditure would be disallowed in computing the income for A.Y.2014-15. If the tax deducted during the P.Y.2013-14 has been paid after 31st July/30th September, 2014, the same would be allowed as deduction in the year of payment.

Section 201 provides that the payer (including the principal officer of the company) who fails to deduct the whole or any part of the tax on the amount credited or payment made to a resident payee shall not be deemed to be an assessee-in-default in respect of such tax if such resident payee –

- (i) has furnished his return of income under section 139;
- (ii) has taken into account such sum for computing income in such return of income; and
- (iii) has paid the tax due on the income declared by him in such return of income,

and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed.

The date of deduction and payment of taxes by the payer shall be deemed to be the date on which return of income has been furnished by the resident payee.

Consequently, in cases where such person responsible for deducting tax is not deemed to be an assessee-in-default on account of payment of taxes by the resident payee, it shall be deemed that the payer has deducted and paid the tax on such sum on the date of furnishing return of income by the resident payee.

Since the date of furnishing the return of income by the resident payee is taken to be the date on which the payer has deducted tax at source and paid the same, the expenditure/payment in respect of which the payer has failed to deduct tax at source shall be disallowed under section 40(a)(ia) in the year in which the said expenditure is incurred. Such expenditure will be allowed as deduction in the subsequent year in which the return of income is furnished by the resident payee, since tax is deemed to have been deducted and paid by the payer in that year.

- (3) any sum paid on account of tax or cess levied on profits on the basis of or in proportion to the profits and gains of any business or profession;
- (a) Any sum paid outside India (on account of any rate or tax levied) which is eligible for tax relief under section 90 or deduction from the income-tax payable under section 91 is not allowable and is deemed to have never been allowable as a deduction under section 40(a).

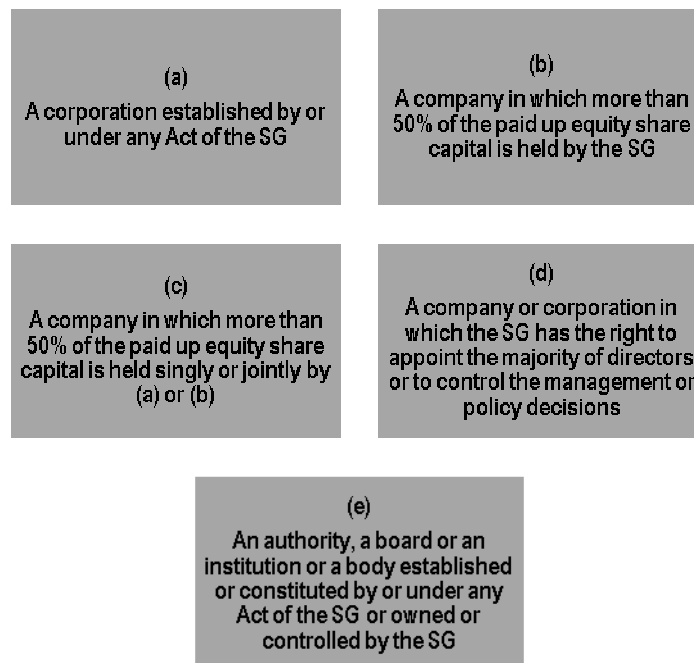
- (b) However, the tax payers will continue to be eligible for tax credit in respect of income-tax paid in a foreign country in accordance with the provisions of section 90 or section 91, as the case may be.
- (c) Any sum paid outside India (on account of any rate or tax levied) and eligible for relief under section 90A will not be allowed as a deduction.
- (4) any sum paid on account of wealth tax.

For the purpose of this disallowance the expression 'wealth-tax' means the wealth-tax chargeable under Wealth-tax Act, 1957, or any tax of similar nature or character chargeable under any law in any country outside India or any tax chargeable under such law with reference to the value of the assets of, or the capital employed in a business or profession carried on by the assessee, whether or not the debts of business or profession are allowed as a deduction in computing the amount with reference to which such tax is charged, but does not include any tax chargeable with reference to the value of any particular asset of the business or profession.

(5) (i) *any amount paid by way of royalty, licence fee, service fee, privilege fee, service charge, etc., which is levied exclusively on, or*

(ii) *any amount appropriated, directly or indirectly, from a State Government undertaking, by the State Government (SG)*

A State Government undertaking includes –



- (6) any sum which is chargeable under the head 'Salaries' if it is payable outside India or to a non-resident and if the tax has not been paid thereon nor deducted therefrom under Chapter XVII-B.

(7) any contribution to a provident fund or the fund established for the benefit of employees of the assessee, unless the assessee has made effective arrangements to make sure that tax shall be deducted at source from any payments made from the fund which are chargeable to tax under the head 'Salaries'.

(8) Tax paid on perquisites on behalf of employees is not deductible- In case of an employee, deriving income in the nature of perquisites (other than monetary payments), the amount of tax on such income paid by his employer is exempt from tax in the hands of that employee. Correspondingly, such payment is not allowed as deduction from the income of the employer. Thus, the payment of tax on perquisites by an employer on behalf of employee will be exempt from tax in the hands of employee but will not be allowable as deduction in the hands of the employer.

(ii) Section 40(b) - In the case of any firm assessable as such or a limited liability partnership (LLP) the following amounts shall not be deducted in computing the income from business of any firm/LLP:

(1) Any salary, bonus, commission, remuneration by whatever name called, to any partner who is not a working partner. (In the following discussion, the term 'remuneration' is applied to denote payments in the nature of salary, bonus, commission);

(2) Any remuneration paid to the working partner or interest to any partner which is not authorised by or which is inconsistent with the terms of the partnership deed;

(3) It is possible that the current partnership deed may authorise payments of remuneration to any working partner or interest to any partner for a period which is prior to the date of the current partnership deed. The approval by the current partnership deed might have been necessitated due to the fact that such payment was not authorised by or was inconsistent with the earlier partnership deed. Such payments of remuneration or interest will also be disallowed. However, it should be noted that the current partnership deed cannot authorise any payment which relates to a period prior to the date of earlier partnership deed.

Next, by virtue of a further restriction contained in sub-clause (iii) of section 40(b), such remuneration paid to the working partners will be allowed as deduction to the firm from the date of such partnership deed and not for any period prior thereto. Consequently, if, for instance, a firm incorporates the clause relating to payment of remuneration to the working partners, by executing an appropriate deed, say, on July 1, but effective from April 1, the firm would get deduction for the remuneration paid to its working partners from July 1 and onwards, but not for the period from April 1 to June 30. In other words, it will not be possible to give retrospective effect to oral agreements entered into vis a vis such remuneration prior to putting the same in a written partnership deed.

(4) Any interest payment authorised by the partnership deed falling after the date of such deed to the extent such interest exceeds 12% simple interest p.a.

(5) Any remuneration paid to a partner, authorised by a partnership deed and falling after the date of the deed in excess of the following limits:

On the first ₹ 3 lakh of book profit or in case of loss, the limit would be the higher of ₹ 1,50,000 or 90% of book profit and on the balance of book profit, the limit would be 60%.

Illustration 12

A firm has paid ₹ 7,50,000 as remuneration to its partners for the P.Y.2013-14, in accordance with its partnership deed, and it has a book profit of ₹ 10 lakh. What is the remuneration allowable as deduction?

Answer

The allowable remuneration calculated as per the limits specified in section 40(b)(v) would be –

Particulars	₹
On first ₹ 3 lakh of book profit [₹ 3,00,000 × 90%]	2,70,000
On balance ₹ 7 lakh of book profit [₹ 7,00,000 × 60%]	4,20,000
	6,90,000

The excess amount of ₹ 60,000 (i.e., ₹ 7,50,000 – ₹ 6,90,000) would be disallowed as per section 40(b)(v).

There are four Explanations to section 40(b):

Explanation 1 provides that where an individual is a partner in a firm in a representative capacity:

- (i) interest paid by the firm to such individual otherwise than as partner in a representative capacity shall not be taken into account for the purposes of this clause.
- (ii) interest paid by the firm to such individual as partner in a representative capacity and interest paid by the firm to the person so represented shall be taken into account for the purposes of this clause.

Explanation 2 provides that where an individual is a partner in a firm otherwise than in a representative capacity, interest paid to him by the firm shall not be taken into account if he receives the same on behalf of or for the benefit of any other person.

Explanation 3 defines the term “book profit”. It means the net profit as shown in the P & L A/c for the relevant previous year computed in accordance with the provisions for computing income from profits and gains.

The above amount should be increased by the remuneration paid or payable to all the partners of the firm if the same has been deducted while computing the net profit.

Explanation 4 defines a working partner. Accordingly, it means an individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner.

(iii) **Section 40(ba) - Association of persons or body of individuals :** Any payment of interest, salary, commission, bonus or remuneration made by an association of persons or body of individuals to its members will also not be allowed as a deduction in computing the income of the association or body.

There are three Explanations to section 40(ba):

Explanation 1 - Where interest is paid by an AOP or BOI to a member who has paid interest to

the AOP/BOI, the amount of interest to be disallowed under clause (ba) shall be limited to the net amount of interest paid by AOP/BOI to the partner.

Explanation 2 - Where an individual is a member in an AOP/BOI on behalf of another person, interest paid by AOP/BOI shall not be taken into account for the purposes of clause (ba). But, interest paid to or received from each person in his representative capacity shall be taken into account.

Explanation 3 - Where an individual is a member in his individual capacity, interest paid to him in his representative capacity shall not be taken into account.

6.7 Expenses or payments not deductible in certain circumstances [Section 40A]

(i) **Payments to relatives and associates** - Sub-section (2) of section 40A provides that where the assessee incurs any expenditure in respect of which a payment has been or is to be made to a relative or to an associate concern so much of the expenditure as is considered to be excessive or unreasonable shall be disallowed by the Assessing Officer. While doing so he shall have due regard to :

- (a) the market value of the goods, service or facilities for which the payment is made; or
- (b) the legitimate needs of the business or profession carried on by the assessee; or
- (c) the benefit derived by or accruing to the assessee from such a payment.

The word "relative" as defined in the section 2(41) means, in relation to individual, the spouse, brother or sister of any lineal ascendant or descendant of that individual. Whether the assessee is a firm, H.U.F. or an association of persons the relationship will have to be reckoned for the purpose, with reference to the partners of the firm and the members of the family or association. Similarly, where the assessee is a company the relationship will have to be reckoned with reference to the directors or persons having substantial interest in the company.

The related person as mentioned in section 40A(2) includes, *inter alia*, a company, firm, association of persons or Hindu undivided family having a substantial interest in the business or profession of the assessee or any director, partner or member of such company, firm, association or family, or any relative of such director, partner or member. Further, the related person in relation to a company shall include any other company carrying on business or profession in which the first mentioned company has substantial interest.

A person shall be deemed to have a substantial interest in a business or profession if -

- in a case where the business or profession is carried on by a company, such person is, at any time during the previous year, the beneficial owner of equity shares carrying not less than 20% of the voting power and
- in any other case such person is, at any time during the previous year, beneficially entitled to not less than 20% the profits of such business or profession.

(ii) **Cash payments in excess of ₹ 20,000** - According to section 40A(3), where the assessee incurs any expenditure, in respect of which payment or aggregate of payments made to a person in

a day otherwise than by an account payee cheque drawn on a bank or by an account payee bank draft exceeds ₹ 20,000, such expenditure shall not be allowed as a deduction.

For example if, in respect of an expenditure of ₹ 60,000 incurred by X Ltd., 4 cash payments of ₹ 15,000 are made on a particular day to one Mr.Y – one in the morning at 10 a.m., one at 12 noon, one at 3 p.m. and one at 6 p.m., the entire expenditure of ₹ 60,000 would be disallowed under section 40A(3), since the aggregate of cash payments made during a day to Mr.Y exceeds ₹ 20,000.

In case of an assessee following mercantile system of accounting, if an expenditure has been allowed as deduction in any previous year on due basis, and payment has been made in a subsequent year otherwise than by account payee cheque or account payee bank draft, then the payment so made shall be deemed to be the income of the subsequent year if such payment or aggregate of payments made to a person in a day exceeds ₹ 20,000 [Section 40A(3A)].

This limit of ₹ 20,000 has been raised to ₹ 35,000 in case of payment made to transport operators for plying, hiring or leasing goods carriages. Therefore, payment or aggregate of payments up to ₹ 35,000 in a day can be made to a transport operator otherwise than by way of account payee cheque or account payee bank draft. In all other cases, the limit would continue to be ₹ 20,000.

However, no disallowance would be made in such cases and under such circumstances as may be prescribed, having regard to the nature and extent of banking facilities available, considerations of business expediency and other relevant factors.

The provision applies to all categories of expenditure involving payments for goods or services which are deductible in computing the taxable income. It does not apply to loan transactions because advancing of loans or repayments of the principal amount of loan does not constitute an expenditure deductible in computing the taxable income. However, interest payments of amounts exceeding ₹ 20,000 at a time are required to be made by account payee cheques or drafts as interest is a deductible expenditure. This requirement does not apply to payment made by commission agents for goods received by them for sale on commission or consignment basis because such a payment is not an expenditure deductible in computing the taxable income of the commission agent. For the same reason, this requirement does not apply to advance payment made by the commission agent to the party concerned against supply of goods. However, where commission agent purchases goods on his own account but not on commission basis, the requirement will apply. The provisions regarding payments by account payee cheque or draft apply equally to payments made for goods purchased on credit.

Rule 6DD provides for cases and circumstances in which a payment or aggregate of payments exceeding twenty thousand rupees may be made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft. As per this rule, no disallowance under sub-section (3) of section 40A shall be made and no payment shall be deemed to be the profits and gains of business or profession under sub-section (3A) of section 40A where a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds twenty thousand rupees in the cases and circumstances specified hereunder, namely:

- (a) where the payment is made to
 - (i) the Reserve Bank of India or any banking company;
 - (ii) the State Bank of India or any subsidiary bank;
 - (iii) any co-operative bank or land mortgage bank;
 - (iv) any primary agricultural credit society or any primary credit society;
 - (v) the Life Insurance Corporation of India;
- (b) where the payment is made to the Government and, under the rules framed by it, such payment is required to be made in legal tender;
- (c) where the payment is made by
 - (i) any letter of credit arrangements through a bank;
 - (ii) a mail or telegraphic transfer through a bank;
 - (iii) a book adjustment from any account in a bank to any other account in that or any other bank;
 - (iv) a bill of exchange made payable only to a bank;
 - (v) the use of electronic clearing system through a bank account;
 - (vi) a credit card;
 - (vii) a debit card.
- (d) where the payment is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee;
- (e) where the payment is made for the purchase of -
 - (i) agricultural or forest produce; or
 - (ii) the produce of animal husbandry (including livestock, meat, hides and skins) or dairy or poultry farming; or
 - (iii) fish or fish products; or
 - (iv) the products of horticulture or apiculture,to the cultivator, grower or producer of such articles, produce or products;

Note -

- (i) The expression 'fish or fish products' (iii) above would include 'other marine products such as shrimp, prawn, cuttlefish, squid, crab, lobster etc.'.
- (ii) The 'producers' of fish or fish products for the purpose of rule 6DD(e) 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.

However, the above exception will not be available on the 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.

- (f) where the payment is made for the purchase of the products manufactured or processed without the aid of power in a cottage industry, to the producer of such products;
- (g) where the payment is made in a village or town, which on the date of such payment is not served by any bank, to any person who ordinarily resides, or is carrying on any business, profession or vocation, in any such village or town;
- (h) where any payment is made to an employee of the assessee or the heir of any such employee, on or in connection with the retirement, retrenchment, resignation, discharge or death of such employee, on account of gratuity, retrenchment compensation or similar terminal benefit and the aggregate of such sums payable to the employee or his heir does not exceed fifty thousand rupees;
- (i) where the payment is made by an assessee by way of salary to his employee after deducting the income-tax from salary in accordance with the provisions of section 192 of the Act, and when such employee -
 - (i) is temporarily posted for a continuous period of fifteen days or more in a place other than his normal place of duty or on a ship; and
 - (ii) does not maintain any account in any bank at such place or ship;
- (j) where the payment was required to be made on a day on which the banks were closed either on account of holiday or strike;
- (k) where the payment is made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person;
- (l) where the payment is made by an authorised dealer or a money changer against purchase of foreign currency or travellers cheques in the normal course of his business.

(iii) **Disallowance of provision for gratuity** - Section 40A(7) provides that no deduction would be allowable to any taxpayer carrying on any business or profession in respect of any provision (whether called as provision or by any other names) made by him towards the payment of gratuity to his employers on their retirement or on the termination of their employment for any reason. The reason for this disallowance is that, under section 36(1)(v), deduction is allowable in computing the profits and gains of the business or profession in respect of any sum paid by a taxpayer in his capacity as an employer in the form of contributions made by him to an approved gratuity fund created for the exclusive benefit of his employees under an irrevocable trust. Further, section 37(1) provides that any expenditure other than the expenditure of the nature described in sections 30 to 36 laid out or expended, wholly and exclusively for the purpose of the business or profession must be allowed as a deduction in computing the taxable income from business. A reading of these two provisions clearly indicates that the intention of the legislature has always been that the deduction in respect of gratuity be allowable to the employer either in the year in which the gratuity is actually paid or in the year in which contributions to an approved gratuity fund are actually

made by employer. This provision, therefore, makes it clear that any amount claimed by the assessee towards provision for gratuity, by whatever name called would be disallowable in the assessment of employer even if the assessee follows the mercantile system of accounting.

However, no disallowance would be made under section 40A(7) in the case where any provision is made by the employer for the purpose of payment of sum by way of contribution to an approved gratuity fund during the previous year or for the purpose of making payment of any gratuity that has become payable during the previous year by virtue of the employee's retirement, death, termination of service etc.

(iv) Contributions by employers to funds, trust etc. [Sections 40A(9) to (11)] - These sub-sections have been introduced to curb the growing practice amongst employers to claim deductions from taxable profits of the business of contributions made apparently to the welfare of employees from which, however, no genuine benefit flows to the employees.

Accordingly, no deduction will be allowed where the assessee pays in his capacity as an employer, any sum towards setting up or formation of or as contribution to any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act, 1860 or other institution for any purpose. However, where such sum is paid in respect of funds covered by sections 36(1)(iv), 36(1)(iva) and 36(1)(v) or any other law, then the deduction will not be denied.

(v) Deduction in respect of Head Office expenses, in the case of non-residents - Section 44C restricts the scope of deduction available to non-resident taxpayers in the matter of allowance of head office expenses in computing their taxable income from the business carried on in India. These restrictions would have the effect of overriding anything to the contrary contained in the provisions for allowance of expenses and other deductions contained in sections 28 to 43A of the Income-tax Act, 1961. This provision prescribes the limits upto which the deduction could be allowed in computing profits and gains from any business carried on by the non-resident in India and apply to the expenses in the matter of head office expenses.

For the purpose of those restrictions and the consequent disallowance, the expression 'head office expenditure' must be taken to mean executive and general administration expenses incurred by the assessee outside India including also the expenditure incurred in respect of the following items viz.,

- (i) rent, rates, taxes, repairs or insurance in respect of any premises outside India used for the purpose of the business or profession;
- (ii) salary, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profit in lieu of or in addition to salary, whether paid or allowed to any employee or other persons employed in, or managing the affairs of any office in India;
- (iii) travelling expenses incurred in respect of any employee or other person who is employed in or who is looking after the management of the affairs of any office outside India; and
- (iv) such other matter connected with executive and general administration of the business as may be prescribed by the CBDT from time to time.

The limits prescribed are the following:

- (i) an amount equal to 5% of the adjusted total income of the assessee; or

- (ii) an amount of so much of the expenditure in the nature of head office expenses (explained above), which are incurred by the assessee, as is attributable to the business or profession of the assessee in India.

The limit upto which the deduction is permissible to the assessee is the lesser of the aforesaid two amounts and consequently, the basis for allowance would be the lower of the above two items. If, however the actual amount on account of head office expenses claimed by the assessee is less than the limits specified above, the deduction admissible would be confined to the amount of actual expenditure incurred by the assessee.

For the purpose of determining the amount of deduction admissible to the assessee, the expression 'adjusted total income' used in item (i) above must be taken to mean the total income of the assessee computed in accordance with the provisions of the Income-tax Act before giving effect to the following items of allowance on deduction viz.,—

- (a) depreciation allowance under section 32(2);
- (b) capital expenditure on family planning incurred by companies admissible as a deduction under section 36(ix);
- (c) any brought-forward business loss qualifying for set off against business income in accordance with the provisions of section 72(1);
- (d) any brought-forward loss in regard to any speculation business qualifying for set off against income from speculation under section 73(3);
- (e) any loss computed under the head 'Capital gains' and brought forward from earlier assessment year qualifying for set-off under section 74(1); and
- (f) any loss attributable to the casual item of income assessable under section 56 qualifying for set-off in accordance with the provisions of section 74A(3).

Thus, the total income of the assessee computed for the relevant accounting year must be first ascertained before giving effect to the provisions for the aforesaid allowance and 5% thereof would be treated as the limit upto which head office expenses would be admissible as a deduction in computing the business income of the non-resident for income-tax purposes.

However, in cases where the adjusted total income of the assessee, 5% of which is to be taken as the basis for determining the first of the qualifying limits, happens to be a loss, the proviso to section 44C authorises the limit of 5% to be taken with reference to the average adjusted total income. For this purpose the expression 'average adjusted total income' would mean —

- (i) in cases where the total income of the assessee is assessable for each of the three assessment years immediately preceding the relevant assessment year - one-third of the aggregate amount of the adjusted total income of the previous years relevant to the aforesaid three assessment years.
- (ii) where the total income of the assessee is assessable for only two of the aforesaid three assessment years - one-half of the aggregate amount of the adjusted total income in respect of the two previous years relevant to the aforesaid two assessment years;
- (iii) in cases where the total income of the assessee becomes assessable only for one of the

three assessment years aforesaid - the amount of adjusted total incomes in respect of the previous year relevant to the assessment year.

The aforesaid provisions of restricting allowances on account of deduction in respect of head office expenditure would apply in the case of all non-resident taxpayers whose income from business or profession is chargeable to income-tax under section 28 of the Income-tax Act. The provisions for disallowance of the excess of the expenditure over the least of the limits mentioned above would apply even if the expenditure is such that it does not attract the provisions for disallowance contained in any other section of the Income-tax Act.

6.8 Profits chargeable to tax [Section 41]

This section enumerates certain receipts which are deemed to be income under the head "Business or profession." Such receipts would attract charge even if the business from which they arise had ceased to exist prior to the year in which the liability under this section arises. The particulars of such receipts are given below:

(i) Section 41(1) - Suppose an allowance or deduction has been made in any assessment year in respect of loss, expenditure or trading liability incurred by A. Subsequently, if A has obtained, whether in cash or in any manner whatsoever, any amount in respect of such loss or expenditure of some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by A, or the value of benefit accruing to him shall be taxed as income of that previous year. It does not matter whether the business or profession in respect of which the allowance or deduction has been made is in existence in that year or not.

It is possible that after the above allowance in respect of loss, expenditure, or trading liability has been given to A, he could have been succeeded in his business by another person. In such a case, the successor will be liable to be taxed in respect of any such benefit received by him during a subsequent previous year.

Successor in business:

- (i) Where there has been an amalgamation of a company with another company, the successor will be the amalgamated company.
- (ii) Where a firm carrying on a business or profession is succeeded by another firm the successor will be the other firm.
- (iii) In any other case, where one person is succeeded by any other person in that business or profession the other person will be the successor.
- (iv) In case of a demerger, the successor will be the resulting company.

Remission or cessation of a trading liability includes remission or cessation of liability by a unilateral act of the assessee by way of writing off such liability in his accounts.

(ii) Balancing charge, etc. - The provisions of section 41(2) relating to balancing charge, of section 41(3) relating to assets acquired for scientific research and of section 41(4) dealing with recovery of bad debts have been dealt with earlier under the respective items.

(iii) Section 41(4A) - The withdrawal from special reserve created and maintained under section 36(1)(viii) will be deemed to be profits and gains of business and charged accordingly

in the year of withdrawal. Even if the business is closed, it will be deemed to be in existence for this purpose. This also applies to section 41(5).

Brought forward losses of defunct business - In cases where a receipt is deemed under this section to be profit of a business under this section relating to a business that had ceased to exist and there is an unabsorbed loss, which arose in that business during the previous year in which it had ceased to exist, it would be set off against income that is chargeable under this section. This sub-section thus constitutes an exception to the rule that if a business has ceased to exist, any loss relating to it cannot be carried forward and set off against any income from any source.

6.9 Special provisions for deduction in case of business for prospecting etc. for mineral oil [Section 42]

This section has been enacted to permit an assessee to claim an allowance which may on general principles be inadmissible, e.g., allowance in respect of expenditure which would be regarded as an accretion to capital on the ground that it brings into existence an asset of enduring benefit or to constitute initial expenditure incurred on the setting up of a profit-earning machinery in motion. It must further be noted that this concession can be availed of only in relation to contract or arrangements entered into by the Central Government for prospecting for, or the extraction or production of mineral oils.

Allowable expenses : The allowance permissible under this section shall be in relation to (i) the expenditure by way of in fructuous or abortive exploration expenses in respect of an area surrendered prior to the beginning of commercial production by the assessee; (ii) after the beginning of commercial production, the expenditure incurred by the assessee, whether before or after such commercial production in respect of drilling or exploration activities in services in respect of physical assets used in that connection (except those assets which qualify for depreciation allowance under section 32); and (iii) to the depletion of mineral oil in the mining area in respect of the assessment year relevant to the previous year in which commercial production is begun and for such succeeding years as may be specified in the agreement.

Amount of deduction: The sum of those allowances should be computed and deduction should be made in the manner specified in the agreement entered into by the Central Government with any person for the association or participation in the business of the Central Government for the prospecting or exploration of mineral oil. It has been specifically provided that the other provisions of the Act are being deemed, for the purpose of this allowance, to have been modified to the extent necessary to give effect to the terms of the agreement. It may be noted that allowances in this regard are made in lieu of or in addition to the other allowances permissible under the Act, depending upon the terms of the agreement.

Subject to the provisions of the agreement entered into by the Central Government, where the business of assessee consisting of the prospecting for or extraction or production of petroleum and natural gas is transferred or any interest therein is transferred, wholly or partly, in accordance with the aforesaid agreement, various situations would arise. The tax treatment in respect of those situations are as follows:

- (1) Where the proceeds of the transfer so far as they consist of capital sums are less than

the expenditure incurred remaining unallowed, a deduction equal to such expenditure remaining unallowed, as reduced by the proceeds of transfer, shall be allowed in respect of the previous year in which such business or interest is transferred.

(2) Where such proceeds exceed the amount of the expenditure incurred remaining unallowed, so much of the excess as does not exceed the difference between the expenditure incurred in connection with the business or to obtain interest therein and the amount of such expenditure remaining unallowed, shall be chargeable to income-tax as profits and gains of the business in the previous year in which the business or interest therein, whether wholly or partly, had been transferred.

However, in a case where the provisions of this clause do not apply, the deduction to be allowed for expenditure incurred remaining unallowed shall be arrived at by subtracting the proceeds of transfer (so far as they consist of capital sums) from the expenditure remaining unallowed.

Explanation - Where the business or interest in such business is transferred in a previous year in which such business carried on by the assessee is no longer in existence, the provisions of this clause shall apply as if the business is in existence in that previous year.

(3) Where such proceeds are not less than the amount of the expenditure incurred remaining unallowed, no deduction for such expenditure shall be allowed in respect of the previous year in which the business or interest in such business is transferred or in respect of any subsequent year or years.

Special provisions in case of amalgamation/demerger: Where in a scheme of amalgamation, the amalgamating company sells or otherwise transfers the business to the amalgamated company (being an Indian company), the provisions of this sub-section—

- (i) shall not apply in the case of the amalgamating company and
- (ii) shall, as far as may be, apply to the amalgamated company as they would have applied to the amalgamated company if the latter had not transferred the business or interest in the business.

The section provides for similar provisions in the case of demerger where the resulting company, being an Indian company, shall claim the production under the said section.

6.10 Changes in the rate of exchange of currency [Section 43A]

The section provides that where an assessee has acquired any asset from a foreign country for the purpose of his business or profession, and due to a change thereafter in the exchange rate of the two currencies involved, there is an increase or decrease in the liability (expressed in Indian rupees) of the assessee at the time of making the payment, the following values may be changed accordingly with respect to the increase or decrease in such liability:

- (i) the actual cost of the asset under section 43(1)
- (ii) the amount of capital expenditure incurred on scientific research under section 35(1)(iv)
- (iii) the amount of capital expenditure on acquisition of patents or copyrights under section 35A
- (iv) the amount of capital expenditure incurred by a company for promoting family planning amongst its employees under section 36(1)(ix)

(v) the cost of acquisition of a non-depreciable capital asset falling under section 48.

The amount arrived at after making the above adjustment shall be taken as the amount of capital expenditure or the cost of acquisition of the capital asset, as the case may be.

The section further clarifies that where any adjustment has already been made under the erstwhile section 43A to the amount of capital expenditure or cost of acquisition of an asset on account of increase or decrease in liability due to exchange rate fluctuation, it should be verified that the amount of such adjustment is equal to the change in the liability at the time of making payment.

In this context,

- (a) "rate of exchange" means the rate of exchange determined or recognised by the Central Government for the conversion of Indian currency into foreign currency or foreign currency into Indian currency;
- (b) "foreign currency" and "Indian currency" have the meanings respectively assigned to them in section 2 of the Foreign Exchange Management Act, 1999.

Where the whole or any part of the liability aforesaid is met, not by the assessee, but, directly or indirectly, by any other person or authority, the liability so met shall not be taken into account for the purposes of this section.

Where the assessee has entered into a contract with a authorised dealer as defined in section 2 of the Foreign Exchange Management Act, 1999 for providing him with a specified sum in a foreign currency on or after a stipulated future date at the rate of exchange specified in the contract to enable him to meet the whole or any part of the liability aforesaid, the amount, if any, for adjustment under this section shall be computed with reference to the rate of exchange specified therein.

6.11 Certain Deductions to be Only on Actual Payment [Section 43B]

The following sums are allowed as deduction only on the basis of actual payment within the time limits specified in section 43B.

- (a) Any sum payable by way of tax, duty, cess or fee, by whatever name called, under any law for the time being in force.
- (b) Any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees.
- (c) Bonus or Commission for services rendered payable to employees.
- (d) Any sum payable by the assessee as interest on any loan or borrowing from any public financial institution or a State Financial Corporation or a State Industrial Investment Corporation.
- (e) Interest on any loan or advance from a scheduled bank on actual payment basis.
- (f) Any sum paid by the assessee as an employer in lieu of earned leave of his employee.

The above sums can be paid by the assessee on or before the due date for furnishing the return of income under section 139(1) in respect of the previous year in which the liability to pay such sum was incurred and the evidence of such payment is furnished by the assessee along with such return.

For the purposes of clause (a), "any sum payable" means a sum for which the assessee incurred liability in the previous year even though such sum might not have been payable within that year under the relevant law. For example, an assessee may collect sales tax from customers during the month of March, 2013. However, in respect of such collections he may have to discharge the liability only within say 10th April, 2013 under the sales tax law. The explanation covers this type of liability also. Consequently, if an assessee following accrual method of accounting has created a provision in respect of such a liability the same is not deductible unless remitted within the due date specified in this section.

For this purpose, scheduled bank has the meaning assigned to it in clause (iii) of the *Explanation* to section 11(5), that is, the State Bank of India (SBI), a subsidiary of SBI, a nationalised bank or any other bank included in the Second Schedule to the Reserve Bank of India Act, 1934.

"State Industrial Investment Corporation" means a Government company within the meaning of section 617 of the Companies Act, 1956, engaged in providing long-term finance for industrial projects and eligible for deduction under section 36(1)(iii).

Explanation 3B provides that where a deduction in respect of earned leave encashment paid to any employee is allowed in computing the business income of the employer for the previous year in which the liability to pay was incurred (applicable for previous year 2000-2001 or any earlier year), no deduction shall be allowed in respect of such sum in the previous year in which the sum is actually paid.

Explanation 3C & 3D clarifies that if any sum payable by the assessee as interest on any such loan or borrowing or advance referred to in (d) and (e) above, 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 only reiterate the rationale that conversion of interest into a loan or borrowing or advance does not amount to actual payment.

The manner in which the converted interest will be allowed as deduction has been clarified in *Circular No.7/2006 dated 17.7.2006*. 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.

Illustration 13

Hari, an individual, carried on the business of purchase and sale of agricultural commodities like paddy, wheat, etc. He borrowed loans from Andhra Pradesh State Financial Corporation and Indian Bank and has not paid interest as detailed hereunder:

		₹
(i)	Andhra Pradesh State Financial Corporation (P.Y. 2012-13 & 2013-14)	15,00,000
(ii)	Indian Bank (P.Y. 2013-14)	<u>30,00,000</u>
		<u>45,00,000</u>

Both Andhra Pradesh State Financial Corporation and Indian Bank, while restructuring the loan facilities of Hari during the year 2013-14, converted the above interest payable by Hari to them as a loan repayable in 60 equal installments. During the year ended 31.3.2014, Hari paid 5 installments to Andhra Pradesh State Financial Corporation and 3 installments to Indian Bank.

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

Solution

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

In the given case of Hari, the unpaid interest of ₹ 15,00,000 due to Andhra Pradesh State Financial Corporation (APSFC) and of ₹ 30,00,000 due to Indian Bank was converted into loan. Such conversion would not amount to payment of interest and would not, therefore, be eligible for deduction in the year of such conversion. Hence, claim of Hari that the entire interest of ₹ 45,00,000 is to be allowed as deduction in the year of conversion is not tenable. The deduction shall be allowed only to the extent of repayment made during the financial year. Accordingly, the amount of interest eligible for deduction for the A.Y. 2014-15 shall be calculated as follows:

	Interest outstanding	Number of Installments	Amount per installment	Installments paid	Interest allowable (₹)
APSFC	15 lakh	60	25,000	5	1,25,000
Indian Bank	30 lakh	60	50,000	3	1,50,000
Total amount eligible for deduction					2,75,000

6.12 Special Provision for Computation of Cost of Acquisition of Certain Assets [Section 43C]

(i) Where an asset acquired under a scheme of amalgamation is sold by an amalgamated company as its stock-in-trade then in computing the profits and gains derived from sale of such stock-in-trade the cost of acquisition of stock-in-trade to the amalgamated company shall be the cost of acquisition of such stock-in-trade or the asset to the amalgamating company as increased by the cost if any of any improvement thereto and the expenditure incurred wholly and exclusively in connection with such a transfer.

(ii) The provisions of section 43C will thus apply to the following cases of revaluation:

- (a) When the stock-in-trade of the amalgamating company is taken over at reduced price by the amalgamated company under the scheme of amalgamation.
- (b) Where a capital asset of the amalgamating company is taken over as stock-in-trade by the amalgamated company after revaluation under the scheme of amalgamation.
- (iii) The situation referred to at (b) above will in turn cover three situations:
 - (1) When the capital asset is converted to stock-in-trade by the amalgamating company with revaluation and the revalued asset is taken over by the amalgamated company under the scheme of amalgamation.
 - (2) Where the capital asset is taken over as stock-in-trade by the amalgamated company at renewed price at the time of amalgamation.
 - (3) Where the capital asset of the amalgamating company is taken over by the amalgamated company as a capital asset and has been converted into stock-in-trade and revalued.
- (iv) In a case referred to above, where the revaluation and conversion of capital asset into stock-in-trade takes place in the hands of the amalgamated company the provisions of section 45(2) will apply. So in such a case the provision of section 43C will not apply. This has been done with a view to ensure that a tax payer does not face double taxation in respect of the same transaction. However when the stock-in-trade referred to in item (i) as well as at (a) and (b) above are sold, the provisions of section 43C will apply.
- (v) A similar provision in section 43C has also been made to cover cases where the asset sold as stock-in-trade has been acquired by the assessee either by way of full or partial partition of HUF or under a gift or will or an irrevocable trust and such asset is sold as stock-in-trade.

6.13 Stamp Duty Value of land and building to be taken as the full value of consideration in respect of transfer, even if the same are held by the transferor as stock-in-trade [New Section 43CA]

- (i) *At present, the provisions of section 50C require adoption of stamp duty value of land or building or both, which are held as a capital asset, if the same are transferred for a consideration which is less than the value adopted, assessed or assessable by any authority of a State Government for the purpose of payment of stamp duty in respect of such transfer.*
- (ii) *However, such provisions are not applicable in case of transfer of immovable property, held by the transferor as stock-in-trade.*
- (iii) *Therefore, as an anti-avoidance measure, new section 43CA has been inserted to provide that where the consideration for the transfer of an asset (other than capital asset), being land or building or both, is less than the stamp duty value, the value so adopted or assessed or assessable (i.e., the stamp duty value) shall be deemed to be the full value of the consideration for the purposes of computing income under the head "Profits and gains of business of profession".*
- (iv) *Further, where the date of an agreement fixing the value of consideration for the transfer of the asset and the date of registration of the transfer of the asset are not same, the stamp duty value may be taken as on the date of the agreement for transfer*

instead of on the date of registration for such transfer, provided at least a part of the consideration has been received by any mode other than cash on or before the date of the agreement.

(v) *The Assessing Officer may refer the valuation of the asset to a valuation officer as defined in section 2(r) of the Wealth-tax Act, 1957 in the following cases -*

(1) *Where the assessee claims before any Assessing Officer that the value adopted or assessed or assessable by the authority for payment of stamp duty exceeds the fair market value of the property as on the date of transfer and*

(2) *the value so adopted or assessed or assessable by such authority has not been disputed in any appeal or revision or no reference has been made before any other authority, court or High Court.*

(vi) *Where the value ascertained by the Valuation Officer exceeds the value adopted or assessed or assessable by the Stamp Valuation Authority, the value adopted or assessed or assessable shall be taken as the full value of the consideration received or accruing as a result of the transfer.*

The term "assessable" covers transfers executed through power of attorney. The term 'assessable' has been defined to mean the price which the stamp valuation authority would have, notwithstanding anything to the contrary contained in any other law for the time being in force, adopted or assessed, if it were referred to such authority for the purposes of the payment of stamp duty.

Illustration 14

Case	Date of transfer of land / building held as stock-in-trade	Actual consideration	Stamp duty value on the date of agreement	Stamp duty value on the date of registration	Full value of consideration	Remark
		₹ in lakhs				
1	31/1/2013	100	120 (31/7/2012)	210 (31/1/2013)	100	Section 43CA is not applicable since the date of transfer is before 1/4/2013
2	1/5/2013	100 (₹10 lakhs received by cheque on 31/8/2012)	120 (1/9/2012)	210 (1/5/2013)	120	Stamp duty value on the date of agreement to be adopted as full value of consideration.

3	1/5/2013	100 (₹10 lakhs received by cash on 31/8/2012)	120 (1/9/2012)	210 (1/5/2013)	210	Stamp duty value on the date of registration to be adopted as full value of consideration.
4	31/3/2014	100 (Full amount received on the date of registration)	120 (1/5/2013)	210 (31/3/2014)	210	Stamp duty value of the date of registration would be the full value of consideration.

6.14 Special Provision in case of income of Public Financial Institutions [Section 43D]

(i) In the case of a public financial institution or a scheduled bank or a State financial corporation or a State industrial investment corporation, the income by way of interest on such categories of bad and doubtful debts, as may be prescribed having regard to the guidelines issued by the Reserve Bank of India in relation to such debts, shall be chargeable to tax in the previous year in which it is credited to the profit and loss account by the said institutions for that year or in the previous year in which it is actually received by them, whichever is earlier. This provision is now applicable to co-operative banks also [Sub-clause (a)].

(ii) In the case of a public company, the income by way of interest in relation to such categories of bad and doubtful debts as may be prescribed having regard to the guidelines issued by the National Housing Bank established under the National Housing Bank Act, 1987 in relation to such debts shall be chargeable to tax in the previous year in which it is credited to the profit and loss account by the said public company for that year or in the previous in which it is actually received by it, whichever is earlier. [Sub-clause (b)].

6.15 Insurance Business [Section 44]

The profits and gains of any business of insurance, including any such business carried on by a mutual insurance company or by a co-operative society, shall be computed in accordance with the rules contained in the First Schedule of the Income-tax Act, 1961. This is notwithstanding anything to the contrary contained in the provisions of the Income-tax Act, 1961 relating to computation of income chargeable under the head "Income from house property", "Capital gains" or "Income from other sources" or in section 199 or in sections 28 to 43B.

6.16 Special provisions in the case of certain associations [Section 44A]

This is a provision calculated to encourage the development activities carried on by the trade, professional and other associations other than those whose incomes are already exempted

under section 10(23A). This section provides that where the expenditure incurred by an association solely for purposes of protection or advancement of the common interest of its members exceeds the amount collected by the association from the members whether by way of subscription or otherwise, the resulting deficiency shall be allowed as a deduction in computing the income of the association assessable under the head "profits and gains of business or profession"; if there is no such income, then, it will be allowed as a deduction in computing the income under any other head. However, only an amount up to 50% of total taxable income of the association can be set off against the deficiency aforementioned. In computing the taxable income of the association, effect must first be given to the allowances or losses brought forward under any other section of the Act. This section applies only to such associations which do not distribute their income amongst their members except in the form of grants to affiliated associations.

6.17 Compulsory maintenance of accounts [Section 44AA]

This section provides that every person carrying on the legal, medical, engineering or architectural profession or accountancy or technical consultancy or interior decoration or any other profession as has been notified by the Central Board of Direct Taxes in the Official Gazette must statutorily maintain such books of accounts and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of the Income-tax Act. The persons carrying on these professions are statutorily obliged to maintain the prescribed books of account and other documents regardless of the quantum of their income and also regardless of the question whether the profession was set up prior to or after the coming into force of this new provision.

The professions notified so far are as follows:

The profession of authorised representative; the profession of film artiste (actor, camera man, director, music director, art director, editor, singer, lyricist, story writer, screen play writer, dialogue writer and dress designer); the profession of Company Secretary; and information technology professionals.

Every taxpayer carrying on any business or profession (other than the professions specified above) must maintain the books of account prescribed by the Central Board of Direct Taxes in the following circumstances:

- (a) in cases where the income from the business or profession exceeds ₹ 1,20,000 or the total sales turnover or gross receipts, as the case may be, in the business or profession exceed ₹ 10,00,000 in any one of three years immediately preceding the accounting year; or
- (b) in cases where the business or profession is newly set up in any previous year, if his income from business or profession is likely to exceed ₹ 1,20,000 or his total sales turnover or gross receipts, as the case may be, in the business or profession are likely to exceed ₹ 10,00,000 during the previous year ;
- (c) in cases where profits and gains from the business are calculated on a presumptive basis under section 44AE or 44BB or 44BBB and the assessee has claimed that his income is lower than the profits or gains so deemed to be the profits and gains of his business.

- (d) in cases where the profits and gains from the business are deemed to be the profits and gains of the assessee under section 44AD and he has claimed such income to be lower than the profits and gains so deemed to be the profits and gains of his business and his income exceeds the basic exemption limit during such previous year.

In such cases, compulsory tax audit would also become necessary.

The Central Board of Direct Taxes has been authorised, having due regard to the nature of the business or profession carried on by any class of persons, to prescribe by rules the books of account and other documents including inventories, wherever necessary, to be kept and maintained by the taxpayer, the particulars to be contained therein and the form and manner in which and the place at which they must be kept and maintained. Further, the Central Board of Direct Taxes has also been empowered to prescribe, by rules, the period for which the books of account and other documents are required to be kept and maintained by the taxpayer.

Rule 6F of the Income-tax Rules contains the details relating to the books of account and other documents to be maintained by certain professionals under section 44A.

As per Rule 6F, every person carrying on legal, medical, engineering, or architectural profession or the profession of accountancy or technical consultancy or interior decoration or authorised representative or film artist shall keep and maintain the books of account and other documents specified in sub-rule (2) in the following cases :

- if his gross receipts exceed ₹ 1,50,000 in all the 3 years immediately preceding the previous year ; or
- if, where the profession has been newly set up in the previous year, his gross receipts are likely to exceed ₹ 1,50,000 in that year.

Note : Students may note that professionals whose gross receipts are less than the specified limits given above are also required to maintain books of account but these have not been specified in the Rule. In other words, they are required to maintain such books of account and other documents as may enable the Assessing Officer to compute the total income in accordance with the provisions of this Act.

Sub-rule (2) of Rule 6F: The following books of account and other documents are required to be maintained.

- (i) a cash book;
- (ii) a journal, if accounts are maintained on mercantile basis ;
- (iii) a ledger;
- (iv) Carbon copies of bills and receipts issued by the person whether machine numbered or otherwise serially numbered, in relation to sums exceeding ₹ 25;
- (v) Original bills and receipts issued to the person in respect of expenditure incurred by the person, or where such bills and receipts are not issued, payment vouchers prepared and signed by the person, provided the amount does not exceed ₹ 50. Where the cash book contains adequate particulars, the preparation and signing of payment vouchers is not required.

In case of a person carrying on medical profession, he will be required to maintain the following in addition to the list given above:

- (i) a daily case register in Form 3C.
- (ii) an inventory under broad heads of the stock of drugs, medicines and other consumable accessories as on the first and last day of the previous year used for his profession.

The above books of account and documents shall be kept and maintained for a minimum of 6 years from the end of the relevant assessment year. However, where the assessment in relation to any assessment year has been reopened under section 147 within the period specified in section 149, all the books of account and other documents which were kept and maintained at the time of reopening the assessment shall continue to be so kept and maintained till the assessment so reopened has been completed.

The books and documents shall be kept and maintained at the place where the person is carrying on the profession, or where there is more than one place, at the principal place of his profession. However, if he maintains separate set of books for each place of his profession, such books and documents may be kept and maintained at the respective places.

6.18 Audit of accounts of certain persons carrying on business or profession [Section 44AB]

(i) It is obligatory in the following cases for a person carrying on business or profession to get his accounts audited before the "specified date" by a Chartered Accountant:

- (1) if the total sales, turnover or gross receipts in business exceeds ₹ 100 lakh in any previous year; or
- (2) if the gross receipts in profession exceeds ₹ 25 lakh in any previous year; or
- (3) where the assessee is covered under section 44AE, 44BB or 44BBB and claims that the profits and gains from business are lower than the profits and gains computed on a presumptive basis. In such cases, the normal monetary limits for tax audit in respect of business would not apply.
- (4) where the assessee is covered under section 44AD, and he claims that the profits and gains from business are lower than the profits and gains computed on a presumptive basis and his income exceeds the basic exemption limit.

(ii) The person mentioned above would have to furnish by the specified date a report of the audit in the prescribed forms. For this purpose, the Board has prescribed under Rule 6G, Forms 3CA/3CB/3CD containing forms of audit report and particulars to be furnished therewith.

(iii) In cases where the accounts of a person are required to be audited by or under any other law before the specified date, it will be sufficient if the person gets his accounts audited under such other law before the specified date and also furnish by the said date the report of audit in the prescribed form in addition to the report of audit required under such other law. Thus, for example, the provision regarding compulsory audit does not imply a second or separate audit of accounts of companies whose accounts are already required to be audited under the

Companies Act, 1956. The provision only requires that companies should get their accounts audited under the Companies Act, 1956 before the specified date and in addition to the report required to be given by the auditor under the Companies Act, 1956 furnish a report for tax purposes in the form to be prescribed in this behalf by the CBDT.

(iv) However, the requirement of audit under section 44AB does not apply to a person who derives income of the nature referred to in sections 44B and 44BBA.

(v) The expression "specified date" in relation to the accounts of the previous year or years relevant to any assessment year means the due date for furnishing the return of income under section 139(1). For due date of furnishing return of income, refer section 139(1) in Chapter 10 "Provisions for filing return of income".

(vi) It may be noted that under section 271B, penal action can be taken for not getting the accounts audited and for not filing the audit report by the specified date. In cases where the audit report has been filed before furnishing of the return, non furnishing of a copy of the audit report or proof of its filing by the specified date along with the return of income will, however, be only a defect under section 139(9) which can be rectified.

Note - The Institute has brought out a Guidance Note dealing with the various aspects of tax audit under section 44AB. Students are advised to read the same carefully.

6.19 Special provisions for computing profits and gains of business on presumptive basis [Section 44AD]

- (i) The presumptive taxation scheme under section 44AD covers all small businesses with total turnover/gross receipts of up to ₹ 100 lakh (except the business of plying, hiring and leasing goods carriages covered under section 44AE).
- (ii) Resident individuals, HUFs and partnership firms (but not LLPs) would be covered under this scheme.
- (iii) The scheme would not apply to an assessee who is availing deductions under section 10AA or deduction under any provisions of Chapter VIA under the heading "C.—Deductions in respect of certain incomes" in the relevant assessment year.
- (iv) The presumptive rate of tax would be 8% of total turnover or gross receipts. However, the assessee has the option to declare in his return of income, an amount higher than the presumptive income so calculated, claimed to have been actually earned by him.
- (v) All deductions allowable under sections 30 to 38 shall be deemed to have been allowed in full and no further deduction shall be allowed. However, in the case of a firm, salary and interest would be allowed as deduction subject to the conditions and limits prescribed under section 40(b).
- (vi) The written down value of any asset of such business shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed the deduction in respect of depreciation for each of the relevant assessment years.
- (vii) The intention of widening the scope of this scheme is to reduce the compliance and

administrative burden on small businessmen and relieve them from the requirement of maintaining books of account. Such assessee's opting for the presumptive scheme are not required to maintain books of account under section 44AA or get them audited under section 44AB.

- (viii) Further, they would also be relieved from the requirement of advance tax payments. It would be sufficient compliance if they pay their tax while filing their return of income before the due date.
- (ix) An assessee with turnover of upto ₹ 100 lakh, who shows an income below the presumptive rate prescribed under these provisions, will, in case his total income exceeds the taxable limit, be required to maintain books of accounts under section 44AA and also get them audited under section 44AB.

Thus, merely because an eligible assessee does not opt for presumptive taxation under section 44AD, it would not make him liable to maintain books of account under section 44AA or get the same audited under section 44AB. He will have to comply with these requirements only if his total income exceeds the taxable limit. If his total income does not exceed the taxable limit, the requirement of maintaining books of accounts under section 44AA and having the same audited under section 44AB would not arise.

- (x) The following persons are specifically excluded from the applicability of the presumptive provisions of section 44AD -
 - (a) a person carrying on profession as referred to in section 44AA(1) i.e., legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or any other profession as is notified by the Board (namely, authorized representatives, film artists, company secretaries and profession of information technology have been notified by the Board for this purpose);
 - (b) a person earning income in the nature of commission or brokerage; or
 - (c) a person carrying on any agency business.

6.20 Special provisions for computing profits and gains of business of plying, hiring or leasing goods carriages [Section 44AE]

- (i) This section provides for estimating business income of an owner of trucks from the plying, hire or leasing of such trucks;
- (ii) The scheme applies to persons owning not more than 10 trucks at any time during the previous year;
- (iii) The estimated income from each truck in case of a heavy goods vehicle will be deemed to be ₹ 5,000 for every month or part of a month during which the truck is owned by the assessee for the previous year. The assessee can also declare a higher amount in his return of income. In such case, the latter will be considered to be his income;
- (iv) In case of a truck, other than a heavy goods vehicle, the estimated income will be

deemed to be ₹ 4,500 for every month or part of the month during which such truck is owned by the assessee in the previous year. However, he may also declare a higher income and in such a case, the higher amount will be considered to be his income;

(v) The assessee will be deemed to have been allowed the deductions under sections 30 to 38. Accordingly, the written down value of any asset used for the purpose of the business of the assessee will be deemed to have been calculated as if the assessee had claimed and had actually been allowed the deduction in respect of depreciation for each of the relevant assessment years.

(vi) The assessee joining the scheme will not be required to maintain books of account under section 44AA and get the accounts audited under section 44AB in respect of such income.

An assessee may claim lower profits and gains than the deemed profits and gains specified in sub-section (1) of that section subject to the condition that the books of account and other documents are kept and maintained as required under sub-section (2) of section 44AA and the assessee gets his accounts audited and furnishes a report of such audit as required under section 44AB.

Illustration 15

An assessee owns a light commercial vehicle for 9 months 15 days, a medium goods vehicle for 9 months and a medium goods vehicle for 12 months during the previous year. Compute his income applying the provisions of section 44AE.

Solution

His profits and gains from the 3 trucks shall be deemed to be ₹ 4,500 × 10 + ₹ 4,500 × 9 + ₹ 4,500 × 12 = ₹ 1,39,500.

Illustration 16

An assessee owns a heavy goods vehicle for 9 months and 7 days, medium goods vehicle for 9 months and light commercial vehicle for 12 months during the previous year. Compute his income applying the provisions of section 44AE.

Solution

His profits and gains from the 3 trucks shall be deemed to be ₹ 5,000 × 10 + ₹ 4,500 × 9 + ₹ 4,500 × 12 = ₹ 1,44,500.

6.21 Special provision for computing the profits and gains of shipping business in case of non-residents [Section 44B]

(i) This section provides for computation of the profits and gains of the business of shipping carried on by non-residents to the extent they are chargeable to income-tax in India. According to this, a sum equal to 7½% of the aggregate of the following amounts must be deemed to be the profits and gains of the business of shipping chargeable to tax under the head 'profits and gains of business or profession'.

(ii) 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.

(iii) 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 total of the above two amounts must be ascertained and 7½% thereof would be calculated and taken as the income from the business chargeable to tax in India. 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. In other words, the income would be computed on this basis without applying the various provisions contained in sections 28 to 43A. Consequential provisions are also seen in section 172.

For the purposes of sub-section (2), receipts forming the basis of estimates on non resident shipping lines will include demurrage and handling charges.

6.22 Provisions for computation of taxable income from activities connected with exploration of mineral oils [Section 44BB]

(i) The computation of taxable income of non-resident taxpayer engaged in the business of providing services and facilities in connection with or supplying plant and machinery on hire, used or to be used in the exploration for, and exploitation of mineral oils involves a number of complications.

(ii) As a measure of simplification, section 44BB provides for determination of income of such taxpayer at 10% of the aggregate of certain amounts. The amounts in respect of which the provisions will apply would be the amounts paid or payable to the taxpayer or to any person on his behalf whether in or out of India, on account of the provision of such services or facilities or supplying plant and machinery for the aforesaid purposes. This amount will also include facilities or supply of plant and machinery. This provision will not, however apply to any income to which the provisions of section 42, 44D, 44DA, 115A or 293A apply. It may be noted that section 44BB applies only to non-resident assesseees.

(iii) Such taxpayers may claim lower income than the present presumptive rate of 10%, if they keep and maintain books of accounts and documents as required under sub-section (2) of section 44AA and get their accounts audited under the provisions of section 44AB of the Act. The assessment in all such cases shall be done by the Assessing Officer under section 143(3).

Note - If the income of a non-resident is in the nature of fees for technical services, it shall be taxable under the provisions of either section 44DA or section 115A irrespective of the business to which it relates. Section 44BB would apply only in a case where consideration is for services and other facilities relating to exploration activity which are not in the nature of technical services.

6.23 Special provision for computing profits and gains of the business of operation of aircraft in the case of non-residents [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.

Illustration 17

Mr. Tiwari, a non-resident, operates an aircraft between Bangkok and Mumbai. He received the following amounts in the course of the business of operation of aircraft during the year ending 31.3.2014:

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

The total expenditure incurred by Mr. Tiwari for the purposes of the business during the year ending 31.3.2014 was ₹ 1.8 crore.

Compute the income of Mr. Tiwari chargeable to tax in India under the head "Profits and gains of business or profession" for the assessment year 2014-15.

Solution

Keeping in view the provisions of section 44BBA, the income of Mr. Tiwari 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 Mumbai	3,00,00,000
Amount received in India on account of carriage of goods from Mumbai	2,00,00,000
Amount received in India on account of carriage of passengers from Bangkok	1,00,00,000
Amount received in Bangkok on account of carriage of passengers from Mumbai	2,00,00,000
	8,00,00,000

Income from business under section 44BBA at 5% of ₹ 8,00,00,000 is ₹ 40,00,000, which is the income of Mr. Tiwari chargeable to tax in India under the head "Profits and gains of business or profession" for the A.Y. 2014-15.

6.24 Special provision for computing profits and gains of foreign companies engaged in the business of civil construction etc. in certain turnkey power projects [Section 44BBB]

(i) Under this provision in the case of a foreign company engaged in the business of construction or the business of erection of plant or machinery or testing or commissioning thereof in connection with a turnkey power project approved by the Central Government in this behalf, a sum equal to 10% of the amount paid or payable (whether in or out of India) to the said assessee or to any person on his behalf on account of such civil construction, erection, testing or commissioning shall be deemed to be the profits and gains of such business chargeable to tax under the head 'profits and gains of business or profession'.

(ii) However, such taxpayers may claim lower income than the present presumptive rate of 10%, if they keep and maintain books of accounts and documents as required under section 44AA(2) and get their accounts audited under the provisions of section 44AB. The assessment in all such cases shall be done by the Assessing Officer under section 143(3).

6.25 Special provisions for computing income by way of royalties etc. in case of non-residents [Section 44DA]

The provisions of this section are as follows -

(i) The income by way of royalty or fees for technical services received from Government or an Indian concern in pursuance of an agreement made by a non-corporate non-resident or a foreign company with Government or the Indian concern after the 31st March, 2003 in respect of such non-corporate non-resident or a foreign company which carries on business in India, shall be computed on the basis of books of accounts required to be maintained under the Act.

(ii) Such business should be carried on through a permanent establishment, or the assessee should perform professional services from a fixed place of profession in India

(iii) They should keep and maintain books of account and other documents in accordance with the provisions contained in section 44AA.

(iv) They should get their accounts audited by an accountant as defined in the Explanation below section 288(2) and furnish along with the return of income, the report of such audit in the prescribed form duly signed and verified by such accountant.

(v) No deduction will be allowed while computing income of such non-resident, of the expenditure which is not wholly and exclusively incurred for the business of such permanent establishment or fixed place and also of any amount paid by the permanent establishment to its head office or any of its offices.

(vi) There have been legal decisions which have expressed contradictory views regarding the scope and applicability of section 44BB vis-à-vis section 44DA on the issue of taxability of fee for technical services relating to the exploration sector.

(vii) In order to reflect the correct legislative intention regarding taxation of income by way of fee for technical services, section 44BB has been amended to exclude the applicability of

section 44BB to the income which is covered under section 44DA. A similar amendment has been made in section 44DA to provide that provisions of section 44BB would not be applicable in respect of the income covered under section 44DA.

(viii) Therefore, if the income of a non-resident is in the nature of fees for technical services, it shall be taxable under the provisions of either section 44DA or section 115A irrespective of the business to which it relates. Section 44BB would apply only in a case where consideration is for services and other facilities relating to exploration activity which are not in the nature of technical services.

6.26 Method of computing deduction in the case of business reorganisation of co-operative banks [Section 44DB]

- (i) This section provides the manner in which the deduction under the following sections are to be allowed in a case where business reorganisation of a co-operative bank has taken place during the financial year –
 - (1) Section 32 (Depreciation);
 - (2) Section 35D (Amortisation of certain preliminary expenses);
 - (3) Section 35DD (Amortisation of expenses in case of amalgamation or demerger);
 - (4) Section 35DDA (Amortisation of expenditure incurred under voluntary retirement scheme).
- (ii) Business reorganisation means the reorganisation of business involving the amalgamation or demerger of a co-operative bank.
- (iii) Co-operative bank shall have the meaning assigned to it in clause (cci) of section 5 of the Banking Regulation Act, 1949 i.e., a primary co-operative bank or Central Co-operative bank or a State co-operative bank.
- (iv) Predecessor co-operative bank means the amalgamating co-operative bank or the demerged co-operative bank, as the case may be.
- (v) Successor co-operative bank means the amalgamated co-operative bank or the resulting bank, as the case may be.
- (vi) The amount of deduction allowable to the predecessor co-operative bank under the above-mentioned sections has to be determined in accordance with the following formula-

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

A = the amount of deduction allowable to the predecessor co-operative bank if the business reorganisation had not taken place;

B = the number of days comprised in the period beginning with the 1st day of the financial year and ending on the day immediately preceding the date of business reorganisation; and

C = the total number of days in the financial year in which the business reorganisation has taken place.

- (vii) The amount of deduction allowable to the successor co-operative bank under the above-mentioned sections has to be determined in accordance with the formula -

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

A = the amount of deduction allowable to the predecessor co-operative bank if the business reorganisation had not taken place;

B = the number of days comprised in the period beginning with the date of business reorganisation and ending on the last day of the financial year; and

C = the total number of days in the financial year in which the business reorganisation has taken place.

For example, let us take a case where the deduction allowable under section 32 to the predecessor co-operative bank is, say, ₹ 1,20,000 and the business re-organisation took place on 1.11.2013. Then, the deduction allowable to the predecessor co-operative bank under section 32 would be ₹ 70,356 i.e., ₹ 1,20,000 x 214/365. The deduction allowable to the successor co-operative bank would be ₹ 49,644 i.e., ₹ 1,20,000 x 151/365.

- (viii) In a case where an undertaking of the predecessor co-operative bank entitled to the deduction under sections 35D, 35DD or 35DDA is transferred before the expiry of the period specified therein to a successor co-operative bank on account of business reorganisation, the provisions of section 35D, section 35DD or section 35DDA shall apply to the successor co-operative bank in the financial years subsequent to the year of business reorganisation as they would have applied to the predecessor co-operative bank, as if the business reorganisation had not taken place.
- (ix) Amalgamated co-operative bank means -
- (1) a co-operative bank with which one or more amalgamating co-operative banks merge; or
 - (2) a co-operative bank formed as a result of merger of two or more amalgamating co-operative banks.
- (x) Amalgamating co-operative bank means -
- (1) a co-operative bank which merges with another co-operative bank; or
 - (2) every co-operative bank merging to form a new co-operative bank.
- (xi) Amalgamation means the merger of an amalgamating co-operative bank or banks with an amalgamated co-operative bank, in such a manner that -
- (1) all the assets and liabilities of the amalgamating co-operative bank or banks immediately before the merger (other than the assets transferred, by sale or distribution on winding up, to the amalgamated co-operative bank) become the assets and liabilities of the amalgamated co-operative bank;

- (2) the members holding 75% or more voting rights in the amalgamating co-operative bank become members of the amalgamated co-operative bank; and
 - (3) the shareholders holding 75% or more in value of the shares in the amalgamating co-operative bank (other than the shares held by the amalgamated co-operative bank or its nominee or its subsidiary, immediately before the merger) become shareholders of the amalgamated co-operative bank.
- (xii) Demerger means the transfer by a demerged co-operative bank of one or more of its undertakings to any resulting co-operative bank, in such manner that -
- (1) all the assets and liabilities of the undertaking or undertakings immediately before the transfer become the assets and liabilities of the resulting co-operative bank;
 - (2) the assets and the liabilities are transferred to the resulting co-operative bank at values (other than change in the value of assets consequent to their revaluation) appearing in its books of account immediately before the transfer;
 - (3) the resulting co-operative bank issues, in consideration of the transfer, its membership to the members of the demerged co-operative bank on a proportionate basis;
 - (4) the shareholders holding 75% or more in value of the shares in the demerged co-operative bank (other than shares already held by the resulting bank or its nominee or its subsidiary immediately before the transfer), become shareholders of the resulting co-operative bank, otherwise than as a result of the acquisition of the assets of the demerged co-operative bank or any undertaking thereof by the resulting co-operative bank;
 - (5) the transfer of the undertaking is on a going concern basis; and
 - (6) the transfer is in accordance with the conditions specified by the Central Government, by notification in the Official Gazette, having regard to the necessity to ensure that the transfer is for genuine business purposes.
- (xiii) Demerged co-operative bank means the co-operative bank whose undertaking is transferred, pursuant to a demerger, to a resulting bank.
- (xiv) Resulting co-operative bank means -
- (1) one or more co-operative banks to which the undertaking of the demerged co-operative bank is transferred in a demerger; or
 - (2) any co-operative bank formed as a result of demerger.

Illustration 18

Alpha Co-operative Bank amalgamated with Beta Co-operative Bank on 1.12.2013. The depreciation for the year ended 31.3.2014 calculated as per Income-tax Rules, 1962, allowable to Alpha Co-operative Bank had the amalgamation had not taken place amounts to ₹ 2,40,000. Compute the deduction on account of depreciation allowable in the hands of Alpha Co-operative Bank and Beta Co-operative Bank for A.Y. 2014-15.

Solution

- (i) The amount of deduction allowable to the amalgamating co-operative bank (i.e. Alpha Co-operative bank, in this case) under section 32 has to be determined in accordance with the following formula -

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

A = the amount of deduction allowable to the predecessor co-operative bank (i.e. Alpha Co-operative bank, in this case) if the business reorganisation had not taken place. In this case, the amount of deduction is ₹ 2,40,000.

B = the number of days comprised in the period beginning with the 1st day of the financial year (i.e. 1.4.2013, in this case) and ending on the day immediately preceding the date of business reorganization (i.e. 30.11.2013, in this case); and

C = the total number of days in the financial year in which the business reorganisation has taken place (i.e. 365 days).

- (ii) The amount of deduction allowable to the amalgamated co-operative bank (i.e. Beta Co-operative bank, in this case) under section 32 has to be determined in accordance with the formula -

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

A = the amount of deduction allowable to the predecessor co-operative bank (i.e. Alpha Co-operative bank, in this case) if the business reorganisation had not taken place. In this case, the amount of deduction is ₹ 2,40,000.

B = the number of days comprised in the period beginning with the date of business reorganisation (i.e. 1.12.2013, in this case) and ending on the last day of the financial year (i.e. 31.3.2014); and

C = the total number of days in the financial year in which the business reorganisation has taken place (i.e. 365 days).

- (iii) In this case, the deduction that would have been allowable under section 32 to Alpha co-operative bank had the business reorganization had not taken place is ₹ 2,40,000 and the business re-organisation took place on 1.12.2013. Therefore, the deduction allowable to Alpha co-operative bank under section 32 would be ₹ 1,60,438 i.e., ₹ 2,40,000 x 244/365. The deduction allowable to Beta co-operative bank would be ₹ 79,562 i.e., ₹ 2,40,000 x 121/365.

6.27 Computation of business income in cases where income is partly agricultural and partly business in nature

- (i) Income from the manufacture of rubber [Rule 7A]

(1) Income derived from the sale of centrifuged latex or cenex or latex based crepes or brown crepes or technically specified block rubbers manufactured or processed from field

latex or coagulum obtained from rubber plants grown by the seller in India shall be computed as if it were income derived from business, and 35% of such income shall be deemed to be income liable to tax.

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

(ii) Income from the manufacture of coffee [Rule 7B]

(1) Income derived from the sale of coffee grown and cured by the seller in India shall be computed as if it were income derived from business, and 25% of such income shall be deemed to be income liable to tax.

(2) Income derived from the sale of coffee grown cured, roasted and grounded by the seller in India, with or without mixing of chicory or other flavouring ingredients, shall be computed as if it were income derived from business, and 40% of such income shall be deemed to be income liable to tax.

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

(iii) Income from the manufacture of tea [Rule 8]

(1) Income derived from the sale of tea grown and manufactured by the seller in India shall be computed as if it were income derived from business, and 40% of such income shall be deemed to be income liable to tax.

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

7.1 Introduction

In this chapter on capital gains, the discussion begins with the definition of capital asset and transfer and then the various circumstances under which capital gains tax is levied are enumerated. There are certain transactions which are not to be regarded as transfer for the purposes of capital gains. These transactions have also been discussed in this chapter. For computing long-term capital gains, knowledge of cost inflation index is necessary. Again, there is a separate method of computation of capital gains in respect of depreciable assets. Also, there are exemptions from capital gains under certain circumstances. All these are discussed in this chapter.

Section 45 provides that any profits or gains arising from the transfer of a capital asset effected in the previous year will be chargeable to income-tax under the head 'Capital Gains'. Such capital gains will be deemed to be the income of the previous year in which the transfer took place. In this charging section, two terms are important. One is "capital asset" and the other is "transfer".

7.2 Capital Asset

(1) **Definition:** According to section 2(14), a capital asset means property of any kind held by an assessee, whether or not connected with his business or profession, but does not include—

- (i) any stock-in-trade, consumable stores or raw materials held for the purpose of the business or profession of the assessee;
- (ii) personal effects, that is to say, movable property (including wearing apparel and furniture) held for personal use by the assessee or any member of his family dependent on him, but excludes -
 - (a) jewellery;
 - (b) archaeological collections;
 - (c) drawings;
 - (d) paintings;
 - (e) sculptures; or
 - (f) any work of art.
- (iii) Rural agricultural land in India i.e. agricultural land in India which is not situated in any

7.2 Income Tax

specified area.

- (iv) 6½% Gold Bonds, 1977, or 7% Gold Bonds, 1980, or National Defence Gold Bonds, 1980, issued by the Central Government;
- (v) Special Bearer Bonds, 1991 issued by the Central Government;
- (vi) Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 notified by the Central Government.

Note – ‘Property’ includes and shall be deemed to have always included any rights in or in relation to an Indian company, including rights of management or control or any other rights whatsoever.

(2) **Rural Agricultural Lands** - We can note from the above definition that only rural agricultural lands in India are excluded from the purview of the term ‘capital asset’. Hence urban agricultural lands constitute capital assets. Accordingly, the agricultural land described in (a) and (b) below, being land situated within the specified urban limits, would fall within the definition of “capital asset”, and transfer of such land would attract capital gains tax -

- (a) agricultural land situated in any area within the jurisdiction of a municipality or cantonment board having population of not less than ten thousand according to last preceding census, or
- (b) *agricultural land situated in any area within such distance, measured aerially, in relation to the range of population according to the last preceding census as shown hereunder -*

	<i>Shortest aerial distance from the local limits of a municipality or cantonment board referred to in item (a)</i>	<i>Population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.</i>
(i)	≤ 2 kilometers	$> 10,000 \leq 1,00,000$
(ii)	≤ 6 kilometers	$> 1,00,000 \leq 10,00,000$
(iii)	≤ 8 kilometers	$> 10,00,000$

Example

	<i>Area</i>	<i>Shortest aerial distance from the local limits of a municipality or cantonment board referred to in item (a)</i>	<i>Population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.</i>	<i>Is the land situated in this area a capital asset?</i>
(i)	A	1 km	9,000	No
(ii)	B	1.5 kms	12,000	Yes

(iii)	C	2 kms	11,00,000	Yes
(iv)	D	3 kms	80,000	No
(v)	E	4 kms	3,00,000	Yes
(v)	F	5 kms	12,00,000	Yes
(vi)	G	6 kms	8,000	No
(vii)	H	7 kms	4,00,000	No
(viii)	I	8 kms	10,50,000	Yes
(ix)	J	9 kms	15,00,000	No

Explanation regarding gains arising on the transfer of urban agricultural land - *Explanation* to section 2(1A) clarifies that capital gains arising from transfer of any agricultural land situated in any non-rural area (as explained above) will not constitute agricultural revenue within the meaning of section 2(1A). In other words, the capital gains arising from the transfer of such urban agricultural lands would not be treated as agricultural income for the purpose of exemption under section 10(1). Hence, such gains would be exigible to tax under section 45.

(3) **Other capital assets** - It is not possible to enumerate the forms which a capital asset can take. Goodwill, leasehold rights, a partner's right or share in the firm, a manufacturing licence and the right to subscribe for share of a company etc. are all examples of capital asset.

(4) **Jewellery** - As noted above, jewellery is treated as capital asset and the profits or gains arising from the transfer of jewellery held for personal use are chargeable to tax under the head "capital gains". For this purpose, the expression 'jewellery' includes the following:

- (i) Ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stones and whether or not worked or sewn into any wearing apparel;
- (ii) Precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel.

(5) **Zero Coupon Bond** – Section 2(48) defines the expression 'Zero Coupon Bond'. As per this definition, 'zero coupon bond' means a bond issued by any infrastructure capital company or infrastructure capital fund or a public sector company or a scheduled bank on or after 1st June, 2005, in respect of which no payment and benefit is received or receivable before maturity or redemption from such issuing entity and which the Central Government may notify in this behalf. Accordingly, the Central Government has specified the following bonds issued on or before 31.3.2009 as zero coupon bonds –

- (i) 10 year zero coupon bonds of HUDCO, SIDBI, NABARD and IDFC;
- (ii) 15 year zero coupon bonds of HUDCO;
- (iii) 15 year zero coupon bonds of Power Finance Corporation; and
- (iv) 10 year zero coupon bonds of National Housing Bank.

The Central Government has also specified the following bonds issued on or before 31.3.2011 as zero coupon bonds –

- (a) Bhavishya Nirman Bond, a 10 year zero coupon bond of National Bank of Agriculture and Rural Development (NABARD), issued on or before 31.3.2011
- (b) 10 year Deep Discount Bond (Zero Coupon Bond) of Rural Electrification Corporation Limited (REC) issued on or before 31.3.2011.

The income on transfer of a ZCB (not being held as stock-in-trade) is to be treated as capital gains. Section 2(47)(iva) provides that maturity or redemption of a ZCB shall be treated as a transfer for the purposes of capital gains tax. ZCBs held for not more than 12 months would be treated as short term capital assets. Where the period of holding of ZCBs is more than 12 months, the resultant long term capital gains arising on maturity or redemption would be treated in the same manner as applicable to capital gains arising from the transfer of other listed securities or units covered by section 112. Thus, where the tax payable in respect of any income arising from transfer of ZCBs exceeds 10% of the amount of capital gains before giving effect to the provisions of the second proviso to section 48 on indexation, then, such excess shall be ignored for the purpose of computing the tax payable.

The terms “infrastructure capital company” and “infrastructure capital fund” have been defined in section 2(26A) and 2(26B), respectively. For details, refer Chapter 1- Basic Concepts.

7.3 Short-term and long-term capital assets

Section 2(42A) defines short-term capital asset as a capital asset held by an assessee for not more than 36 months immediately preceding the date of its transfer. Therefore, a capital asset held by an assessee for more than 36 months immediately preceding the date of its transfer is a long-term capital asset.

However, in the case of company shares, various securities listed in a recognised Stock Exchange in India, units of the Unit Trust of India and of Mutual Funds specified under section 10(23D) or a Zero Coupon Bond, the said assets will be considered as long-term capital assets if they are held for more than 12 months. Further, in the case of a capital asset being a share or any other security or a right to subscribe to any share or security where such right is renounced in favour of any other person, the period shall be calculated for treating the capital asset as a short-term capital asset from the date of allotment of such share or security or from the date of offer of such right by the company or institution concerned.

Determination of period of holding - The following points must be noted in this regard:

- (i) In the case of a share held in a company in liquidation, the period subsequent to the date on which the company goes into liquidation should be excluded.
- (ii) Section 49(1) specifies some special circumstances under which capital asset becomes the property of an assessee. For example, an assessee may get a capital asset on a distribution of assets on the partition of a HUF or he may get a gift or he may get the property under a will or from succession, inheritance etc. In such cases, the period for which the asset was held by the previous owner should be taken into account.
- (iii) In the case of shares held in an amalgamated company in lieu of shares in the amalgamating

company, the period will be counted from the date of acquisition of shares in the amalgamating company.

(iv) In the case of a capital asset being a share or any other security or a right to subscribe to any share or security where such right is renounced in favour of any other person, the period shall be calculated from the date of allotment of such share or security or from the date of offer of such right by the company or institution concerned.

(v) In respect of other capital assets, the period for which any capital asset is held by the assessee shall be determined in accordance with any rules made by the CBDT in this behalf.

(vi) In the case of a capital asset, being a financial asset, allotted without any payment and on the basis of holding of any other financial asset the period shall be reckoned from the date of the allotment of such financial asset.

(vii) In the case of a capital asset being shares in an Indian company, which becomes the property of the assessee in consideration of a demerger, the period of holding shall include the period for which the shares were held in the demerged company by the assessee.

(viii) In the case of a capital asset being equity shares, or trading or clearing rights, of a stock exchange acquired by a person pursuant to demutualization or corporatisation of a recognised stock exchange in India as referred to in clause (xiii) of section 47, there shall be included while calculating the period of holding of such assets the period, for which the person was a member of the recognised stock exchange immediately prior to such demutualization or corporatisation.

(ix) In the case of a capital asset, being any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer free of cost or at concessional rate to his employees (including former employee or employees), the period shall be reckoned from the date of allotment or transfer of such specified security or sweat equity shares.

“Specified security” means the securities as defined in section 2(h) of the Securities Contracts (Regulation) Act, 1956 and, where employees’ stock option has been granted under any plan or scheme therefor, includes the securities offered under such plan or scheme.

“Sweat equity shares” means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

In respect of capital assets other than those listed above, the period of holding shall be determined subject to any rules which the Board may make in this behalf.

7.4 Transfer: What it means [Section 2(47)]

The Act contains an inclusive definition of the term ‘transfer’. Accordingly, transfer in relation to a capital asset includes the following types of transactions :—

- (i) the sale, exchange or relinquishment of the asset; or
- (ii) the extinguishment of any rights therein; or
- (iii) the compulsory acquisition thereof under any law; or
- (iv) the owner of a capital asset may convert the same into the stock-in-trade of a business carried on by him. Such conversion is treated as transfer; or

- (v) the maturity or redemption of a Zero Coupon Bond; or
- (vi) Part-performance of the contract : Sometimes, possession of an immovable property is given in consideration of part-performance of a contract. For example, A enters into an agreement for the sale of his house. The purchaser gives the entire sale consideration to A. A hands over complete rights of possession to the purchaser since he has realised the entire sale consideration. Under Income-tax Act, the above transaction is considered as transfer; or
- (vii) Lastly, there are certain types of transactions which have the effect of transferring or enabling the enjoyment of an immovable property. For example, a person may become a member of a co-operative society, company or other association of persons which may be building houses/flats. When he pays an agreed amount, the society etc. hands over possession of the house to the person concerned. No conveyance is registered. For the purpose of income-tax, the above transaction is a transfer. Even power of attorney transactions are covered.

Note – Section 2(47) provides an inclusive definition of “transfer”, in relation to a capital asset. Explanation 2 to section 2(47) clarifies that ‘transfer’ includes and shall be deemed to have always included –

(1) disposing of or parting with an asset or any interest therein, or	}	- directly or indirectly,
(2) creating any interest in any asset in any manner whatsoever		- absolutely or conditionally,
		- voluntarily or involuntarily

by way of an agreement (whether entered into in India or outside India) or otherwise.

The above transactions would be deemed as a transfer notwithstanding that such transfer of rights has been characterized as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India.

7.5 Scope and year of chargeability [Section 45]

(i) **General Provision [Section 45(1)]** - Any profits or gains arising from the transfer of a capital asset effected in the previous year (other than exemptions covered under this chapter) shall be chargeable to Income-tax under this head in the previous year in which the transfer took place.

(ii) **Receipts from insurance parties [Section 45(1A)]** - Where any person receives any money or other assets under any insurance from an insurer on account of damage to or destruction of any capital asset, as a result of flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature, riot or civil disturbance, accidental fire or explosion or because of action by an enemy or action taken in combating an enemy (whether with or without declaration of war), then, any profits or gains arising from receipt of such money or other assets shall be chargeable to income-tax under the head “Capital gains” and shall be deemed to be the income of the such person for the previous year in which money or other asset was received.

For the purposes of section 48, the value of any money or the fair market value of other assets on the date of such receipt shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of such capital assets.

(iii) Conversion or treatment of a capital asset as stock-in-trade [Section 45(2)] - A person who is the owner of a capital asset may convert the same or treat it as stock-in-trade of the business carried on by him. As noted above, the above transaction is a transfer. As per section 45(2), the profits or gains arising from the above conversion or treatment will be chargeable to income-tax as his income of the previous year in which such stock-in-trade is sold or otherwise transferred by him. In order to compute the capital gains, the fair market value of the asset on the date of such conversion or treatment shall be deemed to be the full value of the consideration received as a result of the transfer of the capital asset.

Illustration 1

A is the owner of a car. On 1-4-2013, he starts a business of purchase and sale of motor cars. He treats the above car as part of the stock-in-trade of his new business. He sells the same on 31-3-2014 and gets a profit of ₹ 1 lakh. Discuss the tax implication.

Solution

Since car is a personal asset, conversion or treatment of the same as the stock-in-trade of his business will not be trapped by the provisions of section 45(2). Hence A is not liable to capital gains tax.

Illustration 2

X converts his capital asset (acquired on June 10, 1988 for ₹ 60,000) into stock-in-trade in March 10, 2013. The fair market value on the date of the above conversion was ₹ 3,50,000. He subsequently sells the stock-in-trade so converted for ₹ 4,00,000 on June 10, 2013. Discuss the tax implication.

Solution

Since the capital asset is converted into stock-in-trade during the previous year relevant to the A.Y. 2013-14, it will be a transfer under section 2(47) during the P.Y. 2012-13. However, the profits or gains arising from the above conversion will be chargeable to tax during the A.Y. 2014-15, since the stock-in-trade has been sold only on June 10, 2013. For this purpose, the fair market value on the date of such conversion (i.e. 10th March, 2013) will be the full value of consideration.

The capital gains will be computed after deducting the indexed cost of acquisition from the full value of consideration. The cost inflation index for 1988-89 i.e., the year of acquisition is 161 and the index for the year of transfer i.e., 2012-13 is 852. The indexed cost of acquisition is $60,000 \times 852/161 = ₹ 3,17,516$. Hence, ₹ 32,484 (i.e. ₹ 3,50,000 – ₹ 3,17,516) will be treated as long-term capital gains chargeable to tax during the A.Y. 2014-15. During the same assessment year, ₹ 50,000 (₹ 4,00,000 - ₹ 3,50,000) will be chargeable to tax as business profits.

Year of chargeability - Capital gains are chargeable as the income of the previous year in which the sale or transfer takes place. In other words, for determining the year of chargeability, the relevant date of transfer is not the date of the agreement to sell, but the actual date of sale i.e., the date on which the effect of transfer of title to the property as contemplated by the parties has taken place [*Alapati Venkatramiah v. CIT* [1965] 57 ITR 185 (SC)]. Thus, in the case of any immovable property of the value exceeding ₹ 100, the title to

the property cannot pass from the transferor to the transferee until and unless a deed of conveyance is executed and registered. Mere delivery of possession of the immovable property could not itself be treated as equivalent to conveyance of the immovable property. In the case of any movable property, the title to which would pass immediately on delivery of the property in accordance with the agreement to sell, the transfer will be complete on such delivery. However, as already noted, Income-tax Act has recognised certain transactions as transfer in spite of the fact that conveyance deed might not have been executed and registered. Power of Attorney sales as explained above or co-operative society transactions for acquisition of house are examples in this regard.

(iv) **Transfer of beneficial interest in securities [Section 45(2A)]** - As per section 45(2A), where any person has had at any time during the previous year any beneficial interest in any securities, then, any profits or gains arising from the transfer made by the Depository or participant of such beneficial interest in respect of securities shall be chargeable to tax as the income of the beneficial owner of the previous year in which such transfer took place and shall not be regarded as income of the depository who is deemed to be the registered owner of the securities by virtue of sub-section (1) of section 10 of the Depositories Act, 1996. For the purposes of section 48 and proviso to section 2(42A), the cost of acquisition and the period of holding of securities shall be determined on the basis of the first-in-first-out (FIFO) method.

When the securities are transacted through stock exchanges, it is the established procedure that the brokers first enter into contracts for purchase/sale of securities and thereafter, follow it up with delivery of shares, accompanied by transfer deeds duly signed by the registered holders. The seller is entitled to receive the consideration agreed to as on the date of contract. Thus, it is the date of broker's note that should be treated as the date of transfer in case of sale transactions of securities provided such transactions are followed up by delivery of shares and also the transfer deeds. Similarly, in respect of the purchasers of the securities, the holding period shall be reckoned to take place directly between the parties and not through stock exchanges. The date of contract of sale as declared by the parties shall be treated as the date of transfer provided it is followed up by actual delivery of shares and the transfer deeds.

Where securities are acquired in several lots at different points of time, the First-In-First-Out (FIFO) method shall be adopted to reckon the period of the holding of the security, in cases where the dates of purchase and sale could not be correlated through specific numbers of the scrips. In other words, the assets acquired last will be taken to be remaining with the assessee while assets acquired first will be treated as sold. Indexation, wherever applicable, for long-term assets will be regulated on the basis of the holding period determined in this manner - *CBDT Circular No. 704, dated 28.4.1995*.

"Beneficial owner" means a person whose name is recorded as such with a depository.

"Depository" means a company formed and registered under the Companies Act, 1956 and which has been granted a certificate of registration under section 12(1A) of the Securities and Exchange Board of India Act, 1992.

"Security" means such security as may be specified by SEBI.

(v) **Introduction of capital asset as capital contribution [Section 45(3)]** - Where a person transfers a capital asset to a firm, AOP or BOI in which he is already a partner/member or is

to become a partner/member by way of capital contribution or otherwise, the profits or gains arising from such transfer will be chargeable to tax as income of the previous year in which such transfer takes place. For this purpose, the value of the consideration will be the amount recorded in the books of account of the firm, AOP or BOI as the value of the capital asset.

Illustration 3

A is the owner of a foreign car. He starts a firm in which he and his two sons are partners. As his capital contribution, he transfers the above car to the firm. The car had cost him ₹ 2,00,000. The same is being introduced in the firm at a recorded value of ₹ 3,50,000. Discuss.

Solution

Car is not capital asset but is a personal effect. Section 45(3), as explained above, covers only cases of transfer of capital asset as contribution and not personal effects. Hence, the above transaction will not be subject to capital gains tax.

(vi) **Distribution of capital assets on a firm's dissolution [Section 45(4)]** - The profits or gains arising from the transfer of capital assets by way of distribution of capital assets on the dissolution of a firm or AOP or BOI or otherwise shall be chargeable to tax as the income of the firm etc. of the previous year in which such transfer takes place. For this purpose, the fair market value of the asset on the date of such transfer shall be the full value of consideration.

The Bombay High Court made a landmark judgment in *Commissioner of Income-tax v. A.N. Naik Associates (2004) 136 Taxman 107*. The Court applied the "mischief rule" about interpretation of statutes and pointed out that the idea behind the introduction of sub-section (4) in section 45 was to plug in a loophole and block the escape route through the medium of the firm. The High Court observed that the expression 'otherwise' has not to be read *ejusdem generis* with the expression 'dissolution of a firm or body of individuals or association of persons'. The expression 'otherwise' has to be read with the words 'transfer of capital assets by way of distribution of capital assets'. If so read, it becomes clear that even when a firm is in existence and there is a transfer of capital asset, it comes within the expression 'otherwise' since the object of the amendment was to remove the loophole which existed, whereby capital gains tax was not chargeable. Therefore, the word 'otherwise' takes into its sweep not only cases of dissolution but also cases of subsisting partners of a partnership, transferring assets in favour of retiring partners.

(vii) **Compensation on compulsory acquisition [Section 45(5)]** - Sometimes, a building or some other capital asset belonging to a person is taken over by the Central Government by way of compulsory acquisition. In that case, the consideration for the transfer is determined by the Central Government. When the Central Government pays the above compensation, capital gains may arise. Such capital gains are chargeable as income of the previous year in which such compensation is received.

Enhanced Compensation - Many times, persons whose capital assets have been taken over by the Central Government and who get compensation from the government go to the court of law for enhancement of compensation. If the court awards a compensation which is higher than the original compensation, the difference thereof will be chargeable to capital gains in the year in which the same is received from the government. For this purpose, the cost of

acquisition and cost of improvement shall be taken to be *nil*.

Reduction of enhanced compensation - Where capital gain has been charged on the compensation received by the assessee for the compulsory acquisition of any capital asset or enhanced compensation received by the assessee and subsequently such compensation is reduced by any court, tribunal or any authority, the assessed capital gain of that year shall be recomputed by taking into consideration the reduced amount. This re-computation shall be done by way of rectification under section 155.

Death of the transferor - It is possible that the transferor may die before he receives the enhanced compensation. In that case, the enhanced compensation or consideration will be chargeable to tax in the hands of the person who received the same.

Note - *Since the tax treatment accorded to a LLP and a general partnership is the same, the conversion from a general partnership firm to an LLP will have no tax implications if the rights and obligations of the partners remain the same after conversion and if there is no transfer of any asset or liability after conversion. However, if there is a change in rights and obligations of partners or there is a transfer of asset or liability after conversion, then the provisions of section 45 would get attracted.*

7.6 Capital gains on distribution of assets by companies in liquidation [Section 46]

(1) Where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as a transfer by the company for the purposes of section 45 [Section 46(1)]. The above section is restricted in its application to the circumstances mentioned therein *i.e.*, the assets of the company must be distributed in specie to shareholders on the liquidation of the company. If, however, the liquidator sells the assets of the company resulting in a capital gain and distributes the funds so collected, the company will be liable to pay tax on such gains.

(2) Shareholders receive money or other assets from the company on its liquidation. They will be chargeable to income-tax under the head 'capital gains' in respect of the market value of the assets received on the date of distribution, or the moneys so received by them. The portion of the distribution which is attributable to the accumulated profits of the company is to be treated as dividend income of the shareholder under section 2(22)(c). The same will be deducted from the amount received/fair market value for the purpose of determining the consideration for computation of capital gains.

(3) Capital gains tax on subsequent sale by the shareholders - If the shareholder, after receipt of any such asset on liquidation of the company, transfers it within the meaning of section 45 at a price which is in excess of his cost of acquisition determined in the manner aforesaid, such excess becomes taxable in his hands under section 45.

7.7 Capital gains on buyback, etc. of shares [Section 46A]

Any consideration received by a shareholder or a holder of other specified securities from any company on purchase of its own shares or other specified securities held by such shareholder or holder of other specified securities shall be chargeable to tax on the difference between the

cost of acquisition and the value of consideration received by the holder of securities or by the shareholder, as the case may be, as capital gains. The computation of capital gains shall be made in accordance with the provisions of section 48.

Such capital gains shall be chargeable in the year in which such shares/securities were purchased by the company. For this purpose, "specified securities" shall have the same meaning as given in *Explanation* to section 77A of the Companies Act, 1956¹.

However, in case of buyback of unlisted shares by domestic companies, additional income-tax@20% (plus surcharge@10% and cess@3%) is leviable in the hands of the company. Consequently, the income arising to the shareholders in respect of such buyback of unlisted shares by the domestic company would be exempt under section 10(34A), where the company is liable to pay additional income-tax on the buyback of shares.

(1)	(2)	(3)
<i>Taxability in the hands of the -</i>	<u><i>Buyback of unlisted shares by domestic companies</i></u>	<u><i>Buyback of shares other than shares referred to in column (2)</i></u>
<i>(i) Company</i>	<i>Subject to additional income-tax@22.66%.</i>	<i>Not subject to tax in the hands of the company.</i>
<i>(ii) Shareholders</i>	<i>Income arising to shareholders exempt under section 10(34A)</i>	<i>Income arising to shareholders taxable as capital gains under section 46A.</i>

7.8 Transactions not regarded as transfer [Section 47]

Section 47 specifies certain transactions which will not be regarded as transfer for the purpose of capital gains tax:

- (1) Any distribution of capital assets on the total or partial partition of a HUF;
- (2) Any transfer of a capital asset under a gift or will or an irrevocable trust;

However, this clause shall not include transfer under a gift or an irrevocable trust of a capital asset being shares, debentures or warrants allotted by a company directly or indirectly to its employees under the Employees' Stock Option Plan or Scheme offered to its employees in accordance with the guidelines issued in this behalf by the Central Government.

- (3) Any transfer of a capital asset by a company to its subsidiary company.

Conditions - (i) The parent company must hold the whole of the shares of the subsidiary company; (ii) The subsidiary company must be an Indian company.

- (4) Any transfer of capital asset by a subsidiary company to a holding company;

Conditions - (i) The whole of shares of the subsidiary company must be held by the holding company; (ii) The holding company must be an Indian company.

Exception - The exemption mentioned in 3 or 4 above will not apply if a capital asset is

¹ Explanation 1 to section 68 of the Companies Act, 2013

transferred as stock-in-trade.

(5) Any transfer in a scheme of amalgamation of a capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company.

(6) Any transfer in a scheme of amalgamation of shares held in an Indian company by the amalgamating foreign company to the amalgamated foreign company.

Conditions - (i) At least 25 percent of the shareholders of the amalgamating foreign company must continue to remain shareholders of the amalgamated foreign company; (ii) Such transfer should not attract capital gains in the country in which the amalgamating company is incorporated.

(7) Any transfer, in a scheme of amalgamation of a banking company with a banking institution sanctioned and brought into force by the Central Government under section 45(7) of the Banking Regulation Act, 1949, of a capital asset by such banking company to such banking institution.

(8) Any transfer by a shareholder in a scheme of amalgamation of shares held by him in the amalgamating company.

Conditions - (i) The transfer is made in consideration of the allotment to him of any share in the amalgamated company, except where the shareholder itself is the amalgamated company; (ii) The amalgamated company is an Indian company.

For example, let us take a case where A Ltd., an Indian company, holds 60% of shares in B Ltd. B Ltd. amalgamates with A Ltd. Since A Ltd. itself is the shareholder of B Ltd., A Ltd., being the amalgamated company, cannot issue shares to itself. However, A Ltd. has to issue shares to the other shareholders of B Ltd.

Illustration 4

M held 2000 shares in a company ABC Ltd. This company amalgamated with another company during the previous year ending 31-3-2014. Under the scheme of amalgamation, M was allotted 1000 shares in the new company. The market value of shares allotted is higher by ₹ 50,000 than the value of holding in ABC Ltd. The Assessing Officer proposes to treat the transaction as an exchange and to tax ₹ 50,000 as capital gain. Is he justified?

Solution

In the above example, assuming that the amalgamated company is an Indian company, the transaction is squarely covered by the exemption explained above and the proposal of the Assessing Officer to treat the transaction as an exchange is not justified.

(9) Any transfer in a demerger, of a capital asset by the demerged company to the resulting company, if the resulting company is an Indian company.

(10) Any transfer in a demerger, of a capital asset, being a share or shares held in an Indian company, by the demerger foreign company to the resulting foreign company.

Conditions - (i) The shareholders holding at least three-fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and

(ii) Such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated.

However, the provisions of sections 391 to 394 of the Companies Act, 1956², shall not apply in case of demergers referred to in this clause.

(11) any transfer in a business reorganisation, of a capital asset by the predecessor co-operative bank to the successor co-operative bank.

(12) any transfer by a shareholder, in a business reorganisation, of a capital asset being a share or shares held by him in the predecessor co-operative bank if the transfer is made in consideration of the allotment to him of any share or shares in the successor co-operative bank.

Note – Refer to section 44DDB for the meanings of “business reorganisation”, “predecessor co-operative bank” and “successor co-operative bank”.

(13) Any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking.

(14) Any transfer of bonds or shares referred to in section 115AC(1).

Conditions - (i) The transfer must be made outside India; (ii) The transfer must be made by the non-resident to another non-resident.

(15) Any transfer of agricultural lands effected before 1-3-1970.

(16) Any transfer of any of the following capital asset to the government or to the University or the National Museum, National Art Gallery, National Archives or any other public museum or institution notified by the Central Government to be of (national importance or to be of) renown throughout any State :

- (i) work of art
- (ii) archaeological, scientific or art collection
- (iii) book
- (iv) manuscript
- (v) drawing
- (vi) painting
- (vii) photograph or
- (viii) print.

(17) Any transfer by way of conversion of bonds or debentures, debenture stock or deposit certificates in any form, of a company into shares or debentures of that company.

(18) Any transfer by way of conversion of Foreign Currency Exchangeable Bonds into shares or debentures of a company.

(19) Transfer by way of exchange of a capital asset being membership of a recognised stock

² Sections 230 to 232 of the Companies Act, 2013

exchange for shares of a company to which such membership is transferred.

Conditions - (i) Such exchange is effected on or before 31st December, 1998 and (ii) such shares are retained by the transferor for a period of not less than three years from the date of transfer.

(20) Capital gains arising from the transfer of land under a scheme prepared and sanctioned under section 18 of the Sick Industrial Companies (Special Provisions) Act, 1985, by a sick industrial company which is managed by its workers' co-operative.

Conditions - Such transfer is made in the period commencing from the previous year in which the said company has become a sick industrial company and ending with the previous year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses.

(21) Where a firm is succeeded by a company or where an AOP or BOI is succeeded by a company in the course of demutualisation or corporatisation of a recognised stock exchange in India, any transfer of a capital asset or intangible asset (in the case of a firm).

Conditions - (i) All assets and liabilities of the firm or AOP or BOI relating to the business immediately before the succession become the assets and liabilities of the company;

(ii) All the partners of the firm immediately before the succession become the shareholders of the company and the proportion in which their capital accounts stood in the books of the firm on the date of succession remains the same;

(iii) The partners of the firm do not receive any consideration or benefit in any form, directly or indirectly, other than by way of allotment of shares in the company.

(iv) The partners of the firm together hold not less than 50% of the total voting power in the company, and their shareholding continues in such manner for a period of 5 years from the date of succession.

(v) The corporatisation of a recognised stock exchange in India is carried out in accordance with a scheme for demutualisation or corporatisation approved by SEBI.

(22) any transfer of a membership right by a member of recognised stock exchange in India for acquisition of shares and trading or clearing rights in accordance with a scheme for demutualization or corporatisation approved by SEBI.

(23) any transfer of a capital asset or intangible asset by a private company or unlisted public company to a LLP or any transfer of a share or shares held in a company by a shareholder on conversion of a company into a LLP in accordance with section 56 and section 57 of the Limited Liability Partnership Act, 2008, shall not be regarded as a transfer for the purposes of levy of capital gains tax under section 45, subject to fulfillment of certain conditions, namely:

(i) the total sales, turnover or gross receipts in business of the company should not exceed ₹ 60 lakh in any of the three preceding previous years;

(ii) the shareholders of the company become partners of the LLP in the same proportion as their shareholding in the company;

(iii) no consideration other than share in profit and capital contribution in the LLP arises to

the shareholders;

- (iv) the erstwhile shareholders of the company continue to be entitled to receive at least 50% of the profits of the LLP for a period of 5 years from the date of conversion;
- (v) all assets and liabilities of the company become the assets and liabilities of the LLP; and
- (vi) no amount is paid, either directly or indirectly, to any partner out of the accumulated profit of the company for a period of 3 years from the date of conversion.

(24) Where a sole proprietary concern is succeeded by a company in the business carried out by it, as a result of which the sole proprietary concern transfers or sells any capital asset or intangible asset to such company.

Conditions - (i) All assets and liabilities of the sole proprietary concern relating to the business immediately before the succession become the assets and liabilities of the company;

(ii) The sole proprietor holds not less than 50% of the total voting power in the company, and his shareholding continues in such manner for a period of 5 years from the date of succession;

(iii) The sole proprietor does not receive any consideration or benefit in any form, directly or indirectly, other than by way of allotment of shares in the company.

(25) Any transfer in a scheme for lending of any securities under an agreement or arrangement which the assessee has entered into with the borrower of such securities and which is subject to the guidelines issued by SEBI or the RBI, for example, the Securities Lending and Borrowing (SLB) Scheme for all market participants in the Indian securities market under the overall framework of Securities Lending Scheme, 1997 of SEBI.

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

Illustration 5

In which of the following situations capital gains tax liability does not arise?

- (i) Mr. A purchased gold in 1970 for ₹ 25,000. In the P.Y. 2013-14, he gifted it to his son at the time of marriage. Fair market value (FMV) of the gold on the day the gift was made was ₹ 1,00,000.
- (ii) A house property is purchased by a Hindu undivided family in 1945 for ₹ 20,000. It is given to one of the family members in the P.Y. 2013-14 at the time of partition of the family. FMV on the day of partition was ₹ 12,00,000.
- (iii) Mr. B purchased 50 convertible debentures for ₹ 40,000 in 1995 which are converted in to 500 shares worth ₹ 85,000 in November 2013 by the company.

Solution

We know that capital gains arise only when we transfer a capital asset. The liability of capital gains tax in the situations given above is discussed as follows:

- (i) As per the provisions of section 47(iii), transfer of a capital asset under a gift is not regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.
- (ii) As per the provisions of section 47(i), transfer of a capital asset (being in kind) on the total or

partial partition of Hindu undivided family is not regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.

- (iii) As per the provisions of section 47(x), transfer by way of conversion of bonds or debentures, debenture stock or deposit certificates in any form of a company into shares or debentures of that company is not regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.

7.9 Important Definitions

(a) **Amalgamation [Section 2(1B)]** - "Amalgamation", in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as a result of the merger, as the amalgamated company) in such a manner that -

- (i) all the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation;
- (ii) all the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation;
- (iii) shareholders holding not less than three-fourth in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation, otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first mentioned company.

(b) **Demerger [Section 2(19AA)]** - "Demerger", in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956³, by a demerged company of its one or more undertaking to any resulting company in such a manner that -

- (i) all the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger;
- (ii) all the liabilities relating to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;
- (iii) the property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;
- (iv) the resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis except where the resulting company itself is a shareholder of the demerged company;

³ Sections 230 to 232 of the Companies Act, 2013

Note - If the resulting company is a shareholder of the demerged company, it cannot issue shares to itself. However, the resulting company has to issue shares to the other shareholders of the demerged company.

(v) the shareholders holding not less than three-fourths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;

(vi) the transfer of the undertaking is on a going concern basis;

(vii) the demerger is in accordance with the conditions, if any, notified under sub-section (5) of section 72A by the Central Government in this behalf.

Explanation 1 - For the purposes of this clause, “undertaking” shall include any part of an undertaking, or a unit or division of an undertaking or a business activity taken as a whole, but does not include individual assets or liabilities or any combination thereof not constituting a business activity.

Explanation 2 - For the purposes of this clause, the liabilities referred to in sub-section (ii), shall include-

(a) the liabilities which arise out of the activities or operations of the undertaking;

(b) the specific loans or borrowings (including debentures) raised, incurred and utilised solely for the activities or operations of the undertaking; and

(c) in cases, other than those referred to in clause (a) or clause (b), so much of the amounts of general or multipurpose borrowings, if any, of the demerged company as stand in the same proportion which the value of the assets transferred in a demerger bears to the total value of the assets of such demerged company immediately before the demerger.

Explanation 3 - For determining the value of the property referred to in sub-clause (iii), any change in the value of assets consequent to their revaluation shall be ignored.

Explanation 4 - For the purposes of this clause, the splitting up or the reconstruction of any authority or a body constituted or established under a Central, State or Provincial Act, or a local authority or a public sector company, into separate authorities or bodies or local authorities or companies, as the case may be, shall be deemed to be a demerger if such split up or reconstruction fulfils such conditions as may be notified by the Central Government in the Official Gazette.

“Demerged company” means the company whose undertaking is transferred, pursuant to a demerger, to a resulting company.

7.10 Withdrawal of exemption in certain cases

Section 47A provides for withdrawal of the benefit of exemption given by section 47 in certain cases.

As noted above, capital gains arising from the transfer of a capital asset by a company to its wholly owned subsidiary company is exempt from tax. Similarly, capital gains arising from the transfer of a capital asset by the subsidiary company to the holding company is also exempt from tax, provided under both circumstances the transferee is an Indian company.

Section 47A provides that the above exemption will be withdrawn in the following cases:

- (1) Where at any time before the expiry of eight years from the date of transfer of a capital asset referred to above, such capital asset is converted by the transferee company or is treated by it as stock-in-trade of its business;
- (2) Where before eight years as noted above, the parent company or its nominee ceases to hold the whole of the share capital of the subsidiary company.

In the above two cases, the amount of capital gains exempt from tax by virtue of the provisions contained in section 47 will be deemed to be the income of the transferor company chargeable under the head 'capital gains' of the year in which such transfer took place.

- (3) Capital gains not charged to tax under section 47(xi) shall be deemed to be the income chargeable under the head "capital gains" of the previous year in which such transfer took place if the shares of the company received in exchange for transfer of membership in a recognised stock exchange are transferred at any time before the expiry of three years of such transfer.

- (4) Where any of the conditions laid down in section 47 for succession of a firm or sole proprietary concern by a company are not complied with, the amount of profits or gains arising from the transfer of such capital asset or intangible asset shall be deemed to be the profits and gains chargeable to tax of the successor company for the previous year in which the conditions are not complied with.

- (5) If subsequent to the conversion of a company into an LLP, any of the conditions laid down in section 47(xiiib) are not complied with, the capital gains not charged under section 45 would be deemed to be chargeable to tax in the previous year in which the conditions are not complied with, in the hands of the LLP or the shareholder of the predecessor company, as the case may be.

7.11 Mode of computation of capital gains

- (i) The income chargeable under the head 'capital gains' shall be computed by deducting the following items from the full value of the consideration received or accruing as a result of the transfer of the capital asset:

- (1) Expenditure incurred wholly and exclusively in connection with such transfer.
- (2) The indexed cost of acquisition and indexed cost of any improvement thereto.

- (ii) However, no deduction shall be allowed in computing the income chargeable under the head "Capital Gains" in respect of any amount paid on account of securities transaction tax under Chapter VII of the Finance (No.2) Act, 2004.

Under section 48, the cost of acquisition will be increased by applying the cost inflation index (CII). Once the cost inflation index is applied to the cost of acquisition, it becomes indexed cost

of acquisition. This means an amount which bears to the cost of acquisition, the same proportion as CII for the year in which the asset is transferred bears to the CII for the first year in which the asset was held by the assessee or for the year beginning on 1st April, 1981, whichever is later. Similarly, indexed cost of any improvement means an amount which bears to the cost of improvement, the same proportion as CII for the year in which the asset is transferred bears to the CII for the year in which the improvement to the asset took place. CII for any year means such index as the Central Government may, having regard to 75% of the average rise in the consumer price index for urban non-manual employees for the immediately preceding previous year to that year by notification in the Official Gazette, specify in this behalf.

Note - The benefit of indexation will not apply to the long-term capital gains arising from the transfer of bonds or debentures other than capital indexed bonds issued by the Government.

In case of depreciable assets (discussed later), there will be no indexation or the capital gains will always be short-term capital gains.

(iii) **Cost Inflation Index:** The cost inflation indices for the financial years so far have been notified as under:

Financial Year	Cost Inflation Index	Financial Year	Cost Inflation Index
1981-82	100	1997-98	331
1982-83	109	1998-99	351
1983-84	116	1999-00	389
1984-85	125	2000-01	406
1985-86	133	2001-02	426
1986-87	140	2002-03	447
1987-88	150	2003-04	463
1988-89	161	2004-05	480
1989-90	172	2005-06	497
1990-91	182	2006-07	519
1991-92	199	2007-08	551
1992-93	223	2008-09	582
1993-94	244	2009-10	632
1994-95	259	2010-11	711
1995-96	281	2011-12	785
1996-97	305	2012-13	852
		2013-14	939

As noted above, for the financial year 1981-82, CII is 100 and the CII for each subsequent year would be determined in such a way that 75% of the rise in consumer price index for urban non-manual employees would be reflected in the rise in CII. It would be seen that the date of transfer of an asset would be immaterial as long as it is within a particular financial year. That means,

transfer of assets in any part of the year would be subject to indexation using the same CII as applicable to an asset transferred on 1st April of the year. The effect is that all the assets transferred during the year will be deemed to be sold on the first day of the year.

(iv) **Special provision for non-residents** - In order to give protection to non-residents who invest foreign exchange to acquire capital assets, section 48 contains a proviso. Accordingly, in the case of non-residents, capital gains arising from the transfer of shares or debentures of an Indian company is to be computed as follows:

The cost of acquisition, the expenditure incurred wholly and exclusively in connection with the transfer and the full value of the consideration are to be converted into the same foreign currency with which such shares were acquired. The resulting capital gains shall be reconverted into Indian currency. The aforesaid manner of computation of capital gains shall be applied for every purchase and sale of shares or debentures in an Indian company. Rule 115A is relevant for this purpose.

Non-residents and foreign companies to be subject to tax at a concessional rate of 10% (without indexation benefit or currency fluctuation) on long-term capital gains arising from transfer of unlisted securities [Section 112]

Under section 115AD, where the total income of a Foreign Institutional Investor includes long-term capital gains on sale of unlisted securities, the same would be taxable@10%, without the benefit of indexation or currency fluctuation. In order to bring parity in tax rate on long-term capital gains (arising on sale of unlisted securities) applicable to non-residents and FIIs, section 112 provides that in the case of non-corporate non-residents and foreign companies, long-term capital gains arising from transfer of unlisted securities would be subject to tax@10% without giving effect to indexation provision under second proviso to section 48 and currency fluctuation under first proviso to section 48.

7.12 Ascertainment of Cost in Specified Circumstances [Section 49]

A person becomes the owner of a capital asset not only by purchase but also by several other methods. Section 49 gives guidelines as to how to compute the cost under different circumstances.

(1) In the following cases, the cost of acquisition of the asset shall be deemed to be cost for which the previous owner of the property acquired it. To this cost, the cost of improvement to the asset incurred by the previous owner or the assessee must be added:

Where the capital asset became the property of the assessee:

- (i) on any distribution of assets on the total or partition of a HUF;
- (ii) under a gift or will;
- (iii) by succession, inheritance or devaluation;
- (iv) on any distribution of assets on the liquidation of a company;
- (v) under a transfer to revocable or an irrevocable trust;
- (vi) under any transfer by a holding company to its 100% subsidiary Indian company or vice versa;

- (vii) under any scheme of amalgamation by the amalgamating company to the amalgamated Indian company;
- (viii) by transfer of shares held in an Indian company in a scheme of amalgamation by the amalgamating foreign company to the amalgamated foreign company;
- (ix) by transfer of capital asset by a banking company to a banking institution in a scheme of amalgamation of the banking company with the banking institution;
- (x) under any such transfer of a capital asset in a business reorganization by the predecessor co-operative bank to the successor co-operative bank;
- (xi) under any such transfer by a shareholder in a business reorganisation, of a capital asset being a share or shares held by him in the predecessor co-operative bank if the transfer is made in consideration of the allotment to him of any share or shares in the successor co-operative bank;
- (xii) on conversion of a company into an LLP;
- (xiii) on succession of a firm or sole proprietorship concern by a company in a business carried on by it, fulfilling the conditions mentioned in section 47(xiii) and section 47(xiv), respectively;
- (xiv) by conversion by an individual of his separate property into a HUF property, by the mode referred to in section 64(2).

The cost of acquisition of the asset is the cost for which the previous owner acquired the asset as increased by the cost of any improvement of the assets incurred or borne by the previous owner or the assessee, as the case may be. Accordingly, section 2(42A) provides that in all such cases, for determining the period for which the capital asset is held by the transferee, the period of holding of the asset by the previous owner shall also be considered.

Note: The issue as to whether indexation benefit in respect of a gifted asset shall apply from the year in which the asset was first held by the assessee or from the year in which the same was first acquired by the previous owner was taken up by the Bombay High Court in *CIT v. Manjula J. Shah* 16 Taxman 42 (Bom.).

As per *Explanation 1* to section 2(42A), in case the capital asset becomes the property of the assessee in the circumstances mentioned in section 49(1), inter alia, by way of gift by the previous owner, then for determining the nature of the capital asset, the aggregate period for which the capital asset is held by the assessee and the previous owner shall be considered.

As per the provisions of section 48, the profit and gains arising on transfer of a long-term capital asset shall be computed by reducing the indexed cost of acquisition from the net sale consideration. The indexed cost of acquisition means the amount which bears to the cost of acquisition the same proportion as Cost Inflation Index (CII) for the year in which the asset is transferred bears to the CII for the year in which the asset was first held by the assessee transferring it i.e., the year in which the asset was gifted to the assessee in case of transfer by the previous owner by way of gift.

In the present case, the assessee had acquired a capital asset by way of gift from the previous owner. The said asset when transferred was a long-term capital asset considering

the period of holding by the assessee as well as the previous owner. The assessee computed the long-term capital gain considering the CII of the year in which the asset was first held by the previous owner. The Assessing Officer raised an objection mentioning that as per meaning assigned to the Indexed cost of acquisition, the CII of the year in which the asset is first held by the assessee need to be considered and not the CII of the year in which the asset was first held by the previous owner.

In the present case, the Bombay High Court held that by way of 'deemed holding period fiction' created by the statute, the assessee is deemed to have held the capital asset from the year the asset was held by the previous owner and accordingly the asset is a long term capital asset in the hands of the assessee. Therefore, for determining the indexed cost of acquisition under section 48, the assessee must be treated to have held the asset from the year the asset was first held by the previous owner and accordingly the CII for the year the asset was first held by the previous owner would be considered for determining the indexed cost of acquisition.

Hence, the Bombay High Court held that the indexed cost of acquisition in case of gifted asset has to be computed with reference to the year in which the previous owner first held the asset and not the year in which the assessee became the owner of the asset.

As per the plain reading of the provisions of section 48, however, the indexed cost of acquisition would be determined by taking CII for the year in which in which asset is first held by the assessee.

Illustration 6

Neerja was carrying on the textile business under a proprietorship concern, Neerja Textiles. On 21.07.2013 the business of Neerja Textiles was succeeded by New Look Textile Private Limited and all the assets and liabilities of Neerja Textiles on that date became the assets and liabilities of New Look Textile Private Limited and Neerja was given 52% share in the share capital of the company. No other consideration was given to Neerja on account of this succession.

The assets and liabilities of Neerja Textiles transferred to the company included an urban land which was acquired by Neerja on 19.7.2010 for ₹ 9,80,000. The company sold the same on 30.03.2014 for ₹ 15,00,000.

Discuss the tax implication of the above mentioned transaction and compute the income chargeable to tax in such case(s).

Answer

Taxability in case of succession of Neerja Textiles by New Look Textile Private Limited

As per provisions of section 47(xiv), in case a proprietorship concern is succeeded by a company in the business carried by it and as a result of which any capital asset is transferred to the company, then the same shall not be treated as transfer and will not be chargeable to capital gain tax in case the following conditions are satisfied:

- (1) all the assets and liabilities of sole proprietary concern becomes the assets and liabilities of the company.
- (2) the shareholding of the sole proprietor in the company is not less than 50% of the total voting power of the company and continues to so remain as such for a period of 5 years from the date of succession.
- (3) the sole proprietor does not receive any consideration or benefit in any form from the company other than by way of allotment of shares in the company.

In the present case, all the conditions mentioned above are satisfied therefore, the transfer of capital asset by Neerja Textiles to New Look Textiles Private Limited shall not attract capital gain tax provided Neerja continues to hold 50% or more of voting power of New Look Textiles Private Limited for a minimum period of 5 years.

Taxability in case of transfer of land by New Look Textiles Private Limited

As per the provisions of section 49(1) and *Explanation 1* to section 2(42A), in case a capital asset is transferred in the circumstances mentioned in section 47(xiv), the cost of the asset in the hands of the company shall be the cost of the asset in the hands of the sole proprietor. Consequently, for the determining the period of holding of the asset, the period for which the asset is held by the sole proprietor shall also be considered.

Therefore, in the present case, the urban land shall be a long-term capital asset since it is held for more than 36 months by New Look Textile Private Limited and Neerja Textiles taken together. Cost of acquisition of land in the hands of the company shall be ₹ 9,80,000 i.e., the purchase cost of the land in the hands of Neerja.

Computation of capital gain chargeable to tax in the hands of New Look Textile Private Ltd.

Particulars	₹
Net Sale Consideration	15,00,000
Less: Indexed cost of acquisition $9,80,000 \times \frac{939}{939}$ (Refer Note below)	<u>9,80,000</u>
Long-term capital gain	<u>5,20,000</u>

Note: The year of transfer and the year in which the company first held the asset are the same in this case, which is the reason why the numerator and the denominator for calculating the indexed cost of acquisition would remain the same. Therefore, in effect, there is no benefit of indexation in this case. However, as per the view expressed by Bombay High Court in *CIT v. Manjula J. Shah* 16 Taxman 42, in case the cost of acquisition of the capital asset in the hands of the assessee is taken to be cost of such asset in the hands of the previous owner, the indexation benefit would be available from the year in which the capital asset is acquired by the previous owner. If this view is considered, the indexed cost of acquisition would have to be calculated by taking the CII of F.Y.2010-11, being the year in which the capital asset was acquired by the previous owner, Neerja, as the denominator, in which case, the capital gains chargeable to tax would undergo a change. The long-term capital gains in such a case would be ₹2,05,738 (₹15,00,000 - ₹12,94,262).

(2) Where shares in an amalgamated company which is an Indian company become the property of the assessee in consideration of the transfer of shares held by him in the amalgamating company under a scheme of amalgamation, the cost of acquisition to him of the shares in the amalgamated company shall be taken as the cost of acquisition of the shares in the amalgamating company [Section 49(2)].

This also applies in relation to business reorganization of a co-operative bank as referred to in section 44DB. The cost of acquisition of shares in the amalgamated co-operative bank, which became the property of the assessee by virtue of a transfer as a result of business reorganisation shall be the cost of acquisition to him of the shares in the amalgamating co-operative bank.

(3) It is possible that a person might have become the owner of shares or debentures in a company during the process of conversion of bonds or debentures, debenture stock or deposit certificates. In such a case, the cost of acquisition to the person shall be deemed to be that part of the cost of debentures, debenture stock, bond or deposit certificate in relation to which such asset is acquired by that person [Section 49(2A)].

(4) Where the capital gain arises from the transfer of specified security or sweat equity shares referred to in section 17(2)(vi), the cost of acquisition of such security or shares shall be the fair market value which has been taken into account for perquisite valuation [Section 49(2AA)].

(5) If a shareholder of a company receives rights in a partnership firm as consideration for transfer of shares on conversion of a company into a LLP, then the cost of acquisition of the capital asset being rights of a partner referred to in section 42 of the LLP Act, 2008 shall be deemed to be the cost of acquisition to him of the shares in the predecessor company, immediately before its conversion [Section 49(2AAA)].

(6) Where the capital gain arises from the transfer of specified security or sweat equity shares, the cost of acquisition of such security or shares shall be the fair market value which has been taken into account while computing the value of fringe benefits under clause (ba) of sub-section (1) of section 115WC [Section 49(2AB)].

The value of fringe benefits would be the fair market value of the specified security or sweat equity shares on the date on which the option vests with employee as reduced by the amount actually paid by, or recovered from the employee in respect of such security or shares. Fair market value means the value determined in accordance with the method prescribed by the CBDT. This fair market value would be taken as the cost of acquisition of the specified security or sweat equity shares. It may be noted that the amount recovered from the employee is not to be deducted for determining the cost of acquisition.

Note – It may be noted that fringe benefit tax is not applicable from A.Y.2010-11 and therefore, the fair market value of the specified securities and sweat equity shares would be taxed as a perquisite in the hands of the employees w.e.f. A.Y.2010-11. Therefore, if specified securities or sweat equity shares have been subject to FBT in the hands of the employer upto A.Y.2009-10, the provisions of section 49(2AB) would apply for determination of the cost of acquisition at the time of transfer. However, if the specified securities or sweat equity shares have been taxed as a perquisite in the hands of the employees w.e.f. A.Y.2010-11, the provisions of section 49(2AA) would apply for determination of the cost of acquisition at the time of transfer of such securities/shares by the employee.

(7) In the case of a demerger, the cost of acquisition of the shares in the resulting company shall be the amount which bears to the cost of acquisition of shares held by the assessee in the demerged company the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger [Section 49(2C)].

This also applies in relation to business reorganization of a co-operative bank as referred to in section 44DB. The cost of acquisition of the shares in the resulting co-operative bank shall be the amount which bears to the cost of acquisition of shares held by the assessee in the demerged co-operative bank, the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged co-operative bank immediately before demerger i.e.,

$$\text{Cost of acquisition of shares in the resulting co-operative bank} = A \times \frac{B}{C}$$

A = Cost of acquisition of shares held in the demerged co-operative bank

B = Net book value of the assets transferred in a demerger

C = Net worth of the demerged co-operative bank i.e. the aggregate of the paid up share capital and general reserves as appearing in the books of account of the demerged company immediately before the demerger.

(8) Further, the cost of acquisition of the original shares held by the shareholder in the demerged company shall be deemed to have been reduced by the amount as so arrived under the sub-section (2C) [Section 49(2D)].

This also applies in relation to business reorganization of a co-operative bank as referred to in section 44DB. The cost of acquisition of the original shares held by the shareholder in the demerged co-operative bank shall be deemed to have been reduced by the amount so arrived at in (6) above.

For the above purpose, "net worth" means the aggregate of the paid up share capital and general reserves as appearing in the books of account of the demerged company immediately before the demerger.

Normally speaking, capital gains must be computed after deducting from the sale price the cost of acquisition to the assessee. The various provisions mentioned above form an exception to this general principle.

(9) Where the capital gain arises from the transfer of such property which has been subject to tax under section 56(2)(vii) or section 56(2)(vii-a), the cost of acquisition of the property shall be deemed to be the value taken into account for the purposes of section 56(2)(vii)/(vii-a). [For illustration, see Chapter 8 on "Income from Other Sources" under section 56(2)(vii)]

7.13 Cost of improvement [Section 55]

(1) Goodwill of a business, etc.: In relation to a capital asset being goodwill of a business or a right to manufacture, produce or process any article or thing, or right to carry on any business, the cost of improvement shall be taken to be Nil.

(2) Any other capital asset: (i) Where the capital asset became the property of the previous owner or the assessee before 1-4-1981, cost of improvement means all expenditure of a capital nature incurred in making any addition or alteration to the capital asset on or after the said date by the previous owner or the assessee.

(ii) In any other case, cost of improvement means all expenditure of a capital nature incurred in making any additions or alterations to the capital assets by the assessee after it became his property. However, there are cases where the capital asset might become the property of the assessee by any of the modes specified in section 49(1). In that case, cost of improvement means capital expenditure in making any addition or alterations to the capital assets incurred by the previous owner.

However, cost of improvement does not include any expenditure which is deductible in computing the income chargeable under the head "Income from house property", "Profits and gains of business or profession" or "Income from other sources".

Illustration 7

Mr. X & sons, HUF, purchased a land for ₹ 40,000 in 1991-92. In 1995-96, a partition takes place when Mr. A, a coparcener, is allotted this plot valued at ₹ 80,000. In 1996-97, he had incurred expenses of ₹ 1,85,000 towards fencing of the plot. Mr. A sells this plot of land for ₹ 15,00,000 in 2013-14 after incurring expenses to the extent of ₹ 20,000. You are required to compute the capital gain for the A.Y. 2014-15.

Financial year	Cost Inflation Index
1991-92	199
1995-96	281
1996-97	305
2013-14	939

Solution

Computation of taxable capital gains for the A.Y. 2014-15

Particulars	₹	₹
Sale consideration		15,00,000
Less: Expenses incurred for transfer		20,000
		14,80,000
Less: (i) Indexed cost of acquisition ($₹ 40,000 \times 939/281$)	1,33,665	
(ii) Indexed cost of improvement ($₹ 1,85,000 \times 939/305$)	5,69,557	7,03,222
Long term capital gains		7,76,778

Note - As per the view expressed by Bombay High Court in CIT v. Manjula J. Shah 16 Taxman 42, in case the cost of acquisition of the capital asset in the hands of the assessee is taken to be cost of such asset in the hands of the previous owner, the indexation benefit would be available from the year in which the capital asset is acquired by the previous owner. If this view is considered, the indexed cost of acquisition would have to be calculated by taking the CII of F.Y.1991-92.

Illustration 8

Mr. B purchased convertible debentures for ₹ 5,00,000 during August 1998. The debentures were converted into shares in September 2002. These shares were sold for ₹ 15,00,000 in August, 2013. The brokerage expenses is ₹ 50,000. You are required to compute the capital gains in case of Mr. B for the assessment year 2014-15.

Financial Year	Cost Inflation Index
1998-99	351
2002-03	447
2013-14	939

Solution**Computation of Capital Gains of Mr. B for the A.Y.2014-15**

Particulars	₹
Sale consideration	15,00,000
Less: Expenses on transfer i.e. Brokerage paid	50,000
Net consideration	14,50,000
Less: Indexed cost of acquisition ($₹ 5,00,000 \times 939/447$)	10,50,336
Long term capital gain	3,99,664

Note : For the purpose of computing capital gains, the holding period is considered from the date of allotment of these shares i.e. September 2002 – August 2013.

Illustration 9

Mr. C purchases a house property for ₹ 1,06,000 on May 15, 1963. The following expenses are incurred by him for making addition/alternation to the house property:

	Particulars	₹
a.	Cost of construction of first floor in 1972-73	1,35,000
b.	Cost of construction of the second floor in 1983-84	3,10,000
c.	Reconstruction of the property in 1992-93	2,50,000

Fair market value of the property on April 1, 1981 is ₹ 4,50,000. The house property is sold by Mr. C on August 10, 2013 for ₹ 80,00,000 (expenses incurred on transfer: ₹ 50,000). Compute the capital gain for the assessment year 2014-15.

Financial year	Cost Inflation Index
1981-82	100
1983-84	116
1992-93	223
2013-14	939

Solution**Computation of capital gain of Mr.C for the A.Y.2014-15**

Particulars	₹	₹
Gross sale consideration		80,00,000
Less: Expenses on transfer		50,000
Net sale consideration		79,50,000
Less: Indexed cost of acquisition (Note 1)	42,25,500	
Less: Indexed cost of improvement (Note 2)	35,62,088	77,87,088
Long-term capital gain		1,62,412

Notes:

Indexed cost of acquisition is computed as follows:

$$₹ 4,50,000 \times 939/100 = ₹ 42,25,500$$

Fair market value on April 1, 1981 (actual cost of acquisition is ignored as it is lower than market value on April 1, 1981.)

Indexed cost of improvement is determined as under:	₹
Construction of first floor in 1972-73 (expenses incurred prior to April 1, 1981 are not considered)	Nil
Construction of second floor in 1983-84 (i.e., ₹ 3,10,000 × 939 / 116)	25,09,397
Alternation/reconstruction in 1992-93 (i.e., ₹ 2,50,000 × 939 / 223)	10,52,691
Indexed cost of improvement	35,62,088

7.14 Cost of Acquisition [Section 55]

(i) **Goodwill of a business or a trademark or brand name associated with a business or a right to manufacture, produce or process any article or thing, or right to carry on any business, tenancy rights, stage carriage permits and loom hours** - In the case of the above capital assets, if the assessee has purchased them from a previous owner, the cost of acquisition means the amount of the purchase price. For example, if A purchases a stage carriage permit from B for ₹ 2 lacs, that will be the cost of acquisition for A.

(ii) **Self-generated assets** - There are circumstances where it is not possible to visualise cost of acquisition. For example, suppose a doctor starts his profession. With the passage of time, the doctor acquires lot of reputation. He opens a clinic and runs it for 5 years. After 5 years he sells the clinic to another doctor for ₹ 10 lacs which includes ₹ 2 lacs for his reputation or goodwill. Now a question arises as to how to find out the profit in respect of goodwill. It is obvious that the goodwill is self-generated and hence it is difficult to calculate the cost of its acquisition. However, it is certainly a capital asset. The Supreme Court in *CIT v. B.C. Srinivasa Shetty [1981] 128 ITR 294 (SC)* held that in order to bring the gains on sale of capital assets to charge under section 45, it is necessary that the provisions dealing with the levy of capital gains tax must be read as a whole. Section 48 deals with the mode of

computing the capital gains. Unless the cost of acquisition is correctly ascertainable, it is not possible to apply the provisions of section 48. Self-generated goodwill is such a type of capital asset where it is not possible to visualise cost of acquisition. Once section 48 cannot be applied, the gains thereon cannot be brought to charge.

This decision of the Supreme Court was applicable not only to self-generated goodwill of a business but also to other self-generated assets like tenancy rights, stage carriage permits, loom hours etc. In order to supersede the decision of the Supreme Court cited above, section 55 was amended. Accordingly, in case of self-generated assets namely, goodwill of a business or a trademark or brand name associated with a business or a right to manufacture, produce or process any article or thing, or right to carry on any business, tenancy rights, stage carriage permits, or loom hours, the cost of acquisition will be taken to be *nil*. However, it is significant to note that the above amendment does not cover self-generated goodwill of a profession. So, in respect of self-generated goodwill of a profession and other self-generated assets not specifically covered by the amended provisions of section 55, the decision of the Supreme Court in *B. C. Srinivasa Setty's* case will still apply.

(iii) **Other assets** - In the following cases, cost of acquisition shall not be *nil*, but will be deemed to be the cost for which the previous owner of the property acquired it:

Where the capital asset became the property of the assessee—

- (1) On any distribution of assets on the total or partial partition of a Hindu undivided family.
- (2) Under a gift or will.
- (3) By succession, inheritance or devolution.
- (4) On any distribution of assets on the liquidation of a company.
- (5) Under a transfer to a revocable or an irrevocable trust.
- (6) Under any such transfer referred to in sections 47(iv), (v), (vi), (via) or (viaa).
- (7) Where the assessee is a Hindu undivided family, by the mode referred to in section 64(2).

(iv) **Financial assets** - Many times persons who own shares or other securities become entitled to subscribe to any additional shares or securities. Further, they are also allotted additional shares or securities without any payment. Such shares or securities are referred to as financial assets in Income-tax Act. Section 55 provides the basis for ascertaining the cost of acquisition of such financial assets.

- (1) In relation to the original financial asset on the basis of which the assessee becomes entitled to any additional financial assets, cost of acquisition means the amount actually paid for acquiring the original financial assets.
- (2) In relation to any right to renounce the said entitlement to subscribe to the financial asset, when such a right is renounced by the assessee in favour of any person, cost of acquisition shall be taken to be *nil* in the case of such assessee.
- (3) In relation to the financial asset, to which the assessee has subscribed on the basis of the said entitlement, cost of acquisition means the amount actually paid by him for acquiring such asset.
- (4) In relation to the financial asset allotted to the assessee without any payment and on the

basis of holding of any other financial assets, cost of acquisition shall be taken to be nil in the case of such assessee. In other words, where bonus shares are allotted without any payment on the basis of holding of original shares, the cost of such bonus shares will be nil in the hands of the original shareholder. However, in respect of bonus shares allotted before 1.4.81, although the cost of acquisition of the shares is nil, the assessee may opt for the fair market value as on 1.4.81 as the cost of acquisition of such bonus shares.

(5) In the case of any financial asset purchased by the person in whose favour the right to subscribe to such assets has been renounced, cost of acquisition means the aggregate of the amount of the purchase price paid by him to the person renouncing such right and the amount paid by him to the company or institution for acquiring such financial asset.

(6) In relation to equity shares allotted to a shareholder of a recognised stock exchange in India under a scheme for demutualisation or corporatisation approved by SEBI, the cost of acquisition shall be the cost of acquiring his original membership of the exchange.

(7) The cost of a capital asset, being trading or clearing rights of a recognised stock exchange acquired by a shareholder (who has been allotted equity share or shares under such scheme of demutualisation or corporatisation), shall be deemed to be nil.

(v) Any other capital asset - (1) Where the capital asset become the property of the assessee before 1-4-1981 cost of acquisition means the cost of acquisition of the asset to the assessee or the fair market value of the asset on 1-4-1981 at the option of the assessee.

(2) Where the capital asset became the property of the assessee by any of the modes specified in section 49(1), it is clear that the cost of acquisition to the assessee will be the cost of acquisition to the previous owner. Even in such cases, where the capital asset became the property of the previous owner before 1-4-1981, the assessee has got a right to opt for the fair market value as on 1-4-1981.

(3) Where the capital asset became the property of the assessee on the distribution of the capital assets of a company on its liquidation and the assessee has been assessed to capital gains in respect of that asset under section 46, the cost of acquisition means the fair market value of the asset on the date of distribution.

(4) A share or a stock of a company may become the property of an assessee under the following circumstances :

- (a) the consolidation and division of all or any of the share capital of the company into shares of larger amount than its existing shares.
- (b) the conversion of any shares of the company into stock,
- (c) the re-conversion of any stock of the company into shares,
- (d) the sub-division of any of the shares of the company into shares of smaller amount, or
- (e) the conversion of one kind of shares of the company into another kind.

In the above circumstances the cost of acquisition to the assessee will mean the cost of

acquisition of the asset calculated with reference to the cost of acquisition of the shares or stock from which such asset is derived.

(vi) Where the cost for which the previous owner acquired the property cannot be ascertained, the cost of acquisition to the previous owner means the fair market value on the date on which the capital asset became the property of the previous owner.

Illustration 10

ABC Ltd., converts its capital asset acquired for an amount of ₹ 50,000 in June, 1991 into stock-in-trade in the month of November, 2011. The fair market value of the asset on the date of conversion is ₹ 2,50,000. The stock-in-trade was sold for an amount of ₹ 3,50,000 in the month of December, 2013. What will be the tax treatment?

Financial year	Cost Inflation Index
1991-92	199
2011-12	785
2013-14	939

Solution

The capital gains on the sale of the capital asset converted to stock-in-trade is taxable in the given case. It arises in the year of conversion (i.e. P.Y. 2011-12) but will be taxable only in the year in which the stock-in-trade is sold (i.e. P.Y. 2013-14). Profits from business will also be taxable in the year of sale of the stock-in-trade (P.Y. 2013-14).

Gross Total Income for the A.Y. 2014-15 is calculated as under:

Particulars	₹	₹
Profits and Gains from Business or Profession		
Sale proceeds of the stock-in-trade	3,50,000	
Less: Cost of the stock-in-trade (FMV on the date of conversion)	<u>2,50,000</u>	1,00,000

Long Term Capital Gains

Full value of the consideration (FMV on the date of the conversion)	2,50,000	
Less: Indexed cost of acquisition (₹ 50,000 x 785/199)	<u>1,97,236</u>	<u>52,764</u>
Gross Total Income		<u>1,52,764</u>

Note: For the purpose of indexation, the cost inflation index of the year in which the asset is converted into stock-in-trade should be considered.

Illustration 11

Ms. Usha purchases 1,000 equity shares in X Ltd. at a cost of ₹ 15 per share (brokerage 1%) in January 1978. She gets 100 bonus shares in August 1980. She again gets 1100 bonus shares by virtue of her holding on February 1985. Fair market value of the shares of X Ltd. on April 1, 1981 is ₹ 25. In January 2014, she transfers all her shares @ ₹ 150 per share (brokerage 2%).

Compute the capital gains taxable in the hands of Ms. Usha for the A.Y. 2014-15 assuming:

- (a) X Ltd is an unlisted company and securities transaction tax was not applicable at the time of sale.
- (b) X Ltd is a listed company and the shares are sold in a recognised stock exchange and securities transaction tax was paid at the time of sale.

Cost Inflation Index for F.Y. 1981-82 : 100, F.Y.1984-85 : 125 & F.Y.2013-14 : 939.

Solution

- (a) **Computation of capital gains for the A.Y. 2014-15**

Particulars	₹
1000 Original shares	
Sale proceeds (1000 × ₹ 150)	1,50,000
Less : Brokerage paid (2% of ₹ 1,50,000)	3,000
Net sale consideration	1,47,000
Less : Indexed cost of acquisition [₹ 25 × 1000 × 939/100]	2,34,750
Long term capital loss (A)	87,750
100 Bonus shares	
Sale proceeds (100 × ₹ 150)	15,000
Less : Brokerage paid (2% of ₹ 15,000)	300
Net sale consideration	14,700
Less : Indexed cost of acquisition [₹ 25 × 100 × 939/100] [See Note below]	23,475
Long term capital loss (B)	8,775
1100 Bonus shares	
Sale proceeds (1100 × ₹ 150)	1,65,000
Less: Brokerage paid (2% of ₹ 1,65,000)	3,300
Net sale consideration	1,61,700
Less: Cost of acquisition	NIL
Long term capital gain (C)	1,61,700
∴ Long term capital gain (A+B+C)	65,175

Note: Cost of acquisition of bonus shares acquired before 1.4.1981 is the FMV as on 1.4.1981 (being the higher of the cost or the FMV as on 1.4.1981).

- (b) The long-term capital gains on transfer of equity shares through a recognized stock exchange on which securities transaction tax is paid is exempt from tax under section 10(38). Hence, the taxable capital gain is Nil.

Illustration 12

On January 31, 2014, Mr. A has transferred self-generated goodwill of his profession for a sale consideration of ₹ 70,000 and incurred expenses of ₹ 5,000 for such transfer. You are required to compute the capital gains chargeable to tax in the hands of Mr. A for the assessment year 2014-15.

Solution

The transfer of self-generated goodwill of profession is not chargeable to tax. It is based upon the Supreme Court's ruling in *CIT vs. B.C. Srinivasa Shetty*. Hence, there is no taxable capital gains.

Illustration 13

Mr. R holds 1000 shares in Star Minus Ltd., an unlimited company, acquired in the year 1981-82 at a cost of ₹ 25,000. He has been offered right shares by the company in the month of August, 2013 at ₹ 140 per share, in the ratio of 2 for every 5 held. He retains 50% of the rights and renounces the balance right shares in favour of Mr. Q for ₹ 25 per share in September 2013. All the shares are sold by Mr. R for ₹ 250 per share in January 2014 and Mr. Q sells his shares in December 2013 at ₹ 230 per share.

What are the capital gains taxable in the hands of Mr. R and Mr. Q?

Financial year	Cost Inflation Index
1981-82	100
2013-14	939

Solution**Computation of capital gains in the hands of Mr. R for the A.Y.2014-15**

Particulars	₹
1000 Original shares	
Sale proceeds (1000 × ₹ 250)	2,50,000
Less : Indexed cost of acquisition [₹ 25,000 × 939/100]	2,34,750
Long term capital gain (A)	15,250
200 Right shares	
Sale proceeds (200 × ₹ 250)	50,000
Less : Cost of acquisition [₹ 140 × 200] [Note 1]	28,000
Short term capital gain (B)	22,000
Sale proceeds (200 × ₹ 25)	5,000
Less : Cost of acquisition [Note 2]	NIL
Short term capital gain (C)	5,000
Capital Gains (A+B+C)	42,250

Note 1: Since the holding period of these shares is less than 1 year, they are short term capital assets and hence cost of acquisition will not be indexed.

Note 2: The cost of the rights renounced in favour of another person for a consideration is taken to be nil. The consideration so received is taxed as short-term capital gains in full. The period of holding is taken from the date of the rights offer to the date of the renouncement.

Computation of capital gains in the hands of Mr. Q for the A.Y.2014-15

Particulars	₹
200 shares :	
Sale proceeds (200 × ₹ 230)	46,000
Less : Cost of acquisition [200 shares × (₹ 25 + ₹ 140)] [Note]	33,000
Short term capital gain	13,000

Note: The cost of the rights is the amount paid to Mr. R as well as the amount paid to the company. Since the holding period of these shares is less than 1 year, they are short term capital assets and hence, cost of acquisition should not be indexed.

7.15 Computation of capital gains in case of depreciable asset [Section 50]

(i) Section 50 provides for the computation of capital gains in case of depreciable assets. It may be noted that where the capital asset is a depreciable asset forming part of a block of assets, section 50 will have overriding effect in spite of anything contained in section 2(42A) which defines a short-term capital asset.

Accordingly, where the capital asset is an asset forming part of a block of assets in respect of which depreciation has been allowed, the provisions of sections 48 and 49 shall be subject to the following modification:

Where the full value of consideration received or accruing for the transfer of the asset plus the full value of such consideration for the transfer of any other capital asset falling with the block of assets during previous year exceeds the aggregate of the following amounts namely:

- (1) expenditure incurred wholly and exclusively in connection with such transfer;
- (2) WDV of the block of assets at the beginning of the previous year;
- (3) the actual cost of any asset falling within the block of assets acquired during the previous year

such excess shall be deemed to be the capital gains arising from the transfer of short-term capital assets.

Where all assets in a block are transferred during the previous year, the block itself will cease to exist. In such a situation, the difference between the sale value of the assets and the WDV of the block of assets at the beginning of the previous year together with the actual cost of any asset falling within that block of assets acquired by the assessee during the previous year will be deemed to be the capital gains arising from the transfer of short-term capital assets.

(ii) **Cost of acquisition in case of power sector assets [Section 50A]:** With respect to the power sector, in case of depreciable assets referred to in section 32(1)(i), the provisions of sections 48 and 49 shall apply subject to the modification that the WDV of the asset (as defined in section 43(6)), as adjusted, shall be taken to be the cost of acquisition.

7.16 Capital gains in respect of slump sale [Section 50B]

(i) Any profits or gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of long-term capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

Short term capital gains - Any profits and gains arising from such transfer of one or more undertakings held by the assessee for not more than thirty-six months shall be deemed to be short-term capital gains [Sub-section (1)].

(ii) The net worth of the undertaking or the division, as the case may be, shall be deemed to be the cost of acquisition and the cost of improvement for the purposes of sections 48 and 49 in relation to capital assets of such undertaking or division transferred by way of such sale and the provisions contained in the second proviso to section 48 shall be ignored [Sub-section (2)].

(iii) Every assessee in the case of slump sale shall furnish in the prescribed form along with the return of income, a report of a chartered accountant indicating the computation of net worth of the undertaking or division, as the case may be, and certifying that the net worth of the undertaking or division has been correctly arrived at in accordance with the provisions of this section [Sub-section (3)].

Explanation 1 to the section defines the expression "net worth" as the aggregate value of total assets of the undertaking or division as reduced by the value of liabilities of such undertaking or division as appearing in the books of account. However, any change in the value of assets on account of revaluation of assets shall not be considered for this purpose.

Explanation 2 provides that the aggregate value of total assets of such undertaking or division shall be as follows:

- (i) In the case of depreciable assets: the written down value of block of assets determined in accordance with the provisions contained in sub-item (C) of item (i) of section 43(6)(c);
- (ii) In case of capital assets in respect of which the whole of the expenditure has been allowed or is allowable as a deduction under section 35AD : Nil;
- (ii) for all other assets : Book value.

7.17 Special Provision for Full Value of Consideration in Certain Cases [Section 50C]

(i) Where the consideration received or accruing as a result of transfer of a capital asset, being land or building or both, is less than the value adopted or assessed or assessable by any authority of a State Government (Stamp Valuation Authority) for the purpose of payment of stamp duty in respect of such asset, such value adopted or assessed or assessable shall be deemed to be the full value of the consideration received or accruing as a result of such transfer [Sub-section (1)].

(ii) Where the assessee claims before an Assessing Officer that the value so adopted or assessed or assessable by the authority for payment of stamp duty exceeds the fair market value of the property as on the date of transfer and the value so adopted or assessed or assessable by such authority has not been disputed in any appeal or revision or no reference

has been made before any other authority, court or High Court, the Assessing Officer may refer the valuation of the capital asset to a valuation officer as defined in section 2(r) of the Wealth-tax Act, 1957. Where any reference has been made before any other authority, Court or the High Court, the provisions of section 16A (relating to reference to Valuation Officer), section 23A (dealing with appealable orders before Commissioner (Appeals), section 24 (order of Appellate Tribunal), section 34AA (appearance by registered valuer), section 35 (rectification of mistakes) and section 37 (power to take evidence on oath) of the Wealth-tax Act, 1957, shall, with necessary modifications, apply in relation to such reference as they apply in relation to a reference made by the Assessing Officer under sub-section (1) of section 16A of that Act [Sub-section (2)].

(iii) Where the value ascertained by such valuation officer exceeds the value adopted or assessed or assessable by the Stamp authority the value adopted or assessed or assessable shall be taken as the full value of the consideration received or accruing as a result of the transfer [Sub-section (3)].

(iv) The term "assessable" has been added to cover transfers executed through power of attorney. The term 'assessable' has been defined to mean the price which the stamp valuation authority would have, notwithstanding anything to the contrary contained in any other law for the time being in force, adopted or assessed, if it were referred to such authority for the purposes of the payment of stamp duty.

7.18 Fair market value of the capital asset on the date of transfer to be taken as sale consideration, in cases where the consideration is not determinable [Section 50D]

Section 50D provides that, in case where the consideration received or accruing as a result of the transfer of a capital asset by an assessee is not ascertainable or cannot be determined, then, for the purpose of computing income chargeable to tax as capital gains, the fair market value of the said asset on the date of transfer shall be deemed to be the full value of consideration received or accruing as a result of such transfer.

7.19 Advance money received [Section 51]

It is possible for an assessee to receive some advance in regard to the transfer of capital asset. Due to the break-down of the negotiation, the assessee may have retained the advance. Section 51 provides that while calculating capital gains, the above advance retained by the assessee must go to reduce the cost of acquisition. However, if advance has been received and retained by the previous owner and not the assessee himself, then the same will not go to reduce the cost of acquisition of the assessee.

Illustration 14

Mr. Kay purchases a house property on April 10, 1978 for ₹ 35,000. The fair market value of the house property on April 1, 1981 was ₹ 70,000. On August 31, 1984, Mr. Kay enters into an agreement with Mr. Jay for sale of such property for ₹ 1,20,000 and received an amount of ₹ 10,000 as advance. However, as Mr. Jay did not pay the balance amount, Mr. Kay forfeited the advance. In May 1987, Mr. Kay constructed the first floor by incurring a cost of ₹ 50,000.

Subsequently, in September 1987, Mr. Kay gifted the house to his friend Mr. Dee. On February 10, 2014, Mr. Dee sold the house for ₹ 8,00,000.

Financial year	Cost Inflation Index
1981-1982	100
1984-1985	125
1987-1988	150
2013-2014	939

You are required to compute the capital gains taxable in the hands of Mr. Dee for the assessment year 2014-15.

Solution

Computation of taxable capital gains of Mr. Dee for A.Y.2014-15

Particulars	₹	₹
Sale consideration		8,00,000
Less: Indexed cost of acquisition (See Note below)	4,38,200	
Indexed cost of improvement (See Note below)	3,13,000	7,51,200
Long-term capital gain		<u>48,800</u>

For the purpose of capital gains, holding period is considered from the date on which the house was purchased by Mr. Kay, till the date of sale. However, indexation of cost of acquisition is considered from the date on which the house was gifted by Mr. Kay to Mr. Dee, till the date of sale. i.e. from September 1987 (P.Y. 1987-88) to February 2014 (P.Y. 2013-14).

Indexed cost of acquisition = $(₹ 70,000 \times 939/150) = ₹ 4,38,200$

Indexed cost of improvement = $(₹ 50,000 \times 939/150) = ₹ 3,13,000$

Amount forfeited by previous owner, Mr. Kay, will not be considered.

Note - As per the view expressed by Bombay High Court in CIT v. Manjula J. Shah 16 Taxman 42, in case the cost of acquisition of the capital asset in the hands of the assessee is taken to be cost of such asset in the hands of the previous owner, the indexation benefit would be available from the year in which the capital asset is acquired by the previous owner. If this view is considered, the indexed cost of acquisition would have to be calculated by taking the CII of F.Y.1981-82, since the Fair Market Value as on 1.4.1981 has been taken as the cost of acquisition.

Illustration 15

Mr. X purchases a house property in December 1975 for ₹ 1,25,000 and an amount of ₹ 75,000 was spent on the improvement and repairs of the property in March, 1981. The property was proposed to be sold to Mr. Z in the month of May, 2003 and an advance of ₹ 40,000 was taken from him. As the entire money was not paid in time, Mr. X forfeited the advance and subsequently sold the property to Mr. Y in the month of March, 2014 for ₹ 40,00,000. The fair value of the property on April 1, 1981 was ₹ 3,90,000. What is the

capital gain chargeable in the hands of Mr.X for the A.Y. 2014-15?

Financial year	Cost Inflation Index
1981-82	100
2003-04	463
2013-14	939

Solution

Capital gains in the hands of Mr. X for the A.Y. 2014-15 is computed as under:

Particulars	₹
Sale proceeds	40,00,000
Less : Indexed cost of acquisition [Note 1]	32,86,500
Indexed cost of improvement [Note 2]	-
Long term capital gains	7,13,500

Note 1: Computation of indexed cost of acquisition

Cost of acquisition (higher of fair market value as on April 1, 1981 and the actual cost of acquisition) 3,90,000

Less : Advance taken and forfeited 40,000

Cost for the purposes of indexation 3,50,000

Indexed cost of acquisition (₹ 3,50,000 x 939/100) 32,86,500

Note 2 : Any improvement cost incurred prior to 1.4.1981 is to be ignored when fair market value as on 1.4.1981 is taken into consideration.

7.20 Exemption of capital gains

(i) Capital Gains on sale of residential house [Section 54]

Eligible assessee – Individual & HUF

Conditions to be fulfilled

- There should be a transfer of residential house (buildings or lands appurtenant thereto)
- It must be a long-term capital asset
- Income from such house should be chargeable under the head "Income from house property"
- A new residential house should be –
 - purchased within 1 year before or 2 years after the date of transfer (or)
 - constructed within a period of 3 years after the date of transfer.

In *CIT v. Ananda Basappa (2009) 309 ITR 329*, the Karnataka High Court observed that where the assessee had purchased two adjacent flats in the same building and made suitable modification to treat them as a single residential unit, exemption under section 54 would be

available in respect of investment made in both the flats. Similar ruling was pronounced by the Karnataka High Court in *CIT v. Smt. K.G. Rukminiamma (2011) 331 ITR 211*, where it was held that the assessee was entitled to exemption in respect of investment in four flats in the same building, where the property owned by the assessee was developed by the builder, who constructed eight residential flats in the said property, four of which was given to the assessee.

Quantum of Exemption

- If cost of new residential house $\geq$ Capital gains, entire capital gains is exempt.
- If cost of new residential house $<$ Capital gains, capital gains to the extent of cost of new residential house is exempt

Examples

- Example 1 - If the capital gains is ₹ 5 lakhs and the cost of the new house is ₹ 7 lakhs, then the entire capital gains of ₹ 5 lakhs is exempt.
- Example 2 - If capital gains is ₹ 5 lakhs and cost of new house is ₹ 3 lakhs, then capital gains is exempt only upto ₹ 3 lakhs. Balance ₹ 2 lakhs is taxable @ 20%.

Consequences of transfer of new asset before 3 years

- If the new asset is transferred before 3 years from the date of its acquisition, then cost of the asset will be reduced by capital gains exempted earlier for computing short-term capital gains.
- Continuing Example 1, if the new house was sold after 2 years for ₹ 8 lakhs, then short term capital gain chargeable to tax would be –

Net Consideration		8,00,000
Less: Cost of acquisition	7,00,000	
Less: Capital gains exempt earlier	5,00,000	2,00,000
Short term capital gains chargeable to tax		6,00,000

Illustration 16

Mr. Cee purchased a residential house on July 20, 2010 for ₹ 10,00,000 and made some additions to the house incurring ₹ 2,00,000 in August 2010. He sold the house property in April 2013 for ₹ 20,00,000. Out of the sale proceeds, he spent ₹ 5,00,000 to purchase another house property in September 2013.

Financial year	Cost Inflation Index
2010-11	711
2013-14	939

What is the amount of capital gains taxable in the hands of Mr. Cee for the A.Y.2014-15?

Solution

The house is sold before 36 months from the date of purchase. Hence, the house is a short-term capital asset and no benefit of indexation would be available.

Particulars	₹
Sale consideration	20,00,000
Less: Cost of acquisition	10,00,000
Cost of improvement	2,00,000
Short-term capital gains	8,00,000

Note: The exemption of capital gains under section 54 is available only in case of long-term capital asset. As the house is short-term capital asset, Mr. Cee cannot claim exemption under section 54. Thus, the amount of taxable short-term capital gains is ₹ 8,00,000.

(ii) Capital Gains on transfer of agricultural land [Section 54B]

Eligible assessee – Individual & HUF

Conditions to be fulfilled

- There should be a transfer of urban agricultural land.
- Such land must have been used for agricultural purposes by the assessee, being an individual or his parent, or a HUF in the 2 immediately preceding years.
- He should purchase another agricultural land (urban or rural) within 2 years from the date of transfer.

Quantum of exemption

- If cost of new agricultural land $\geq$ Capital gains (short-term or long-term), entire capital gains is exempt.
- If cost of new agricultural land $<$ Capital gains (short-term or long-term), capital gains to the extent of cost of new agricultural land is exempt.

Examples

- Example 1 - If the capital gains is ₹ 3 lakhs and the cost of the new agricultural land is ₹ 4 lakhs, then the entire capital gains of ₹ 3 lakhs is exempt.
- Example 2 - If capital gains is ₹ 3 lakhs and cost of new agricultural land is ₹ 2 lakhs, then capital gains is exempt only upto ₹ 2 lakhs.

Consequences of transfer of new agricultural land before 3 years

- If the new agricultural land is transferred before 3 years from the date of its acquisition, then cost of the land will be reduced by capital gains exempted earlier for computing short-term capital gains.
- However, if the new agricultural land is a rural agricultural land, there would be no capital gains on transfer of such land.

Continuing Example 1, if the new agricultural land (urban land) is sold after, say, 2 years for ₹ 6 lakhs, then short term capital gain chargeable to tax would be –

Particulars	₹	₹
Net consideration		6,00,000
Less: Cost of new agricultural land		
Cost of acquisition	4,00,000	
Less: Capital gains exempt earlier	3,00,000	
		1,00,000
Short-term capital gains chargeable to tax		5,00,000

(iii) Capital Gains on transfer by way of compulsory acquisition of land and building [Section 54D]

Eligible assessee – Any assessee

Conditions to be fulfilled

- There must be compulsory acquisition of land and building forming part of an industrial undertaking.
- The land and building should have been used by the assessee for purposes of the business of the industrial undertaking in the 2 years immediately preceding the date of transfer.
- The assessee must purchase any other land or building or construct any building (for shifting or re-establishing the existing undertaking or setting up a new industrial undertaking) within 3 years from the date of transfer.

Quantum of exemption

- If cost of new asset $\geq$ Capital gains, entire capital gains (short-term or long-term) is exempt.
- If cost of new asset $<$ Capital gains, capital gains (short-term or long-term) to the extent of cost of new asset is exempt.

Consequences of transfer of new asset before 3 years

- If the new asset is transferred before 3 years from the date of its acquisition, then cost of the asset will be reduced by capital gains exempted earlier for computing short-term capital gains.

Illustration 17

PQR Ltd., purchased a building for industrial undertaking in May 2003, at a cost of ₹ 4,00,000. The above property was compulsorily acquired by the State Government at a compensation of ₹ 12,00,000 in the month of January, 2014. The compensation was received in March, 2014. The company purchased another building for its industrial undertaking at a cost of ₹ 1,00,000 in the month of March, 2014. What is the amount of the capital gains chargeable to tax in the hands of the company for the A.Y. 2014-15?

Financial year	Cost Inflation Index
2003-04	463
2013-14	939

Solution**Computation of capital gains in the hands of PQR Ltd. for the A.Y.2014-15**

Particulars	₹
Sale proceeds (Compensation received)	12,00,000
Less : Indexed cost of acquisition [₹ 4,00,000 × 939/463]	8,11,231
	<u>3,88,769</u>
Less: Exemption under section 54D (Cost of acquisition of new undertaking)	1,00,000
Taxable long term capital gain	<u>2,88,769</u>

(iv) Capital Gains not chargeable on investment in certain bonds [Section 54EC]

Eligible assessee – Any assessee

Conditions to be fulfilled

- There should be transfer of a long-term capital asset.
- Such asset can also be a depreciable asset held for more than 36 months.
- The capital gains arising from such transfer should be invested in a long-term specified asset within 6 months from the date of transfer.
- Long-term specified asset means specified bonds, redeemable after 3 years, issued by the National Highways Authority of India (NHAI) or the Rural Electrification Corporation Limited (RECL).
- The assessee should not transfer or convert or avail loan or advance on the security of such bonds for a period of 3 years from the date of acquisition of such bonds.

Other points

- In case of conversion of capital asset into stock in trade and subsequent sale of stock in trade - period of 6 months to be reckoned from the date of sale of stock in trade for the purpose of section 54EC exemption [CBDT Circular No.791 dated 2-6-2000].

- Receipt of money on liquidation of company – is chargeable to tax in the hands of shareholders [Section 46(2)] – However, there is no transfer of capital asset in such a case – Therefore, exemption under section 54EC is not available – *CIT v. Ruby Trading Co. (P) Ltd.* 259 ITR 54 (Raj.)

Quantum of exemption

- Capital gains or amount invested in specified bonds, whichever is lower.

Violation of condition

- In case of transfer or conversion of such bonds or availing loan or advance on security of such bonds before the expiry of 3 years, the capital gain exempted earlier shall be taxed as long-term capital gain in the year of violation of condition.

(v) Capital gains in cases of investment in residential house [Section 54F]

Eligible assessee: Individuals / HUFs

Conditions to be fulfilled

- There must be transfer of a long-term capital asset, not being a residential house.
- Transfer of plot of land is also eligible for exemption
- The assessee should -
- Purchase a residential house within a period of 1 year before or 2 years after the date of transfer; or
- Construct a residential house within 3 years from the date of transfer.
- The assessee should not own more than one residential house on the date of transfer.
- The assessee should not –
 - purchase any other residential house within a period of one year or
 - construct any other residential house within a period of 3 years
 from the date of transfer of the original asset.

Quantum of exemption

- If cost of new residential house $\geq$ Net sale consideration of original asset, entire capital gains is exempt.
- If cost of new residential house $<$ Net sale consideration of original asset, only proportionate capital gains is exempt i.e.

$$\text{LTCG} \times \frac{\text{Amount invested in new residential house}}{\text{Net sale consideration}}$$

Illustration 18

From the following particulars, compute the taxable capital gains of Mr.D for A.Y.2014-15-

Cost of jewellery [Purchased in F.Y.1990-91]	₹ 1,82,000
Sale price of jewellery sold in January 2014	₹ 11,50,000
Expenses on transfer	₹ 7,000
Residential house purchased in March 2014	₹ 5,00,000

Solution**Computation of taxable capital gains for A.Y.2014-15**

Particulars	₹
Gross consideration	11,50,000
Less: Expenses on transfer	<u>7,000</u>
Net consideration	11,43,000
Less: Indexed cost of acquisition ($\text{₹ } 1,82,000 \times 939/182$)	<u>9,39,000</u>
	2,04,000
Less: Exemption under section 54F ($\text{₹ } 2,04,000 \times \text{₹ } 5,00,000 / \text{₹ } 11,43,000$)	<u>89,239</u>
Taxable capital gains	<u>1,14,761</u>

Consequences if the new house is transferred within a period of 3 years

- Short-term capital gains would arise on transfer of the new house; and
- The capital gains exempt earlier under section 54F would be taxable as long-term capital gains.
- In the given illustration, if the new residential house is sold for ₹ 6,00,000 after say, 1 year, then
- ₹ 1,00,000 [i.e. ₹ 6,00,000 (-) ₹ 5,00,000] would be chargeable as short-term capital gain of that year in which the new house is sold.
- ₹ 1,14,761, being the capital gains exempt earlier, would be taxable as long-term capital gains of that year in which the new house is sold.

(vi) Capital gains for shifting of industrial undertaking from urban areas [Section 54G]

Eligible assessee: Any assessee

Conditions to be fulfilled

- There should be a shifting of the industrial undertaking from an urban area to any other area
- There should be a transfer of machinery, plant, building or land or any right in building or land used for the business of an industrial undertaking situated in an urban area.
- Such transfer should be in the course of or in consequence of shifting the industrial undertaking from an urban area to any other area.

- The capital gain (short-term or long-term) should be utilized for any of the following purposes within 1 year before or 3 years after the date of transfer –
 - purchase of new plant and machinery
 - acquisition of building or land or construction of building
 - expenses on shifting of the industrial undertaking from the urban area to the other area
 - such other expenditure as the Central Government may specify

Quantum of exemption

- If cost of new assets plus expenses incurred for the specified purpose $\geq$ Capital gains, entire capital gains (short-term or long-term) is exempt.
- If cost of new assets plus expenses incurred for the specified purpose $<$ Capital gains, capital gains (short-term or long-term) to the extent of such cost and expenses is exempt.

Consequences if the new asset is transferred within a period of 3 years

- If the new asset is transferred within a period of 3 years of its purchase or construction, then the capital gain, which was exempt earlier under section 54G would be deducted from the cost of acquisition of the new asset for the purpose of computation of short-term capital gains in respect of the transfer of the new asset

(vii) Exemption of capital gains on transfer of certain capital assets in case of shifting of an industrial undertaking from an urban area to any SEZ [Section 54GA]

Eligible assessee – Any assessee

Conditions to be fulfilled

- There must be transfer of capital assets
- Such transfer must be effected in the course of, or in consequence of the shifting of an industrial undertaking from an urban area to any SEZ, whether developed in an urban area or not.
- The capital asset should be either machinery or plant or building or land or any rights in building or land used for the purposes of the business of an industrial undertaking situated in an urban area.
- The assessee should, within a period of 1 year before or 3 years after the date of transfer,
 - purchase machinery or plant for the purposes of business of the industrial undertaking in the SEZ;
 - acquire building or land or construct building for the purposes of his business in the SEZ;
 - shift the industrial undertaking and transfer the establishment of such undertaking to the SEZ; and
 - incur expenses for such other purposes as may be specified in a scheme framed by the Central Government.

Quantum of exemption

- If cost of new assets plus expenses incurred for shifting $\geq$ Capital gains, entire capital gains (short-term or long-term) is exempt.
- If cost of new assets plus expenses incurred for shifting $<$ Capital gains, capital gains (short-term or long-term) to the extent of such cost and expenses is exempt.

Consequences if the new asset is transferred within a period of 3 years

- If the new asset is transferred within a period of 3 years of its purchase or construction, then the capital gain, which was exempt earlier under section 54G would be deducted from the cost of acquisition of the new asset for the purpose of computation of short-term capital gains in respect of the transfer of the new asset.

(viii) Exemption of long-term capital gains on transfer of residential property if the sale consideration is used for subscription in equity of a new start-up manufacturing SME company to be used for purchase of new plant and machinery [Section 54GB]

- (1) The National Manufacturing Policy (NMP) was announced by the Government in 2011 to encourage investment in the SME segment (Small and Medium Enterprises) in the manufacturing sector.
- (2) Section 54GB exempt long term capital gains on sale of a residential property (house or plot of land) owned by an individual or a HUF in case of re-investment of sale consideration in the equity shares of an eligible company being a newly incorporated SME company engaged in the manufacturing sector, which is utilized by the company for the purchase of new plant and machinery.
- (3) In order to qualify as an "eligible company" under section 54GB the company should be –
 - (i) incorporated in the financial year in which the capital gain arises or in the following year on or before the due date of filing return of income by the individual or HUF;
 - (ii) engaged in the business of manufacture of an article or thing;
 - (iii) a company in which the individual or HUF holds more than 50% of the share capital or 50% of the voting rights, after the subscription in shares by the individual or HUF; and
 - (iv) a company which qualifies to be a Small or Medium Enterprise (SME) under the Micro, Small and Medium Enterprises Development Act, 2006 i.e., investment in the equipment is more than ₹ 25 lakhs but less than ₹ 10 crore.
- (4) The following conditions should be satisfied for claim of exemption of long-term capital gains under this section -
 - (i) The amount of net consideration should be used by the individual or HUF before the due date of furnishing of return of income under section 139(1), for subscription in equity shares of the eligible company.
 - (ii) The amount of subscription as share capital is to be utilized by the eligible company for the purchase of new plant and machinery within a period of one year from the date of subscription in the equity shares.

- (iii) If the amount of net consideration subscribed as equity shares in the eligible company is not utilized by the company for the purchase of plant and machinery before the due date of filing of return by the individual or HUF, the unutilized amount shall be deposited in an account with any specified bank or institution before such due date of filing return of income. The return of income furnished by the assessee, should be accompanied by the proof of such deposit.
- (iv) The said amount is to be utilized in accordance with any scheme which may be notified by the Central Government in the Official Gazette.
- (5) The amount of net consideration utilized by the company for purchase of new plant and machinery and the amount deposited as mentioned in (iv) above, will be deemed to be the cost of new plant and machinery for the purpose of computation of capital gains in the hands of individual or HUF.
- (6) New plant and machinery does not include -
- (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 installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house;
 - (iii) any office appliances including computers or computer software;
 - (iv) any vehicle; or
 - (v) any machinery or plant, the whole of the actual cost of which is allowed as a deduction, whether by way of depreciation or otherwise, in computing the income chargeable under the head "Profits and gains of business or profession" of any previous year.
- (7) Quantum of exemption under section 54GB
- If cost of new plant and machinery $\geq$ Net consideration of residential house, entire capital gains is exempt.
 - If cost of new plant and machinery $<$ Net consideration of residential house, only proportionate capital gains is exempt i.e.
- $$\text{LTCG} \times \frac{\text{Amount invested in new plant and machinery}}{\text{Net consideration}}$$
- (8) The exemption under this section would not be available in respect of transfer of residential property made after 31st March, 2017.
- (9) If the amount deposited by the company as mentioned in point (iv) above, is not utilized wholly or partly for the purchase of new plant and machinery within the period specified, then, the amount of capital gains not charged to tax under section 45 on account of such deposit by the company shall be charged to tax under section 45 as income of the assessee for the previous year in which the period of 1 year from the date of subscription in the equity shares by the assessee expires.

- (10) If the equity shares of the company acquired by the individual or HUF or the new plant and machinery acquired by the company are sold or transferred within a period of five years from the date of acquisition, the amount of capital gains earlier exempt under section 54GB shall be deemed to be the income of the individual or HUF chargeable under the head "Capital Gains" of the previous year in which such equity shares or such new plant and machinery are sold or otherwise transferred. This would be in addition to the capital gains arising on transfer of shares by the individual or HUF or capital gains arising on transfer of new plant and machinery by the company, as the case may be. These are safeguards to restrict the transfer of the shares of the company and of the plant and machinery for a period of 5 years to prevent diversion of these funds.

Illustration 19

Mr. Akash sold his residential property on 2nd February, 2014 for ₹ 90 lakh and paid brokerage@1% of sale price. He had purchased the said property in May 2000 for ₹24,36,000. In June, 2014, he invested ₹75 lakh in equity of A (P) Ltd., a newly incorporated SME manufacturing company, which constituted 63% of share capital of the said company. A (P) Ltd. utilized the said sum for the following purposes –

- (a) Purchase of new plant and machinery during July 2014 – ₹ 65 lakh
- (b) Included in (a) above are ₹6 lakh for purchase of computers and ₹8 lakh for purchase of cars.
- (c) Air-conditioners purchased for ₹1 lakh, included in the (a) above, were installed at the residence of Mr. Akash.
- (d) Amount deposited in specified bank on 28.9.2014 – ₹10 lakh

Compute the chargeable capital gain for the A.Y.2014-15. Assume that Mr. Akash is liable to file his return of income on or before 30th September, 2014 and he files his return on 29.09.2014.

Solution**Computation of taxable capital gains for A.Y.2014-15**

Particulars	₹
Gross consideration	90,00,000
Less: Expenses on transfer (1% of the gross consideration)	<u>90,000</u>
Net consideration	89,10,000
Less: Indexed cost of acquisition (₹ 24,36,000 × 939/406)	<u>56,34,000</u>
	32,76,000
Less: Exemption under section 54GB (₹ 32,76,000 × ₹ 60,00,000 / ₹ 89,10,000)	<u>22,06,061</u>
Taxable capital gains	<u>10,69,939</u>

Deemed cost of new plant and machinery for exemption under section 54GB			
	Particulars	₹	₹
(1)	Purchase cost of new plant and machinery acquired in July, 2014		65,00,000
	Less: Cost of office appliances, i.e., computers	6,00,000	
	Cost of vehicles, i.e., cars	8,00,000	
	Cost of air-conditioners installed at the residence of Mr. Akash	<u>1,00,000</u>	<u>15,00,000</u>
			50,00,000
(2)	Amount deposited in the specified bank before the due date of filing of return		<u>10,00,000</u>
	Deemed cost of new plant and machinery for exemption under section 54GB		<u>60,00,000</u>

(ix) **Capital Gains Account Scheme (CGAS)** - Under sections 54, 54B, 54D, 54F, 54G and 54GA, capital gains is exempt to the extent of investment of such gains / net consideration (in the case of section 54F) in specified assets within the specified time. If such investment is not made before the date of filing of return of income, then the capital gain or net consideration (in case of exemption under section 54F) has to be deposited under the CGAS.

Time limit - Such deposit in CGAS should be made before filing the return of income or on or before the due date of filing the return of income, whichever is earlier. Proof of such deposit should be attached with the return. The deposit can be withdrawn for utilization for the specified purposes in accordance with the scheme.

Consequences if the amount deposited in CGAS is not utilized within the stipulated time of 2 years / 3 years - If the amount deposited is not utilized for the specified purpose within the stipulated period, then the unutilized amount shall be charged as capital gain of the previous year in which the specified period expires. In the case of section 54F, proportionate amount will be taxable.

CBDT Circular No.743 dated 6.5.96 clarifies that in the event of death of an individual before the stipulated period, the unutilized amount is not chargeable to tax in the hands of the legal heirs of the deceased individual. Such unutilized amount is not income but is a part of the estate devolving upon them.

(x) **Extension of time for acquiring new asset or depositing or investing amount of Capital Gain [Section 54H]** - In case of compulsory acquisition of the original asset, where the compensation is not received on the date of transfer, the period available for acquiring a new asset or making investment in CGAS under sections 54, 54B, 54D, 54EC and 54F would be considered from the date of receipt of such compensation and not from the date of the transfer.

7.21 Reference to Valuation Officer [Section 55A]

Section 55A provides that the Assessing Officer may refer the valuation of a capital asset to a Valuation Officer in the following circumstances with a view to ascertaining the fair market value of the capital asset for the purposes of capital gains -

- (i) In a case where the value of the asset as claimed by the assessee is in accordance with the estimate made by a registered valuer, if the Assessing Officer is of the opinion that the value so claimed is at variance with its fair market value.

Under this provision, the Assessing Officer can make a reference to the Valuation Officer in cases where the fair market value is taken to be the sale consideration of the asset. With effect from 1st July, 2012, an Assessing Officer can also make a reference to the Valuation Officer in a case where the fair market value of the asset as on 01.04.1981 is taken as the cost of the asset, if he is of the view that there is any variation between the value as on 01.04.1981 claimed by the assessee in accordance with the estimate made by a registered valuer and the fair market value of the asset on that date.

- (ii) If the Assessing Officer is of the opinion that the fair market value of the asset exceeds the value of the asset as claimed by the assessee by more than 15% of the value of asset as claimed or by more than ₹ 25,000 of the value of the asset as claimed by the assessee.
- (iii) The Assessing Officer is of the opinion that, having regard to the nature of asset and other relevant circumstances, it is necessary to make the reference.

Where any such reference is made as per this section, the provisions of section 16A of the Wealth-tax Act, 1957 shall be applicable in relation to such reference as they apply in relation to a reference made by the Assessing Officer under section 16A of that Act.

7.22 Short term capital gains tax in respect of equity shares/ units of an equity oriented fund [Section 111A]

- (i) This section provides for a concessional rate of tax (i.e. 15%) on the short-term capital gains on transfer of -

- (1) an equity share in a company or
- (2) a unit of an equity oriented fund.

- (ii) The conditions for availing the benefit of this concessional rate are –

- (1) the transaction of sale of such equity share or unit should be entered into on or after 1.10.2004, being the date on which Chapter VII of the Finance (No. 2) Act, 2004 came into force; and
- (2) such transaction should be chargeable to securities transaction tax under the said Chapter.

- (iii) The proviso to this section provides that in the case of resident individuals or HUF, if the basic exemption is not fully exhausted by any other income, then the short-term capital gain will be reduced by the unexhausted basic exemption limit and only the balance would be taxed at 15%. However, the benefit of availing the basic exemption limit is not available in the case of non-residents.

- (iv) Deductions under Chapter VI-A cannot be availed in respect of such short-term capital gains on equity shares of a company or units of an equity oriented mutual fund included in the total income of the assessee.

The expression “equity oriented fund” has the same meaning assigned to it in the explanation to section 10(38) i.e., “Equity oriented fund” means a fund –

- (1) where the investible funds are invested by way of equity shares in domestic companies

to the extent of more than 65% of the total proceeds of such fund; and

(2) which has been set up under a scheme of a Mutual Fund specified under clause (23D).

7.23 Tax on long-term capital gains [Section 112]

(i) Where the total income of an assessee includes long-term capital gains, tax is payable by the assessee @20% on such long-term capital gains. The treatment of long-term capital gains in the hands of different types of assessee are as follows -

(1) **Resident individual or Hindu undivided family:** Income-tax payable at normal rates on total income as reduced by long-term capital gains plus 20% on such long-term capital gains.

However, where the total income as reduced by such long-term capital gains is below the maximum amount which is not chargeable to income-tax then such long-term capital gains shall be reduced by the amount by which the total income as so reduced falls short of the maximum amount which is not chargeable to income-tax and the tax on the balance of such long-term capital gains will be calculated @ 20%.

(2) **Domestic Company:** Long-term capital gains will be charged @ 20%.

(3) **Non-corporate non-resident / foreign company:** (i) Long-term capital gains arising from the transfer of a capital asset, being unlisted securities, would be calculated at the rate of 10% on the capital gains in respect of such asset without giving effect to the indexation provision under second proviso to section 48 and currency fluctuation under first proviso to section 48.

(ii) In respect of other long-term capital gains, the applicable rate of tax would be 20%.

(4) **Residents (other than those included in (i) above):** Long-term capital gains will be charged @20%.

(ii) The proviso to section 112 states that where the tax payable in respect of any income arising from the transfer of listed securities or units or zero coupon bonds, being long-term capital assets, exceeds 10% of the amount of capital gains before indexation, then such excess shall be ignored while computing the tax payable by the assessee.

(iii) For this purpose, "listed securities" means securities as defined by section 2(h) of the Securities Contracts (Regulation) Act, 1956; and "unit" means unit of a mutual fund specified under section 10(23D) or of the Unit Trust of India.

(iv) The provisions of section 112 make it clear that the deductions under Chapter VIA cannot be availed in respect of the long-term capital gains included in the total income of the assessee.

7.24 Exemption of long term capital gains on sale of equity shares/ Units of an equity oriented fund [Section 10(38)]

(i) Section 10(38) exempts long term capital gains on sale of equity shares of a company or units of an equity oriented fund on or after 1.10.2004, being the date on which Chapter VII of the Finance (No.2) Act, 2004 comes into force.

(ii) This exemption is available only if such transaction is chargeable to securities transaction tax.

(iii) However, such long term capital gains exempt under section 10(38) shall be taken into a

account in computing the book profit and income tax payable under section 115JB.

- (iv) For the purpose of this clause, "Equity oriented fund" means a fund –
 - (1) where the investible funds are invested by way of equity shares in domestic companies to the extent of more than 65% of the total proceeds of such fund; and
 - (2) which has been set up under a scheme of Mutual Fund specified under clause (23D).
- (v) The percentage of equity share holding of the fund should be computed with reference to the annual average of the monthly averages of the opening and closing figures.

Income from other Sources

8.1 Introduction

Any income, profits or gains includible in the total income of an assessee, which cannot be included under any of the preceding heads of income, is chargeable under the head 'Income from other sources'. Thus, this head is the residuary head of income and brings within its scope all the taxable income, profits or gains of an assessee which fall outside the scope of any other head. Therefore, when any income, profit or gain does not fall precisely under any of the other specific heads but is chargeable under the provisions of the Act, it would be charged under this head.

8.2 Incomes chargeable under this head [Section 56]

(i) The following income shall be chargeable only under the head 'Income from other sources':

- (1) Dividend income [covered by sections 2(22)(a) to (e)].
- (2) Casual income in the nature of winning from lotteries, crossword puzzles, horse races, card games and other games of any sort, gambling, betting etc. Such winnings are chargeable to tax at a flat rate of 30% under section 115BB.
- (3) Any sum of money or value of property received without consideration or value of property, other than immovable property, received for inadequate consideration to be subject to tax in the hands of the recipient, being an individual or HUF [Section 56(2)(vii)]
 - (i) Section 56(2)(vii) brings to tax any sum of money or the value of any property received by an individual or HUF without consideration or the value of any property, other than immovable property, received for inadequate consideration. For this purpose, "property" means immovable property being land or building or both, shares and securities, jewellery, archaeological collections, drawings, paintings, sculptures, any work of art or bullion.
 - (ii) If an immovable property is received without consideration, the stamp duty value of such property would be taxed as the income of the recipient if it exceeds ₹ 50,000.
 - (iii) *In order to prevent tax avoidance by transferring immovable property at prices significantly lower than the circle rates, section 56(2)(vii) has been amended*

with effect from A.Y.2014-15 to provide that where any immovable property is received for a consideration which is less than the stamp duty value of the property by an amount exceeding ₹ 50,000, the difference between the stamp duty value and the consideration shall be chargeable to tax in the hands of the individual or HUF as “Income from other sources”.

- (iv) *Taking into consideration the possible time gap between the date of agreement and the date of registration, the stamp duty value may be taken as on the date of agreement instead of the date of registration, if the date of the agreement fixing the amount of consideration for the transfer of the immovable property and the date of registration are not the same, provided at least a part of the consideration has been paid by any mode other than cash on or before the date of agreement.*
- (v) If the stamp duty value of immovable property is disputed by the assessee, the Assessing Officer may refer the valuation of such property to a Valuation Officer. In such a case, the provisions of section 50C and section 155(15) shall, as far as may be, apply for determining the value of such property.
- (vi) If movable property is received without consideration, the aggregate fair market value of such property on the date of receipt would be taxed as the income of the recipient, if it exceeds ₹ 50,000. In case movable property is received for inadequate consideration, and the difference between the aggregate fair market value and such consideration exceeds ₹ 50,000, such difference would be taxed as the income of the recipient. The CBDT would prescribe the method of determination of fair market value of a movable property.
- (vii) The provisions of section 56(2)(vii) would apply only to property which is the nature of a capital asset of the recipient and not stock-in-trade, raw material or consumable stores of any business of the recipient. Therefore, only transfer of a capital asset, without consideration and transfer of a capital asset, other than immovable property, for inadequate consideration would attract the provisions of section 56(2)(vii).
- (viii) The table below summarises the scheme of taxability of gifts –

Nature of asset		Particulars	Taxable value
1	Money	Without consideration	The whole amount if the same exceeds ₹ 50,000.

2	Movable property	Without consideration	The aggregate fair market value of the property, if it exceeds ₹ 50,000.
3	Movable property	Inadequate consideration	The difference between the aggregate fair market value and the consideration, if such difference exceeds ₹ 50,000.
4	Immovable property	Without consideration	The stamp value of the property, if it exceeds ₹ 50,000.
5	Immovable property	Inadequate consideration	<i>The difference between the stamp duty value and the consideration, if such difference exceeds ₹ 50,000.</i>

(ix) However, any sum of money or value of property received -

- (a) from any relative; or
 - (b) on the occasion of the marriage of the individual; or
 - (c) under a will or by way of inheritance; or
 - (d) in contemplation of death of the payer or donor, as the case may be; or
 - (e) from any local authority as defined in the Explanation to section 10(20); or
 - (f) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in section 10(23C); or
 - (g) from any trust or institution registered under section 12AA
- would be outside the ambit of section 56(2)(vii).

(x) The term "relative" for the purpose of section 56(2)(vii) would mean –

- (a) in case of an individual –
 - (i) spouse of the individual;
 - (ii) brother or sister of the individual;
 - (iii) brother or sister of the spouse of the individual;
 - (iv) brother or sister of either of the parents of the individual;
 - (v) any lineal ascendant or descendant of the individual;
 - (vi) any lineal ascendant or descendant of the spouse of the individual;
 - (vii) spouse of any of the persons referred to above.
- (b) In case of Hindu Undivided Family, any member thereof.

- (ix) Rules for determination of fair market value of the property other than immovable property
 - (a) Valuation of jewellery
 - (i) the fair market value of jewellery shall be estimated to be the price which such jewellery would fetch if sold in the open market on the valuation date;
 - (ii) in case the jewellery is received by the way of purchase on the valuation date, from a registered dealer, the invoice value of the jewellery shall be the fair market value;
 - (iii) In case the jewellery is received by any other mode and the value of the jewellery exceeds ₹ 50,000, then, the assessee may obtain the report of registered valuer in respect of the price it would fetch if sold in the open market on the valuation date.
 - (b) Valuation of archeological collections, drawings, paintings, sculptures or any work of art
 - (i) the fair market value of archeological collections, drawings, paintings, sculptures or any work of art (artistic work) shall be estimated to be price which it would fetch if sold in the open market on the valuation date;
 - (ii) in case the artistic work is received by the way of purchase on the valuation date, from a registered dealer, the invoice value of the artistic work shall be the fair market value;
 - (iii) in case the artistic work is received by any other mode and the value of the artistic work exceeds ₹ 50,000, then, the assessee may obtain the report of registered valuer in respect of the price it would fetch if sold in the open market on the valuation date.
 - (c) Valuation of shares and securities
 - (a) the fair market value of quoted shares and securities shall be determined in the following manner, namely:-
 - (i) if the quoted shares and securities are received by way of transaction carried out through any recognized stock exchange, the fair market value of such shares and securities shall be the transaction value as recorded in such stock exchange;
 - (ii) if such quoted shares and securities are received by way of transaction carried out other than through any recognized stock exchange, the fair market value of such shares and securities shall be,-
 - (1) the lowest price of such shares and securities quoted on any recognized stock exchange on the valuation date, and
 - (2) the lowest price of such shares and securities on any recognized stock exchange on a date immediately preceding the valuation date when such shares and securities were traded on such stock

exchange, in cases where on the valuation date, there is no trading in such shares and securities on any recognized stock exchange.

- (b) the fair market value of unquoted equity shares shall be the value, on the valuation date, of such unquoted equity shares as determined in the following manner namely;-

The fair market value of unquoted equity shares = $\frac{(A-L)}{PE} \times (PV)$, where,

A = Adjusted book value of assets i.e., book value of assets in the balance sheet as reduced by certain specified deductions, namely, -

- (1) any amount of tax paid as deduction or collection at source; or*
- (2) advance tax payment reduced by the amount of tax claimed as refund under the Income-tax Act, 1961; and*
- (3) any amount shown in the balance-sheet as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset.*

L = Adjusted book value of liabilities, i.e., book value of liabilities shown in the Balance Sheet drawn up on the valuation date but not including the following amounts:-

- (i) the paid-up capital in respect of equity shares;*
- (ii) the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;*
- (iii) reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;*
- (iv) any amount representing provision for taxation, other than amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act, 1961, to the extent of excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;*
- (v) any amount representing provisions made for meeting liabilities, other than ascertained liabilities;*
- (vi) any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares.*

PE = Total amount of paid up equity share capital as shown in Balance Sheet.

PV = the paid up value of such equity shares.

- (c) the fair market value of unquoted shares and securities other than equity shares in a company which are not listed in any recognized stock exchange

shall be estimated to be price it would fetch if sold in the open market on the valuation date and the assessee may obtain a report from a merchant banker or an accountant in respect of such valuation.

Illustration 1

Mr. A, a dealer in shares, received the following without consideration during the P.Y.2013-14 from his friend Mr. B, -

- (1) Cash gift of ₹ 75,000 on his anniversary, 15th April, 2013.
- (2) Bullion, the fair market value of which was ₹ 60,000, on his birthday, 19th June, 2013.
- (3) A plot of land at Faridabad on 1st July, 2013, the stamp value of which is ₹ 5 lakh on that date. Mr. B had purchased the land in April, 2007.

Mr. A purchased from his friend Mr. C, who is also a dealer in shares, 1000 shares of X Ltd. @ ₹ 400 each on 19th June, 2013, the fair market value of which was ₹ 600 each on that date. Mr. A sold these shares in the course of his business on 23rd June, 2013.

Further, on 1st November, 2013, Mr. A took possession of property (building) booked by him two years back at ₹ 20 lakh. The stamp duty value of the property as on 1st November, 2013 was ₹ 32 lakh and on the date of booking was ₹ 23 lakh. He had paid ₹ 1 lakh by cheque as down payment on the date of booking.

On 1st March, 2014, he sold the plot of land at Faridabad for ₹ 7 lakh.

Compute the income of Mr. A chargeable under the head "Income from other sources" and "Capital Gains" for A.Y.2014-15.

Solution

Computation of "Income from other sources" of Mr. A for the A.Y.2014-15

	Particulars	₹
(1)	Cash gift is taxable under section 56(2)(vii), since it exceeds ₹ 50,000	75,000
(2)	Since bullion is included in the definition of property, therefore, when bullion is received without consideration, the same is taxable, since the aggregate fair market value exceeds ₹ 50,000	60,000
(3)	Stamp value of plot of land at Faridabad, received without consideration, is taxable under section 56(2)(vii)	5,00,000
(4)	Difference of ₹ 2 lakh in the value of shares of X Ltd. purchased from Mr. C, a dealer in shares, is not taxable as it represents the stock-in-trade of Mr. A. Since Mr. A is a dealer in shares and it has been mentioned that the shares were subsequently sold in the course of his business, such shares represent the stock-in-trade of Mr. A.	-
(5)	Difference between the stamp duty value of ₹ 23 lakh on the date of booking and the actual consideration of ₹ 20 lakh paid is taxable under section 56(2)(vii).	3,00,000
Income from Other Sources		9,35,000

Computation of "Capital Gains" of Mr. A for the A.Y.2014-15

Particulars	₹
Sale Consideration	7,00,000
Less: Cost of acquisition [deemed to be the stamp value charged to tax under section 56(2)(vii) as per section 49(4)]	5,00,000
Short-term capital gains	2,00,000

Note – The resultant capital gains will be short-term capital gains since for calculating the period of holding, the period of holding of previous owner is not to be considered.

Illustration 2

Discuss the taxability or otherwise of the following in the hands of the recipient under section 56(2)(vii) the Income-tax Act, 1961 -

- Akhil HUF received ₹ 75,000 in cash from niece of Akhil (i.e., daughter of Akhil's sister). Akhil is the Karta of the HUF.*
- Nitisha, a member of her father's HUF, transferred a house property to the HUF without consideration. The stamp duty value of the house property is ₹ 9,00,000.*
- Mr. Akshat received 100 shares of A Ltd. from his friend as a gift on occasion of his 25th marriage anniversary. The fair market value on that date was ₹ 100 per share. He also received jewellery worth ₹ 45,000 (FMV) from his nephew on the same day.*
- Kishan HUF gifted a car to son of Karta for achieving good marks in XII board examination. The fair market value of the car is ₹ 5,25,000.*

Solution

	Taxable/ Non- taxable	Amount liable to tax (₹)	Reason
(i)	Taxable	75,000	Sum of money exceeding ₹ 50,000 received without consideration from a non-relative is taxable under section 56(2)(vii). Daughter of Mr. Akhil's sister is not a relative of Akhil HUF, since she is not a member of Akhil HUF.
(ii)	Non- taxable	Nil	Immovable property received without consideration by a HUF from its relative is not taxable under section 56(2)(vii). Since Nitisha is a member of the HUF, she is a relative of the HUF. However, income from such asset would be included in the hands of Nitisha under 64(2).
(iii)	Taxable	55,000	As per provisions of section 56(2)(vii), in case the aggregate fair market value of property, other than immovable property, received without consideration exceeds ₹ 50,000, the whole

			of the aggregate value shall be taxable. In this case, the aggregate fair market value of shares (₹ 10,000) and jewellery (₹ 45,000) exceeds ₹ 50,000. Hence, the entire amount of ₹ 55,000 shall be taxable.
(iv)	Non-taxable	Nil	Car is not included in the definition of property for the purpose of section 56(2)(vii), therefore, the same shall not be taxable.

Illustration 3

Mr. Hari, a property dealer, sold a building in the course of his business to his friend Rajesh, who is a dealer in automobile spare parts, for ₹ 90 lakh on 1.1.2014, when the stamp duty value was ₹ 150 lakh. The agreement was, however, entered into on 1.7.2013 when the stamp duty value was ₹ 140 lakh. Mr. Hari had received a down payment of ₹ 15 lakh by cheque from Rajesh on the date of agreement. Discuss the tax implications in the hands of Hari and Rajesh, assuming that Mr. Hari has purchased the building for ₹ 75 lakh on 12th July, 2012.

Would your answer be different if Hari was a share broker instead of a property dealer?

Solution**Case 1: Tax implications if Mr. Hari is a property dealer**

In the hands of Mr. Hari	In the hands of Mr. Rajesh
In the hands of Hari, the provisions of section 43CA would be attracted, since the building represents his stock-in-trade and he has transferred the same for a consideration less than the stamp duty value on the date of agreement. Therefore, ₹ 65 lakh, being the difference between the stamp duty value on the date of agreement (i.e., ₹ 140 lakh) and the purchase price (i.e., ₹ 75 lakh), would be chargeable as business income in the hands of Mr. Hari.	Since Mr. Rajesh is a dealer in automobile spare parts, the building purchased would be a capital asset in his hands. The provisions of section 56(2)(vii) would be attracted in the hands of Mr. Rajesh who has received immovable property, being a capital asset, for inadequate consideration. Therefore, ₹ 50 lakh, being the difference between the stamp duty value of the property (i.e., ₹ 140 lakh) and the actual consideration (i.e., ₹ 90 lakh) would be taxable under section 56(2)(vii) in the hands of Mr. Rajesh.

Case 2: Tax implications if Mr. Hari is a stock broker

In the hands of Mr. Hari	In the hands of Mr. Rajesh
In case Mr. Hari is a stock broker and not a property dealer, the building would represent his capital asset and not stock-in-trade. In such a case, the provisions of section 50C would be attracted in the hands of Mr. Hari and ₹ 75 lakh, being the difference between the stamp duty value on the date of registration (i.e., ₹ 150 lakh) and the purchase price (i.e., ₹ 75 lakh) would be chargeable as short-term capital gains. It may be noted that under section 50C, there is no option to adopt the stamp duty value on the date of agreement, even if the date of agreement is different from the date of registration and part of the consideration has been received on or before the date of agreement otherwise than by way of cash.	There would be no difference in the taxability in the hands of Mr. Rajesh, whether Mr. Hari is a property dealer or a stock broker. Therefore, the provisions of section 56(2)(vii) would be attracted in the hands of Mr. Rajesh who has received immovable property, being a capital asset, for inadequate consideration. Therefore, ₹ 50 lakh, being the difference between the stamp duty value of the property (i.e., ₹ 140 lakh) and the actual consideration (i.e., ₹ 90 lakh) would be taxable under section 56(2)(vii) in the hands of Mr. Rajesh.

(4) Transfer of shares without consideration or for inadequate consideration to attract the provisions of section 56(2) in case of recipient firms and companies also [Section 56(2)(viiia)]

- (i) Section 56(2)(viiia) provides that the transfer of shares of a company without consideration or for inadequate consideration would attract the provisions of section 56(2), if the recipient is a firm or a company. The purpose is to prevent the practice of transferring unlisted shares at prices much below their fair market value.
- (ii) If such shares are received without consideration, the aggregate fair market value on the date of transfer would be taxed as the income of the recipient firm or company, if it exceeds ₹ 50,000. If such shares are received for inadequate consideration, the difference between the aggregate fair market value and the consideration would be taxed as the income of the recipient firm or company, if such difference exceeds ₹ 50,000.
- (iii) However, the provisions of section 56(2)(viiia) would not apply in the case of transfer of shares -
 - (1) of a company in which the public are substantially interested; or
 - (2) to a company in which the public are substantially interested.
- (iv) Certain transactions are exempted from the application of the provisions of this clause, namely, transactions covered under the following sections:

Section	Transaction
47(via)	Transfer of shares held in an Indian company, in a scheme of amalgamation, by the amalgamating foreign company to an amalgamated foreign company.
47(vic)	Transfer of shares held in an Indian company, in a scheme of demerger, by the demerged foreign company to a resulting foreign company.
47(vicb)	Transfer by a shareholder, in a business reorganization, of shares held in the predecessor co-operative bank, in consideration of the allotment of shares in the successor co-operative bank.
47(vid)	Transfer or issue of shares by the resulting company, in a scheme of demerger, to the shareholders of the demerged company in consideration of demerger of the undertaking.
47(vii)	Transfer by a shareholder, in a scheme of amalgamation, of shares in the amalgamating company in consideration of allotment to him of shares in the amalgamated Indian company.

(5) Consideration received in excess of FMV of shares issued by a closely held company to be treated as income of such company, where shares are issued at a premium [Section 56(2)(viib)]

- (i) Section 56(2)(viib) brings to tax the consideration received from a resident person by a company, other than a company in which public are substantially interested, which is in excess of the fair market value (FMV) of shares.
- (ii) Such excess is to be treated as the income of a closely held company taxable under section 56(2) under the head "Income from Other Sources", in cases where consideration received for issue of shares exceeds the face value of shares i.e. where shares are issued at a premium.
- (iii) However, these provisions would not be attracted where consideration for issue of shares is received:
 - (1) by a Venture Capital Undertaking (VCU) from a Venture Capital Fund (VCF) or Venture Capital Company (VCC); or
 - (2) by a company from a class or classes of persons as notified by the Central Government for this purpose.
- (iv) Fair market value of the shares shall be the higher of, the value as may be –
 - (a) determined in accordance with the prescribed method; or
 - (b) substantiated by the company to the satisfaction of the Assessing Officer, based on the value of its assets on the date of issue of shares.

For the purpose of computation of FMV, the value of assets would include the value of intangible assets being goodwill, know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature.

Rule 11UA(2) prescribes the manner of determination of FMV of unquoted equity shares for the purposes of sub-clause (i) of clause (a) of Explanation to section 56(2)(viib).

The FMV shall be the value, on the valuation date, of such unquoted equity shares as determined in the following manner under clause (a) or clause (b), at the option of the assessee, namely:—

$$(a) \text{ the fair market value of unquoted equity shares} = \frac{(A - L)}{PE} \times (PV)$$

A = The book value of the assets in the balance sheet as reduced by the following -

(1) any amount of tax paid as deduction or collection at source (2) any amount of advance tax payment	}	minus the amount of tax claimed as refund under the Income-tax Act, 1961.
(3) any amount shown in the balance-sheet as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;		

L = book value of liabilities shown in the balance-sheet, but not including the following amounts, namely:—

- (i) the paid-up capital in respect of equity shares;
- (ii) the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;
- (iii) reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;
- (iv) any amount representing provision for taxation, other than amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;
- (v) any amount representing provisions made for meeting liabilities, other than ascertained liabilities;
- (vi) any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;

PE = total amount of paid up equity share capital as shown in the balance-sheet

PV = the paid up value of such equity shares

- (b) *the fair market value of the unquoted equity shares determined by a merchant banker or an accountant as per the Discounted Free Cash Flow method.*

Meaning of certain expressions, used in determination of Fair Market Value, amended [Rule 11U]

Consequent to insertion of sub-rule (2) in Rule 11UA, the meaning of certain expressions, defined in Rule 11U and used in determination of Fair Market Value, have been amended. The new definitions are as follows -

<i>For the purpose of sub-rule (2) of Rule 11UA</i>	<i>In any other case</i>
<u><i>Definition of “accountant”</i></u> <i>A fellow of the Institute of Chartered Accountants of India within the meaning of the Chartered Accountants Act, 1949, who is not appointed by the company as an auditor under –</i> <i>(i) section 44AB of the Income-tax Act, 1961 or</i> <i>(ii) section 224 of the Companies Act, 1956¹.</i>	<i>Meaning as assigned in the Explanation below section 288(2) i.e., Chartered Accountant within the meaning of the Chartered Accountants Act, 1949.</i>
<u><i>Definition of “Balance Sheet”</i></u> <i>“Balance sheet”, in relation to any company, means, the balance sheet of such company (including the notes annexed thereto and forming part of the accounts) -</i> <i>- as drawn up on the valuation date</i> <i>- which has been audited by the auditor of the company appointed under section 224 of the Companies Act, 1956.</i> <i>Where the balance sheet on the valuation date is not drawn up, the expression “Balance Sheet” in relation to any company, would mean the balance sheet (including the notes annexed thereto and forming part of the accounts) drawn up as on a date immediately preceding the valuation date which has been approved and adopted in the annual general meeting of the shareholders of the company;</i>	<i>“Balance sheet”, in relation to any company, means the balance sheet of such company (including the notes annexed thereto and forming part of the accounts) –</i> <i>- as drawn up on the valuation date</i> <i>- which has been audited by the auditor appointed under section 224 of the Companies Act, 1956.</i>

¹ Section 139 of the Companies Act, 2013

Illustration 4

The following are the details of the shares issued by Ray (P) Ltd. Discuss the applicability of provisions of section 56(2)(viib) in the hands of the company:

	Face value of shares (₹)	FMV of shares (₹)	Issue price of shares (₹)	Applicability of section 56(2)(viib)
(i)	100	120	130	The provisions of section 56(2)(viib) are attracted in this case since the shares are issued at a premium (i.e., issue price exceeds the face value of shares). The excess of the issue price of the shares over the FMV would be taxable under section 56(2)(viib). ₹ 10 (₹ 130 - ₹ 120) shall be treated as income in the hands of Ray (P) Ltd.
(ii)	100	120	110	The provisions of section 56(2)(viib) are attracted since the shares are issued at a premium. However, no sum shall be chargeable to tax under the said section as the shares are issued at a price less than the FMV of shares.
(iii)	100	90	98	Section 56(2)(viib) is not attracted since the shares are issued at a discount, though the issue price is greater than the FMV.
(iv)	100	90	110	The provisions of section 56(2)(viib) are attracted in this case since the shares are issued at a premium. The excess of the issue price of the shares over the FMV would be taxable under section 56(2)(viib). Therefore, ₹ 20 (₹ 110 - ₹ 90) shall be treated as income in the hands of Ray (P) Ltd.

- (6) Interest received on compensation/enhanced compensation deemed to be income in the year of receipt and taxable under the head "Income from Other Sources" [Sections 56(2)(viii)]
- As per section 145(1), income chargeable under the head "Profits and gains of business or profession" or "Income from other sources", shall be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.
 - Further, the Hon'ble Supreme Court has, in *Rama Bai v. CIT (1990) 181 ITR 400*, held that arrears of interest computed on delayed or on enhanced compensation shall be taxable on accrual basis. The tax payers are facing genuine difficulty on account of this ruling, since the interest would have accrued over a number of years, and consequently the income of all the years would undergo a change.

- (iii) Therefore, to remove this difficulty, clause (b) has been inserted in section 145A to provide that the interest received by an assessee on compensation or on enhanced compensation shall be deemed to be his income for the year in which it is received, irrespective of the method of accounting followed by the assessee.
- (iv) Section 56(2)(viii) provides that income by way of interest received on compensation or on enhanced compensation referred to in clause (b) of section 145A shall be assessed as "Income from other sources" in the year in which it is received.
- (ii) The following income are chargeable under the head "Income from other sources" only if such income are not chargeable under the head "Profits and gains of business or profession" -
 - (1) Any sum received by an employer-assessee from his employees as contributions to any provident fund, superannuation fund or any other fund for the welfare of the employees
 - (2) Interest on securities
 - (3) Income from letting out on hire, machinery, plant or furniture.
 - (4) Where letting out of buildings is inseparable from the letting out of machinery, plant or furniture, the income from such letting.
- (iii) Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy is chargeable under the head "Income from other sources" if such income is not chargeable under the head "Profits and gains of business or profession" or under the head "Salaries" i.e. if such sum is received by any person other than the employer who took the policy and the employee in whose name the policy was taken.
- (iv) Any income chargeable to tax under the Act, but not falling under any other head of income shall be chargeable to tax under the head "Income from other sources" e.g. Salary received by an MPs/MLAs will not be chargeable to income-tax under the head 'Salary' but will be chargeable as "Income from other sources" under section 56.

8.3 Bond washing transactions and dividend stripping [Section 94]

- (i) A bond-washing transaction is a transaction where securities are sold some time before the due date of interest and reacquired after the due date is over. This practice is adopted by persons in the higher income group to avoid tax by transferring the securities to their relatives/friends in the lower income group just before the due date of payment of interest. In such a case, interest would be taxable in the hands of the transferee, who is the legal owner of securities. In order to discourage such practice, section 94(1) provides that where the owner of a security transfers the security just before the due date of interest and buys back the same immediately after the due date and interest is received by the transferee, such interest income will be deemed to be the income of the transferor and would be taxable in his hands.
- (ii) In order to prevent the practice of sale of securities-cum-interest, section 94(2) provides that if an assessee who has beneficial interest in securities sells such securities in such a manner that either no income is received or income received is less than the sum he would have received if such interest had accrued from day to day, then income from such securities for the whole year would be deemed to be the income of the assessee.

- (iii) Section 94(7) provides that where
 - (a) any person buys or acquires any securities or unit within a period of three months prior to the record date and
 - (b) such person sells or transfers –
 - (1) such securities within a period of three months after such date, or
 - (2) such unit within a period of nine months after such date and
 - (c) the dividend or income on such securities or unit received or receivable by such person is exempted,

then, the loss, if any, arising therefrom shall be ignored for the purposes of computing his income chargeable to tax. Such loss should not exceed the amount of dividend or income received or receivable on such securities or unit.

8.4 Applicable rate of tax in respect of casual income [Section 115BB]

- (i) This section provides that income by way of winnings from lotteries, crossword puzzles, races including horse races or card games and other games of any sort or from gambling or betting of any form would be taxed at a flat rate of 30% plus surcharge, if applicable, plus education cess plus secondary and higher education cess.
- (ii) No expenditure or allowance can be allowed from such income.
- (iii) Deduction under Chapter VI-A is not allowable from such income.
- (iv) Adjustment of unexhausted basic exemption limit is also not permitted against such income.

8.5 Deductions allowable [Section 57]

The income chargeable under the head “Income from other sources” shall be computed after making the following deductions:

- (i) In the case of dividends (other than dividends referred to in section 115-O) or interest on securities, any reasonable sum paid by way of commission or remuneration to a banker or any other person for the purpose of realising such dividend or interest on behalf of the assessee.
- (ii) Where the income consists of recovery from employees as contribution to any provident fund etc. in terms of clause (x) of section 2(24), then, a deduction will be allowed in accordance with the provisions of section 36(1)(va) i.e. to the extent the contribution is remitted before the due date under the respective Acts.
- (iii) Where the income to be charged under this head is from letting on hire of machinery, plant and furniture, with or without building, the following items of deductions are allowable in the computation of such income:
 - (a) the amount paid on account of any current repairs to the machinery, plant or furniture.
 - (b) the amount of any premium paid in respect of insurance against risk of damage or destruction of the machinery or plant or furniture.
 - (c) the normal depreciation allowance in respect of the machinery, plant or furniture, due thereon.

(iv) In the case of income in the nature of family pension, a deduction of a sum equal to $33\frac{1}{3}$ per cent of such income or ₹ 15,000, whichever is less, is allowable. For the purposes of this deduction "family pension" means a regular monthly amount payable by the employer to a person belonging to the family of an employee in the event of his death.

(v) Any other expenditure not being in the nature of capital expenditure laid out or expended wholly and exclusively for the purpose of making or earning such income.

(vi) 50% of income by way of compensation/enhanced compensation received chargeable to tax under section 56(2)(viii). No deduction would be allowable under any other clause of section 57 in respect of such income.

Illustration 5

Interest on enhanced compensation received by Mr.G during the previous year 2013-14 is ₹ 5,00,000. Out of this interest, ₹ 1,50,000 relates to the previous year 2009-10, ₹ 1,65,000 relates to previous year 2010-11 and ₹ 1,85,000 relates to previous year 2011-12. Discuss the tax implication, if any, of such interest income for A.Y.2014-15.

Solution

The entire interest of ₹ 5,00,000 would be taxable in the year of receipt, namely, P.Y.2013-14.

Particulars	₹
Interest on enhanced compensation taxable u/s 56(2)(viii)	5,00,000
Less: Deduction under section 57(iv) @50%	2,50,000
Interest chargeable under the head "Income from other sources"	2,50,000

Note - The Supreme Court held in *CIT v. Rajindra Prasad Moody [1978] 115 ITR 519*, that in order to claim deduction under section 57 in respect of any expenditure, it is not necessary that income should in fact have been earned as a result of the expenditure. In this view of the matter, the Court held that the interest on money borrowed for investment in shares which had not yielded any taxable dividend was admissible as a deduction under section 57 under the head, "Income from other sources".

8.6 Deductions not allowable [Section 58]

No deduction shall be made in computing the "Income from other sources" of an assessee in respect of the following items of expenses:

- (i) In the case of any assessee:
 - (1) any personal expense of the assessee;
 - (2) any interest chargeable to tax under the Act which is payable outside India on which tax has not been paid or deducted at source.
 - (3) any payment taxable in India as salaries, if it is payable outside India unless tax has been paid thereon or deducted at source.
- (ii) In addition to these disallowances, section 58(2) specifically provides that the disallowance of payments to relatives and associate concerns and disallowance of payment or

aggregate of payments exceeding ₹ 20,000 made to a person during a day otherwise than by account payee cheque or draft covered by section 40A will be applicable to the computation of income under the head 'Income from other sources' as well.

(iii) Income-tax and wealth-tax paid.

(iv) No deduction in respect of any expenditure or allowance in connection with income by way of earnings from lotteries, cross word puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever shall be allowed in computing the said income.

The prohibition will not, however, apply in respect of the income of an assessee, being the owner of race horses, from the activity of owning and maintaining such horses. In respect of the activity of owning and maintaining race horses, expenses incurred shall be allowed even in the absence of any stake money earned. Such loss shall be allowed to be carried forward in accordance with the provisions of section 74A.

8.7 Deemed income chargeable to tax [Section 59]

The provisions of section 41(1) are made applicable, so far as may be, to the computation of income under this head. Accordingly, where a deduction has been made in respect of a loss, expenditure or liability and subsequently any amount is received or benefit is derived in respect of such expenditure incurred or loss or trading liability allowed as deduction, then it shall be deemed as income in the year in which the amount is received or the benefit is accrued.

8.8 Method of accounting [Section 145]

Income chargeable under the head "Income from other sources" has to be computed in accordance with the cash or mercantile system of accounting regularly employed by the assessee. However, deemed dividend under section 2(22)(e) is chargeable to tax on payment basis under section 8, irrespective of the method of accounting followed by the assessee.

Income of other Persons included in Assessee's Total Income

9.1 Clubbing of Income – An Introduction

Under the Income-tax Act, 1961, an assessee is generally taxed in respect of his own income. However, there are certain cases where an assessee has to pay tax in respect of income of another person. The provisions for the same are contained in sections 60 to 65 of the Act. These provisions have been enacted to counteract the tendency on the part of the tax-payers to dispose of their property or transfer their income in such a way that their tax liability can be avoided or reduced.

For example, in the case of individuals, income-tax is levied on a slab system on the total income. The tax system is progressive i.e. as the income increases, the applicable rate of tax increases. Some taxpayers in the higher income bracket have a tendency to divert some portion of their income to their spouse, minor child etc. to minimize their tax burden. In order to prevent such tax avoidance, clubbing provisions have been incorporated in the Act, under which income arising to certain persons (like spouse, minor child etc.) have to be included in the income of the person who has diverted his income for the purpose of computing tax liability.

9.2 Transfer of income without transfer of asset [Section 60]

- (i) If any person transfers the income from any asset without transferring the asset itself, such income is to be included in the total income of the transferor.
- (ii) It is immaterial whether the transfer is revocable or irrevocable and whether it was made before the commencement of this Act or after its commencement.
- (iii) For example, Mr.A confers the right to receive rent in respect of his house property on his wife, Mrs.A, without transferring the house itself to her. In this case, the rent received by Mrs.A will be clubbed with the income of Mr.A.

9.3 Income arising from revocable transfer of assets [Section 61]

- (i) All income arising to any person by virtue of a revocable transfer of assets is to be included in the total income of the transferor.
- (ii) As per section 63, the transfer is deemed to be revocable if—
 - (a) it contains any provision for the retransfer, directly or indirectly, of the whole or any part of the income or assets to the transferor, or

- (b) it gives, in any way to the transferor, a right to reassume power, directly or indirectly, over the whole or any part of the income or the assets.
- (iii) This clubbing provision will operate even if only part of income of the transferred asset had been applied for the benefit of the transferor. Once the transfer is revocable, the entire income from the transferred asset is includible in the total income of the transferor.

9.4 Exceptions where clubbing provisions are not attracted even in case of revocable transfer [Section 62]

Section 61 will not apply in the following two cases -

- (i) **Transfer not revocable during the life time of the beneficiary or the transferee** - If there is a transfer of asset which is not revocable during the life time of the transferee, the income from the transferred asset is not includible in the total income of the transferor provided the transferor derives no direct or indirect benefit from such income. If the transferor receives direct or indirect benefit from such income, such income is to be included in his total income even though the transfer may not be revocable during the life time of the transferee.
- (ii) **Transfer made before April 1, 1961 and not revocable for a period exceeding six years** - Income arising from the transfer of an asset before 1.4.61, which was not revocable for a period exceeding six years, is not includible in the total income of the transferor provided the transferor does not derive direct or indirect benefit from such income.

In both the above cases, as and when the power to revoke the transfer arises, the income arising by virtue of such transfer will be included in the total income of the transferor.

9.5 Clubbing of income arising to spouse [Section 64(1)(ii)]

9.5.1 Income by way of remuneration from a concern in which the individual has substantial interest

- (i) In computing the total income of any individual, all such income which arises, directly or indirectly, to the spouse of such individual by way of salary, commission, fees or any other form of remuneration, whether in cash or in kind, from a concern in which such individual has a substantial interest shall be included.
- (ii) However, this provision does not apply where the spouse of the said individual possesses technical or professional qualifications and the income to the spouse is solely attributable to the application of his/her technical or professional knowledge or experience. In such an event, the income arising to such spouse is to be assessed in his/her hands.
- (iii) Where both husband and wife have substantial interest in a concern and both are in receipt of income by way of salary etc. from the said concern, such income will be includible in the hands of that spouse, whose total income, excluding such income is higher.
- (iv) Where any such income is once included in the total income of either spouse, income arising in the succeeding year shall not be included in the total income of the other spouse unless the Assessing Officer is satisfied, after giving that spouse an opportunity of being heard, that it is necessary to do so.

9.3 Income Tax

(v) An individual shall be deemed to have substantial interest in a concern under the following circumstances -

(a) If the concern is a company, equity shares carrying not less than 20% of the voting power are, at any time during the previous year, owned beneficially by such person or partly by such person and partly by one or more of his relatives.

(b) In any other case, if such person is entitled, or such person and one or more of his relatives are entitled in the aggregate, at any time during the previous year, to not less than 20% of the profits of such concern.

The term 'relative' in relation to an individual means the husband, wife, brother or sister or any lineal ascendant or descendant of that individual.

Illustration 1

Mr. A is an employee of X Ltd. and he has 25% shares of that company. His salary is ₹ 50,000 p.m. Mrs. A is working as a computer software programmer in X Ltd. at a salary of ₹ 30,000 p.m. She is, however, not qualified for the job. Compute the gross total income of Mr.A and Mrs. A for the A.Y.2014-15, assuming that they do not have any other income.

Solution

Mr. A is an employee of X Ltd and has 25% shares of X Ltd i.e. a substantial interest in the company. His wife is working in the same company without any professional qualifications for the same. Thus, by virtue of the clubbing provisions of the Act, the salary received by Mrs. A from X Ltd. will be clubbed in the hands of Mr. A.

Computation of Gross total income of Mr. A

Particulars	₹
Salary received by Mr. A (₹ 50,000 × 12)	6,00,000
Salary received by Mrs. A (₹ 30,000 × 12)	3,60,000
Gross total income	9,60,000

The gross total income of Mrs. A is nil.

Illustration 2

Will your answer be different if Mrs. A was qualified for the job?

Solution

If Mrs. A possesses professional qualifications for the job, then the clubbing provisions shall not be applicable.

Gross total income of Mr. A = Salary received by Mr. A [₹ 50,000 × 12] = ₹ 6,00,000

Gross total income of Mrs. A = Salary received by Mrs.A [₹ 30,000×12] = ₹ 3,60,000

Illustration 3

Mr. B is an employee of Y Ltd. and has substantial interest in the company. His salary is ₹ 20,000 p.m. Mrs. B is also working in Y Ltd. at a salary of ₹ 12,000 p.m. without any qualifications. Mr. B also receives ₹ 30,000 as interest on securities. Mrs. B owns a house

property which she has let out. Rent received from tenants is ₹ 6000 p.m. Compute the gross total income of Mr. B and Mrs. B for the A.Y.2014-15.

Solution

Since Mrs. B is not professionally qualified for the job, the clubbing provisions shall be applicable.

Computation of Gross total income of Mr.B

Particulars	₹
Income from Salary	
Salary received by Mr. B (₹ 20,000 × 12)	2,40,000
Salary received by Mrs. B (₹ 12,000 × 12)	1,44,000
	3,84,000
Income from other sources	
Interest on securities	30,000
	4,14,000

Computation of Gross total income of Mrs. B

Particulars	₹	₹
Income from Salary		Nil
[clubbed in the hands of Mr. B]		
Income from house property		
Gross Annual Value [₹ 6,000 × 12]	72,000	
Less: Municipal taxes paid	-	
Net Annual Value (NAV)	72,000	
Less: Deductions under section 24		
- 30% of NAV i.e., 30% of ₹ 72,000	21,600	
- Interest on loan	-	50,400
Gross total income		50,400

9.5.2 Income arising to the spouse from an asset transferred without adequate consideration [Section 64(1)(iv)]

(i) Where there is a transfer of an asset (other than house property), directly or indirectly, from one spouse to the other, otherwise than for adequate consideration or in connection with an agreement to live apart, any income arising to the transferee from the transferred asset, either directly or indirectly, shall be included in the total income of the transferor.

(ii) In the case of transfer of house property, the provisions are contained in section 27. If an individual transfers a house property to his spouse, without adequate consideration or otherwise than in connection with an agreement to live apart, the transferor shall be deemed to be the owner of the house property and its annual value will be taxed in his hands.

(iii) It may be noted that any income from the accretion of the transferred asset is not to be clubbed with the income of the transferor.

(iv) The income arising on transferred assets alone have to be clubbed. However, income earned by investing such income (arising from transferred asset) cannot be clubbed.

(v) It is also to be noted that natural love and affection do not constitute adequate consideration. Therefore, where an asset is transferred without adequate consideration, the income from such asset will be clubbed in the hands of the transferor.

(vi) Where the assets transferred, directly or indirectly, by an individual to his spouse are invested by the transferee in the business, proportionate income arising from such investment is to be included in the total income of the transferor. If the investment is in the nature of contribution of capital, proportionate interest on capital will be clubbed with the income of the transferor. Such proportion has to be computed by taking into account the value of the aforesaid investment as on the first day of the previous year to the total investment in the business by the transferee as on that day.

9.6 Transfer of assets for the benefit of spouse [Section 64(1)(vii)]

All income arising directly or indirectly to any persons or association of persons, from the assets transferred, directly or indirectly, without adequate consideration is includible in the income of the transferor to the extent such income is used by the transferee for the immediate or deferred benefit of the transferor's spouse.

9.7 Income arising to son's wife from the assets transferred without adequate consideration by the father-in-law or mother-in-law [Section 64(1)(vi)]

(i) Where an asset is transferred, directly or indirectly, by an individual to his or her son's wife without adequate consideration, the income from such asset is to be included in the total income of the transferor.

(ii) For this purpose, where the assets transferred directly or indirectly by an individual to his son's wife are invested by the transferee in the business, proportionate income arising from such investment is to be included in the total income of the transferor. If the investment is in the nature of contribution of capital, the proportionate interest on capital will be clubbed with the income of the transferor. Such proportion has to be computed by taking into account the value of the aforesaid investment as on the first day of the previous year to the total investment in the business by the transferee as on that day.

9.8 Transfer of assets for the benefit of son's wife [Section 64(1)(viii)]

All income arising directly or indirectly, to any person or association of persons from the assets transferred, directly or indirectly, without adequate consideration will be included in the total income of the transferor to the extent such income is used by the transferee for the immediate or deferred benefit of the transferor's son's wife.

9.9 Clubbing of minor's income [Section 64(1A)]

- (i) All income of a minor is to be included in the income of his parent.
- (ii) However, the income derived by the minor from manual work or from any activity involving his skill, talent or specialised knowledge or experience will not be included in the income of his parent.
- (iii) The income of the minor will be included in the income of that parent, whose total income is greater.
- (iv) Once clubbing of minor's income is done with that of one parent, it will continue to be clubbed with that parent only, in subsequent years. The Assessing Officer, may, however, club the minor's income with that of the other parent, if, after giving the other parent an opportunity to be heard, he is satisfied that it is necessary to do so.
- (v) Where the marriage of the parents does not subsist, the income of the minor will be includible in the income of that parent who maintains the minor child in the relevant previous year.
- (vi) Section 10(32) provides that where the income of an individual includes the income of his minor child, the individual shall be entitled to exemption of such income subject to a maximum of ₹ 1,500 per child. This provision is to provide relief to the individuals in whose total income, the income of the minor child is included.
- (vii) However, the income of a minor child from suffering from any disability of the nature specified in section 80U shall not be included in the hands of the parent but shall be assessed in the hands of the child.
- (viii) It may be noted that the clubbing provisions are attracted even in respect of income of minor married daughter.

Illustration 4

Mr. A has three minor children – two twin daughters and one son. Income of the twin daughters is ₹ 2,000 p.a. each and that of the son is ₹ 1,200 p.a. Compute the income, in respect of minor children, to be clubbed in the hands of Mr. A.

Solution

Taxable income, in respect of minor children, in the hands of Mr. A is

Particulars	₹	₹
Twin minor daughters [₹ 2,000 × 2]	₹ 4,000	
Less: Exempt under section 10(32) [₹ 1,500 × 2]	₹ 3,000	₹ 1,000
Minor son	₹ 1,200	
Less: Exempt under section 10(32)	₹ 1,200	Nil
Income to be clubbed in the hands of Mr. A		₹ 1,000

9.10 Cross Transfers

In the case of cross transfers also (e.g., A making gift of ₹ 50,000 to the wife of his brother B for the purchase of a house by her and a simultaneous gift by B to A's minor son of shares in a foreign company worth ₹ 50,000 owned by him), the income from the assets transferred would be assessed in the hands of the deemed transferor if the transfers are so intimately connected as to form part of a single transaction, and each transfer constitutes consideration for the other by being mutual or otherwise. Thus, in the instant case, the transfers have been made by A and B to persons who are not their spouse or minor child so as to circumvent the provisions of this section, showing that such transfers constituted consideration for each other.

The Supreme Court, in case of *CIT v. Keshavji Morarji* [1967] 66 ITR 142, observed that if two transactions are inter-connected and are parts of the same transaction in such a way that it can be said that the circuitous method was adopted as a device to evade tax, the implication of clubbing provisions would be attracted. Accordingly, the income arising to Mrs. B from the house property should be included in the total income of B and the dividend from shares transferred to A's minor son would be taxable in the hands of A. This is because A and B are the indirect transferors to their minor child and spouse, respectively, of income-yielding assets, so as to reduce their burden of taxation.

9.11 Conversion of self-acquired property into the property of a Hindu Undivided Family [Section 64(2)]

Section 64(2) deals with the case of conversion of self-acquired property into property of a Hindu undivided family.

(i) Where an individual, who is a member of the HUF, converts at any time after 31-12-1969, his individual property into property of the HUF of which he is a member or throws such property into the common stock of the family or otherwise transfers such individual property, directly or indirectly, to the family otherwise than for adequate consideration, the income from such property shall continue to be included in the total income of the individual.

(ii) Where the converted property has been partitioned, either by way of total or partial partition, the income derived from such converted property as is received by the spouse on partition will be deemed to arise to the spouse from assets transferred indirectly by the individual to the spouse and consequently, such income shall also be included in the total income of the individual who effected the conversion of such property.

(iii) Where income from the converted property is included in the total income of an individual under section 64(2), it will be excluded from the total income of the family or, as the case may be, of the spouse of the individual.

9.12 Income includes loss

It is significant to note that as per the *Explanation 2* to section 64, 'income' would include 'loss'. Accordingly, where the specified income to be included in the total income of the individual is a loss, such loss will be taken into account while computing the total income of the individual. It is significant to note that this *Explanation* applies to clubbing provisions under both sections 64(1) and 64(2).

9.13 Distinction between section 61 and section 64

It may be noted that the main distinction between the two sections is that section 61 applies only to a revocable transfer made by any person while section 64 applies to revocable as well as irrevocable transfers made only by individuals.

9.14 Liability of person in respect of income included in the income of another person [Section 65]

Sections 61 to 64 provide for clubbing of income of one person in the hands of the other in circumstances specified therein. However, service of notice of demand (in respect of tax on such income) may be made upon the person to whom such asset is transferred (i.e. the transferee). In such a case, the transferee is liable to pay that portion of tax levied on the transferor which is attributable to the income so clubbed.

Aggregation of Income, Set-off and Carry Forward of Losses

10.1 Aggregation of Income

In certain cases, some amounts are deemed as income in the hands of the assessee though they are actually not in the nature of income. These cases are contained in sections 68, 69, 69A, 69B, 69C and 69D. These are discussed in detail in Chapter 1. The Assessing Officer may require the assessee to furnish explanation in such cases. If the assessee does not offer any explanation or the explanation offered by the assessee is not satisfactory, the amounts referred to in these sections would be deemed to be the income of the assessee. Such amounts have to be aggregated with the assessee's income.

10.2 Concept of set-off and carry forward of losses

Specific provisions have been made in the Income-tax Act, 1961 for the set-off and carry forward of losses. In simple words, "Set-off" means adjustment of losses against the profits from another source/head of income in the same assessment year. If losses cannot be set-off in the same year due to inadequacy of eligible profits, then such losses are carried forward to the next assessment year for adjustment against the eligible profits of that year. The maximum period for which different losses can be carried forward for set-off has been provided in the Act.

10.3 Inter source adjustment [Section 70]

(i) Under this section, the losses incurred by the assessee in respect of one source shall be set-off against income from any other source under the same head of income, since the income under each head is to be computed by grouping together the net result of the activities of all the sources covered by that head. In simpler terms, loss from one source of income can be adjusted against income from another source, both the sources being under the same head.

Example 1: Loss from one house property can be set off against the income from another house property.

Example 2: Loss from one business, say textiles, can be set off against income from any other business, say printing, in the same year as both these sources of income fall under one head of income. Therefore, the loss in one business may be set-off against the profits from another business in the same year.

- (ii) Inter-source set-off, however, is not permissible in the following cases -
- (a) Long-term capital loss
 - (1) Where the net result in respect of any short term capital asset is a loss, such loss shall be allowed to be set-off against income, if any, for that assessment year under the head "capital gains" in respect of any other capital asset, and
 - (2) Where the net result in respect of any long-term capital asset is a loss, such loss shall be allowed to be set-off against income, if any, for that assessment year under the head "capital gains" in respect of any other asset not being a short-term capital asset.

Thus, short-term capital loss is allowed to be set off against both short-term capital gain and long-term capital gain. However, long-term capital loss can be set-off only against long-term capital gain and not short-term capital gain.
 - (b) Speculation loss - A loss in speculation business can be set-off only against the profits of any other speculation business and not against any other business or professional income. However, losses from other business can be adjusted against profits from speculation business.
 - (c) Loss from the activity of owning and maintaining race horses - See section 74A(3) in para 13 of this chapter.
- (iii) It must be noted that loss from an exempt source cannot be set-off against profits from a taxable source of income. For example, long-term capital loss on sale of shares sold through a recognized stock exchange cannot be set-off against long-term capital gains on sale of land.

10.4 Inter head adjustment [Section 71]

Loss under one head of income can be adjusted or set off against income under another head. However, the following points should be considered:

- (i) Where the net result of the computation under any head of income (other than 'Capital Gains') is a loss, the assessee can set-off such loss against his income assessable for that assessment year under any other head, including 'Capital Gains'.
- (ii) Where the net result of the computation under the head "Profits and gains of business or profession" is a loss, such loss cannot be set off against income under the head "Salaries".
- (iii) Where the net result of computation under the head 'Capital Gains' is a loss, such capital loss cannot be set-off against income under any other head.
- (iv) Speculation loss and loss from the activity of owning and maintaining race horses cannot be set off against income under any other head.

Illustration 1

Mr. A submits the following particulars pertaining to the A.Y.2014-15:

10.3 Income Tax

Particulars	₹
Income from salary	4,00,000
Loss from self-occupied property	(-)70,000
Business loss	(-)1,00,000
Bank interest (FD) received	80,000

Compute the taxable income of Mr. A for the A.Y.2014-15.

Solution

Computation of taxable income of Mr. A for the A.Y. 2014-15

Particulars	Amount (₹)	Amount (₹)
Income from salary	4,00,000	3,30,000
Income from house property	(-) 70,000	
Business income	(-)1,00,000	-
Income from other sources (interest on fixed deposit with bank)	80,000	
Business loss to be carried forward	(-) 20,000	
Gross total income [See Note below]		3,30,000
Less: Deduction under chapter VIA		Nil
Taxable income		3,30,000

Note: Gross Total Income includes salary income of ₹ 3,30,000 after adjusting house property loss. Business loss of ₹ 1,00,000 is set off against bank interest of ₹ 80,000 and remaining business loss of ₹ 20,000 will be carried forward as it cannot be set off against salary income.

10.5 Set-off and carry forward of loss from house property [Section 71B]

(i) In any assessment year, if there is a loss under the head 'Income from house property', such loss will first be set-off against income from any other head during the same year.

(ii) If such loss cannot be so set-off, wholly or partly, the unabsorbed loss will be carried forward to the following assessment year to be set-off against income under the head 'Income from house property'.

(iii) The loss under this head is allowed to be carried forward upto 8 assessment years immediately succeeding the assessment year in which the loss was first computed.

(iv) For example, loss from one house property can be adjusted against the profits from another house property in the same assessment year. Any loss under the head 'Income from house property' can be set off against any income under any other head in the same assessment year. However, if after such set off, there is still any loss under the head "Income from house property", then the same shall be carried forward to the next year.

(v) It is to be remembered that once a particular loss is carried forward, it can be set off only against the income from the same head in the forthcoming assessment years.

10.6 Carry forward and set-off of business losses [Sections 72 & 80]

Under the Act, the assessee has the right to carry forward the loss in cases where such loss cannot be set-off due to the absence or inadequacy of income under any other head in the same year. The loss so carried forward can be set-off against the profits of subsequent previous years.

Section 72 covers the carry forward and set-off of losses arising from a business or profession.

Conditions

The assessee's right to carry forward business losses under this section is, however, subject to the following conditions:-

- (i) The loss should have been incurred in business, profession or vocation.
- (ii) The loss should not be in the nature of a loss in the business of speculation.
- (iii) The loss may be carried forward and set-off against the income from business or profession though not necessarily against the profits and gains of the same business or profession in which the loss was incurred. However, a loss carried forward cannot, under any circumstances, be set-off against the income from any head other than "Profits and gains of business or profession".
- (iv) The loss can be carried forward and set off only against the profits of the assessee who incurred the loss. That is, only the person who has incurred the loss is entitled to carry forward or set off the same. Consequently, the successor of a business cannot carry forward or set off the losses of his predecessor except in the case of succession by inheritance.
- (v) A business loss can be carried forward for a maximum period of 8 assessment years immediately succeeding the assessment year in which the loss was incurred.
- (vi) As per section 80, the assessee must have filed a return of loss under section 139(3) in order to carry forward and set off a loss. In other words, the non-filing of a return of loss disentitles the assessee from carrying forward the loss sustained by him. Such a return should be filed within the time allowed under section 139(1). However, this condition does not apply to a loss from house property carried forward under section 71B and unabsorbed depreciation carried forward under section 32(2).

Illustration 2

Mr. B, a resident individual, furnishes the following particulars for the P.Y. 2013-14:

Particulars	₹
<i>Income from salary (Net)</i>	45,000
<i>Income from house property</i>	(24,000)
<i>Income from business – non-speculative</i>	(22,000)
<i>Income from speculative business</i>	(4,000)
<i>Short-term capital gains</i>	(25,000)
<i>Long-term capital gains</i>	19,000

What is the total income chargeable to tax for the A.Y. 2014-15?

Solution

The total income chargeable to tax for the A.Y. 2014-15 is calculated as under:

Particulars	Amount (₹)	Amount (₹)
Income from salaries	45,000	21,000
Income from house property	(24,000)	
Profits and gains of business and profession		
Business loss to be carried forward [Note 1]	(22,000)	
Speculative loss to be carried forward [Note 2]	(4,000)	
Capital Gains		
Long term capital gain	19,000	
Short term capital loss	(25,000)	
Short term capital loss to be carried forward [Note 3]	(6,000)	
Taxable income		21,000

Note 1: Business loss cannot be set-off against salary income. Therefore, loss of ₹ 22,000 from the non-speculative business cannot be set off against the income from salaries. Hence, such loss has to be carried forward to the next year for set-off against business profits, if any.

Note 2: Loss of ₹ 4,000 from the speculative business can be set off only against the income from the speculative business. Hence, such loss has to be carried forward.

Note 3: Short term capital loss can be set off against both short term capital gain and long term capital gain. Therefore, short term capital loss of ₹ 25,000 can be set-off against long-term capital gains to the extent of ₹ 19,000. The balance short term capital loss of ₹ 6,000 cannot be set-off against any other income and has to be carried forward to the next year for set-off against capital gains, if any.

10.7 Carry forward and set-off of accumulated business losses and unabsorbed depreciation in certain cases of Amalgamation/ Demerger, etc. [Section 72A]

(i) **Amalgamation** - This section applies where there has been an amalgamation of –

- (1) a company owning an industrial undertaking or a ship or a hotel with another company or an amalgamation of a banking company with a specified bank; or
- (2) public sector companies engaged in the business of operation of aircrafts.

It provides that the accumulated loss and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or depreciation, as the case may be, of the amalgamated company for the previous year in which the amalgamation took place. Other provisions of the Act relating to set off and carry forward shall also apply accordingly.

Conditions for availing benefit under this section

(1) Conditions to be fulfilled by the amalgamating company

- (i) The amalgamating company should have been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for 3 or more years.
- (ii) The amalgamating company has held continuously as on the date of amalgamation, at least 3/4th of the book value of the fixed assets held by it, 2 years prior to the date of amalgamation.

(2) Conditions to be fulfilled by the amalgamated company

- (i) The amalgamated company should hold at least 3/4th in the book value of fixed assets of the amalgamating company acquired as a result of amalgamation for a minimum period of 5 years from the effective date of amalgamation.
- (ii) The amalgamated company continues the business of the amalgamating company for at least 5 years.
- (iii) The amalgamated company must also fulfill such other conditions prescribed under Rule 9C for the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose -
 - (1) The amalgamated company shall achieve the level of production of at least 50% of the installed capacity (capacity as on the date of amalgamation) of the said undertaking before the end of 4 years from the date of amalgamation and continue to maintain the said minimum level of production till the end of 5 years from the date of amalgamation. Central Government has the power to modify this requirement on an application made by the amalgamated company.
 - (2) The amalgamated company shall furnish to the Assessing Officer a certificate in Form No.62 verified by a Chartered Accountant in this regard.

In case the above specified conditions are not fulfilled, that part of carry forward of loss and unabsorbed depreciation remaining to be utilized by the amalgamated company shall lapse and such loss or depreciation as has been set-off shall be treated as the income in the year in which there is a failure to fulfill the conditions.

(ii) **Demerger** - Where there has been a demerger of an undertaking, the accumulated loss and the unabsorbed depreciation directly relatable to the undertaking transferred by the demerged company to the resulting company shall be allowed to be carried forward and set off in the hands of the resulting company.

If the accumulated loss or unabsorbed depreciation is not directly relatable to the undertaking, the same will be apportioned between the demerged company and the resulting company in the same proportion in which the value of the assets have been transferred.

The Central Government is empowered to notify such conditions as it considers necessary to ensure that the demerger or amalgamation is for genuine business purpose.

(iii) **Re-organisation of business [Section 72A(6)]**: In case of re-organisation of business, whereby a firm is succeeded by a company as per the provisions of section 47(xiii), or a sole proprietary concern is succeeded by a company as per the provisions of section 47(xiv), then the accumulated business loss and the unabsorbed depreciation of the firm / proprietary concern, as the case may be, shall be deemed to be the loss or depreciation allowance of the successor company for the previous year in which the business re-organisation took place. Other provisions of the Act relating to set-off and carry forward will apply accordingly.

However, this facility will not be available if it is found that any of the conditions laid down in the corresponding sub-sections (xiii) and (xiv) of section 47 have not been complied with. In such case, the set-off of loss or allowance of depreciation made in any previous year in the hands of the successor company shall be deemed to be the income of the company chargeable to tax in the year in which the conditions have been violated.

(iv) **Conversion of a company into LLP [Section 72A(6A)]**: The successor LLP would be allowed to carry forward and set-off the business loss and unabsorbed depreciation of the predecessor company. However, if the entity fails to fulfill the conditions specified in section 47(xiiib), the benefit of set-off of business loss/unabsorbed depreciation availed by the LLP would be deemed to be the profits and gains of the LLP chargeable to tax in the previous year in which the LLP fails to fulfill any of the conditions.

Meanings of certain terms

“Accumulated loss” means so much of the loss of the predecessor firm or the proprietary concern or the amalgamating company or the demerged company, as the case may be, under the head “Profit and gains of business or profession” (not being a loss sustained in a speculation business) which such predecessor firm or the proprietary concern or amalgamating company or demerged company, would have been entitled to carry forward and set off under the provisions of section 72 if the re-organisation of business or amalgamation or demerger had not taken place.

“Unabsorbed depreciation” means so much of the allowance for depreciation of the predecessor firm or the proprietary concern or the amalgamating company or the demerged company, as the case may be, which remains to be allowed and which would have been allowed to the predecessor firm or the proprietary concern or amalgamating company or demerged company, as the case may be, under the provisions of this Act, if the re-organisation of business or amalgamation or demerger had not taken place.

“Industrial undertaking” means any undertaking which is engaged in -

- (i) the manufacture or processing of goods;
- (ii) the manufacture of computer software;
- (iii) the business of generation or distribution of electricity or any other form of power;

- (iv) providing telecommunication services, whether basic or cellular, including radio paging, domestic satellite service, network of trunking, broad band network and internet services.
- (v) mining;
- (vi) the construction of ships, aircraft or rail systems.

“Specified bank” means the State Bank of India (SBI) constituted under the SBI Act, 1955 or a subsidiary bank as defined in the SBI (Subsidiary Banks) Act, 1959 or a corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980.

10.8 Set-off of losses of a banking company against the profit of a banking institution under a scheme of amalgamation [Section 72AA]

- (i) This section provides for carry forward and set off of accumulated loss and unabsorbed depreciation allowance of a banking company against the profits of a banking institution under a scheme of amalgamation sanctioned by the Central Government.
- (ii) Where a banking company has been amalgamated with a banking institution under a scheme sanctioned and brought into force by the Central Government under section 45(7) of the Banking Regulation Act, 1949, the accumulated loss and unabsorbed depreciation of the amalgamating banking company shall be deemed to be the loss or the allowance for depreciation of the banking institution for the previous year in which the scheme of amalgamation is brought into force, and all the provisions contained in the Income-tax Act, 1961, relating to set off and carry forward of loss and unabsorbed depreciation shall apply accordingly.
- (iii) The *Explanation* to this section defines the expressions “accumulated loss”, “banking company”, “banking institution” and “unabsorbed depreciation” as follows –
 - (a) “accumulated loss” means so much of the loss of the amalgamating banking company under the head “Profits and gains of business or profession” (not being a loss sustained in a speculation business) which such amalgamating banking company, would have been entitled to carry forward and set-off under the provisions of section 72 if the amalgamation had not taken place;
 - (b) “banking company” shall have the same meaning assigned to it in clause (c) of section 5 of the Banking Regulation Act, 1949;
 - (c) “banking institution” shall have the same meaning assigned to it in sub-section (15) of section 45 of the Banking Regulation Act, 1949;
 - (d) “unabsorbed depreciation” means so much of the allowance for depreciation of the amalgamating banking company which remains to be allowed and which would have been allowed to such banking company if the amalgamation had not taken place.

10.9 Provisions relating to carry forward and set off of accumulated loss and unabsorbed depreciation in business reorganisation of co-operative banks [Section 72AB]

- (i) Under this section, in a case where the amalgamation has taken place during the previous year, set-off of accumulated loss and the unabsorbed depreciation of the predecessor co-operative bank will be allowed in the hands of the successor co-operative bank as if the amalgamation had not taken place. All the other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation would apply accordingly.
- (ii) The benefit of carry-forward and set-off of accumulated losses under this section would be allowed only on fulfillment of the following conditions -
 - (a) **Conditions to be fulfilled by the predecessor co-operative bank**
 - (1) It should have been engaged in the business of banking for three or more years; and
 - (2) It has held at least three-fourths of the book value of fixed assets as on the date of the business reorganisation, continuously for two years prior to the date of business reorganisation;
 - (b) **Conditions to be fulfilled by the successor co-operative bank**
 - (1) It should hold at least three-fourths of the book value of fixed assets of the predecessor co-operative bank acquired through business reorganisation, continuously for a minimum period of five years immediately succeeding the date of business reorganisation;
 - (2) It continues the business of the predecessor co-operative bank for a minimum period of five years from the date of business reorganisation; and
 - (3) It fulfils such other conditions as may be prescribed to ensure the revival of the business of the predecessor co-operative bank or to ensure that the business reorganisation is for genuine business purpose.
- (iii) The amount of set-off of the accumulated loss and unabsorbed depreciation allowable to the resulting co-operative bank has to be calculated in the following manner -
 - (1) In a case where the whole of the amount of such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting co-operative bank - the entire accumulated loss or unabsorbed depreciation of the demerged co-operative bank is allowed to be set-off.
 - (2) In a case where the accumulated loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting co-operative bank - the amount which bears the same proportion to the accumulated loss or unabsorbed depreciation of the demerged co-operative bank as the assets of the undertaking

transferred to the resulting co-operative bank bears to the assets of the demerged co-operative bank.

For example, if A Co.op Bank is the demerged co-operative bank and B Co. op Bank is the resulting co-operative bank, the amount of set-off of the accumulated loss and unabsorbed depreciation allowable to B Co-op. bank would be –

$$\text{Unabsorbed business loss/depreciation of A Co - Op bank} \times \frac{\text{Assets of the undertaking transferred to B Co - op bank}}{\text{Assets of A Co - op bank}}$$

- (iv) The Central Government may specify other conditions by notification in the Official Gazette as it considers necessary, to ensure that the business reorganisation is for genuine business purposes.
- (v) The period commencing from the beginning of the previous year and ending on the date immediately preceding the date of business reorganisation, and the period commencing from the date of such business reorganisation and ending with the previous year shall be deemed to be two different previous years for the purposes of set off and carry forward of loss and allowance for depreciation.

For example, if the date on which business re-organisation took place is 1.11.2013, then the period between 1.4.2013 and 31.10.2013 and the period between 1.11.2013 and 31.3.2014 would be deemed to be two different previous years for the purposes of set-off and carry forward of unabsorbed business losses and depreciation.

- (vi) In a case where the conditions specified in (ii) above or notified under (iv) above are not complied with, the set-off of accumulated loss or unabsorbed depreciation allowed in any previous year to the successor co-operative bank shall be deemed to be the income of the successor co-operative bank chargeable to tax for the year in which the conditions are not complied with.
- (vii) Accumulated loss means so much of loss of the amalgamating co-operative bank or the demerged co-operative bank, as the case may be, under the head "Profits and gains of business or profession" (not being a loss sustained in a speculation business) which such amalgamating co-operative bank or the demerged co-operative bank, would have been entitled to carry forward and set-off under the provisions of section 72 as if the business reorganisation had not taken place.
- (viii) Unabsorbed depreciation means so much of the allowance for depreciation of the amalgamating co-operative bank or the demerged co-operative bank, as the case may be, which remains to be allowed and which would have been allowed to such bank as if the business reorganisation had not taken place.

10.10 Losses in Speculation Business [Section 73]

(i) The meaning of the expression 'speculative transaction' as defined in section 43(5) and the treatment of income from speculation business has already been discussed under the head "Profits and gains of business or profession".

(ii) Since speculation is deemed to be a business distinct and separate from any other business carried on by the assessee, the losses incurred in speculation can be neither set off in the same year against any other non-speculation income nor be carried forward and set off against other income in the subsequent years.

(iii) Therefore, if the losses sustained by an assessee in a speculation business cannot be set-off in the same year against any other speculation profit, they can be carried forward to subsequent years and set-off only against income from any speculation business carried on by the assessee.

(iv) The loss in speculation business can be carried forward only for a maximum period of 4 years from the end of the relevant assessment year in respect of which the loss was computed. Loss from the activity of trading in derivatives, however, is not to be treated as speculative loss.

(v) The *Explanation* to this section discourages companies (other than banking and investment companies) from indulging in speculation business or dealing in shares otherwise than in the ordinary course of their business. It provides that where any part of the business of a company (other than investment company / banking / financing company) consists of the purchase and sale of the shares of other companies, such a company shall be deemed to be carrying on speculation business to the extent to which the business consists of the purchase and sale of such shares. Thus, companies engaged in the business of banking or the granting of loans and advances as their principal business would be exempted from the operation of this Explanation. Accordingly, both investment companies and banking companies would not be treated as carrying on speculation business in cases where they purchase and sell shares of other companies.

(vi) For this purpose, an investment company means a company whose Gross Total Income consists mainly of income which is chargeable under the heads "Income from house property", "Capital gains" and "Income from the other sources".

10.11 Carry forward & set off of losses by specified businesses [Section 73A]

(i) Any loss computed in respect of the specified business referred to in section 35AD shall be set off only against profits and gains, if any, of any other specified business.

(ii) 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.

(iii) 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.

Note - 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. An 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.

10.12 Losses under the head 'Capital Gains' [Section 74]

Section 74 provides that where for any assessment year, the net result under the head 'Capital gains' is short term capital loss or long term capital loss, the loss shall be carried forward to the following assessment year to be set off in the following manner:

- (i) Where the loss so carried forward is a short term capital loss, it shall be set off against any capital gains, short term or long term, arising in that year.
- (ii) Where the loss so carried forward is a long term capital loss, it shall be set off only against long term capital gain arising in that year.
- (iii) Net loss under the head capital gains cannot be set off against income under any other head.
- (iv) Any unabsorbed loss shall be carried forward to the following assessment year up to a maximum of 8 assessment years immediately succeeding the assessment year for which the loss was first computed.

Illustration 3

During the P.Y. 2013-14, Mr. C has the following income and the brought forward losses:

Particulars	₹
Short term capital gains on sale of shares	1,50,000
Long term capital loss of A.Y. 2012-13	(96,000)
Short term capital loss of A.Y.2013-14	(37,000)
Long term capital gain	75,000

What is the capital gain taxable in the hands of Mr. C for the A.Y.2014-15?

Solution

The capital gains taxable are as under:

Particulars	₹	₹
Short term capital gains on sale of shares	1,50,000	
Less: Brought forward short term capital loss of the A.Y.2013-14	(37,000)	1,13,000

10.13 Income Tax

Long term capital gain	75,000	
Less: Brought forward long term capital loss of A.Y.2012-13 [See Note below]	(75,000)	Nil
Taxable short-term capital gains		1,13,000

Note: Long-term capital loss cannot be set off against short-term capital gain. Hence, the unadjusted long term capital loss of A.Y. 2012-13 of ₹ 21,000 (i.e. ₹ 96,000 – ₹ 75,000) has to be carried forward to the next year to be set-off against long-term capital gains of that year.

10.13 Losses from the activity of owning and maintaining race horses [Section 74A(3)]

(i) According to provisions of section 74A(3), the losses incurred by an assessee from the activity of owning and maintaining race horses cannot be set-off against the income from any other source other than the activity of owning and maintaining race horses.

(ii) Such loss can be carried forward for a maximum period of 4 assessment years for being set-off against the income from the activity of owning and maintaining race horses in the subsequent years.

(iii) For this purpose, the “amount of loss incurred by the assessee in the activity of owning and maintaining race horses” means the amount by which such income by way of stake money falls short of the amount of revenue expenditure incurred by the assessee for the purpose of maintaining race horses. i.e. Loss = Stake money – revenue expenditure for the purpose of maintaining race horses.

(iv) Further, the expression ‘horse race’ means a horse race upon which wagering or betting may be lawfully made.

(v) “Income by way of stake money” means the gross amount of prize money received on a race horse or race horses by the owner thereof on account of the horse or horses or any one or more of the horses winning or being placed second or in any lower position in horse races.

Illustration 4

Mr. D has the following income for the P.Y. 2013-14 -

Particulars	₹
Income from the activity of owning and maintaining the race horses	75,000
Income from textile business	85,000
Brought forward textile business loss	50,000
Brought forward loss from the activity of owning and maintaining the race horses (relating to A.Y.2011-12)	96,000

What is the taxable income in the hands of Mr. D for the A.Y. 2014-15?

Solution

The taxable income is calculated as under:

Particulars	₹	₹
Income from the activity of owning and maintaining race horses	75,000	
Less: Brought forward loss from the activity of owning and maintaining race horses	<u>96,000</u>	
Loss from the activity of owning and maintaining race horses to be carried forward to A.Y.2015-16	<u>(21,000)</u>	
Income from textile business	85,000	
Less: Brought forward business loss from textile business.	50,000	35,000
Taxable business income		35,000

Note: Loss from the activity of owning and maintaining race horses cannot be set-off against any other source/head of income.

10.14 Carry forward and set-off of losses in case of change in constitution of firm or succession [Section 78]

- (i) Where there is a change in the constitution of a firm, so much of the loss proportionate to the share of a retired or deceased partner remaining unabsorbed, shall not be allowed to be carried forward by the firm. However, unabsorbed depreciation can be carried forward.
- (ii) Where any person carrying on any business or profession has been succeeded in such capacity by another person otherwise than by inheritance, such other person shall not be allowed to carry forward and set off against his income, any loss incurred by the predecessor.
- (iii) Where there is a succession by inheritance, the legal heirs (assessable as BOI) are entitled to set-off the business loss of the predecessor. Such carry forward and set-off is possible even if the legal heirs constitute themselves as a partnership firm. In such a case, the firm can carry forward and set-off the business loss of the predecessor.

10.15 Carry forward and set-off of losses in case of closely held companies [Section 79]

- (i) Where in any previous year, there has been a change in the shareholding of a company in which the public are not substantially interested, any unabsorbed loss of the company shall be allowed to be carried forward and set off against the income of the previous year only if the beneficial shareholders of at least 51% of the voting power on the last day of the previous year remained the same as on the last day of the year or years in which the loss was incurred.
- (ii) However, this restriction shall not apply in the following two cases:
 - (1) where a change in the voting power is consequent upon the death of a shareholder or on account of transfer of shares by way of gift by a shareholder to his relative; and

- (2) where the change in shareholding takes place in an Indian company, being a subsidiary of a foreign company, as a result of amalgamation or demerger of the foreign company. However, this is subject to the condition that 51% of the shareholders of the amalgamating/demerged company continue to be shareholders of the amalgamated/resulting company.
- (iii) The provisions of this section are applicable only in respect of carry forward of losses and not in respect of carry forward of unabsorbed depreciation, which is covered by section 32(2).

10.16 Order of set-off of losses

As per the provisions of section 72(2), brought forward business loss is to be set-off before setting off unabsorbed depreciation. Therefore, the order in which set-off will be effected is as follows -

- Current year depreciation / Current year capital expenditure on scientific research and current year expenditure on family planning, to the extent allowed.
- Brought forward loss from business/profession [Section 72(1)]
- Unabsorbed depreciation [Section 32(2)]
- Unabsorbed capital expenditure on scientific research [Section 35(4)].
- Unabsorbed expenditure on family planning [Section 36(1)(ix)]

Illustration 5

Mr. E has furnished his details for the A.Y.2014-15 as under:

Particulars	₹
Income from salaries	1,50,000
Income from speculation business	60,000
Loss from non-speculation business	(40,000)
Short term capital gain	80,000
Long term capital loss of A.Y.2012-13	(30,000)
Winning from lotteries	20,000

What is the taxable income of Mr. E for the A.Y. 2014-15?

Solution

Computation of taxable income of Mr. E for the A.Y.2014-15

Particulars	₹	₹
Income from salaries		1,50,000
Income from speculation business	60,000	
Less : Loss from non-speculation business	(40,000)	20,000
Short-term capital gain		80,000

Winnings from lotteries	20,000
Taxable income	2,70,000

Note: Long term capital loss can be set off only against long term capital gain. Therefore, long term capital loss of ₹ 30,000 has to be carried forward to the next assessment year.

Illustration 6

Compute the gross total income of Mr. F for the A.Y.2014-15 from the information given below –

Particulars	₹
Net income from house property	1,25,000
Income from business (before providing for depreciation)	1,35,000
Short term capital gains on sale of shares	56,000
Long term capital loss from sale of property (brought forward from A.Y.2013-14)	(90,000)
Income from tea business	1,20,000
Dividends from Indian companies carrying on agricultural operations	80,000
Current year depreciation	26,000
Brought forward business loss (loss incurred six years ago)	(45,000)

Solution

The gross total income of Mr. F for the A.Y. 2014-15 is calculated as under:

Particulars	₹	₹
Income from house property		1,25,000
Income from business		
Profits before depreciation	1,35,000	
Less: Current year depreciation	26,000	
Less: Brought forward business loss	45,000	
	64,000	
Income from tea business (40% is business income)	48,000	1,12,000
Income from the capital gains		
Short term capital gains	56,000	
Long term capital loss from property (cannot be set off)	Nil	56,000
Gross Total Income		2,93,000

Note: Dividend from Indian companies is exempt from tax. 60% of the income from tea business is treated as agricultural income and therefore, exempt from tax.

Deductions From Gross Total Income

11.1 General Provisions

As we have seen earlier, section 10 exempts certain incomes. Such income are excluded from total income and do not enter into the computation process at all. On the other hand, Chapter VI-A contains deductions from gross total income. The important point to be noted here is that if there is no gross total income, then no deductions will be permissible. This Chapter contains deductions in respect of certain payments, deductions in respect of certain incomes and other deductions.

Section 80A: (i) Section 80A(1) provides that in computing the total income of an assessee, there shall be allowed from his gross total income, the deductions specified in sections 80C to 80U.

(ii) According to section 80A(2), the aggregate amount of the deductions under this chapter shall not, in any case, exceed the gross total income of the assessee. Thus, an assessee cannot have a loss as a result of the deduction under Chapter VI-A and claim to carry forward the same for the purpose of set-off against his income in the subsequent year.

(iii) Section 80A(3) provides that in the case of AOP/BOI, if any deduction is admissible under section 80G/80GGA/80GGC/80-IA/80-IB/80-IC/80-ID/80-IE, no deduction under the same section shall be made in computing the total income of a member of the AOP or BOI in relation to the share of such member in the income of the AOP or BOI.

(iv) The profits and gains allowed as deduction under section 10AA or under any provision of Chapter VIA under the heading "C.-Deductions in respect of certain incomes" in any assessment year, shall not be allowed as deduction under any other provision of the Act for such assessment year [Sub-section (4)];

(v) The deduction, referred to in (iv) above, shall not exceed the profits and gains of the undertaking or unit or enterprise or eligible business, as the case may be [Sub-section (4)];

(vi) No deduction under any of the provisions referred to in (iv) above, shall be allowed if the deduction has not been claimed in the return of income [Sub-section (5)];

(vii) The transfer price of goods and services between such undertaking or unit or enterprise or eligible business and any other business of the assessee shall be determined at the market value of such goods or services as on the date of transfer [Sub-section (6)].

(viii) For this purpose, the expression "market value" has been defined to mean,-

(a) in relation to any goods or services sold or supplied, the price that such goods or services would fetch if these were sold by the undertaking or unit or enterprise or eligible business in the open market, subject to statutory or regulatory restrictions, if any;

(b) in relation to any goods or services acquired, the price that such goods or services would cost if these were acquired by the undertaking or unit or enterprise or eligible business from the open market, subject to statutory or regulatory restrictions, if any;

(ix) Where a deduction under any provision of this Chapter under the heading “C – Deductions in respect of certain incomes” is claimed and allowed in respect of the profits of such specified business for any assessment year, no deduction under section 35AD is permissible in relation to such specified business for the same or any other assessment year.

In short, once the assessee has claimed the benefit of deduction under section 35AD for a particular year in respect of a specified business, he cannot claim benefit under Chapter VI-A under the heading “C.-Deductions in respect of certain incomes” for the same or any other year and *vice versa*.

Section 80AB: This section provides that for the purpose of calculation of deductions specified in Chapter VI-A under the heading “C - Deductions in respect of certain incomes”, the net income computed in accordance with the provisions of the Act (before making any deduction under Chapter VI-A) shall alone be regarded as income received by the assessee and which is included in his gross total income. Accordingly, the deductions specified in the aforesaid sections will be calculated with reference to the net income as computed in accordance with the provisions of the Act (before making deduction under Chapter VI-A) and not with reference to the gross amount of such income. This is notwithstanding anything contained in the respective sections of Chapter VI-A.

Section 80AC: Furnishing return of income on or before due date mandatory for claiming exemption under sections 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID and 80-IE

(i) Section 80AC stipulates compulsory filing of return of income on or before the due date specified under section 139(1), as a pre-condition for availing benefit under the following sections –

- (1) Section 80-IA applicable to undertakings or enterprises engaged in infrastructure development, etc.
- (2) Section 80-IAB applicable to undertakings or enterprises engaged in any business of developing a special economic zone.
- (3) Section 80-IB applicable to certain industrial undertakings other than infrastructure development undertakings.
- (4) Section 80-IC applicable to certain undertakings or enterprises in certain special category States.
- (5) Section 80-ID applicable to undertakings engaged in the business of hotels and convention centres in specified area.
- (6) Section 80-IE applicable to certain undertakings in North-Eastern States.

(ii) The effect of this provision is that in case of failure to file return of income on or before the stipulated due date, the undertakings would lose the benefit of deduction under these sections.

Section 80B(5): "Gross total income" means the total income computed in accordance with the provisions of the Act without making any deduction under Chapter VI-A. "Computed in accordance with the provisions of the Act" implies—

- (i) that deductions under appropriate computation section have already been given effect to;
- (ii) that income of other persons, if includible under sections 60 to 64, has been included;
- (iii) the intra head and/or inter head losses have been adjusted; and
- (iv) that unabsorbed business losses, unabsorbed depreciation etc., have been set-off.

Let us first consider the deductions allowable in respect of certain payments.

11.2 Deduction in respect of payments

11.2.1 Deduction in respect of investment in specified assets [Section 80C]

- (i) Section 80C provides for a deduction from the Gross Total Income, of savings in specified modes of investments.
- (ii) Deduction under section 80C is available only to an individual or HUF.
- (iii) The maximum qualifying amount is ₹ 1 lakh in respect of deductions under section 80C along with sections 80CCC (in respect of contribution to approved pension fund) and 80CCD(1) (Contribution of employee-assessee to pension scheme of Central Government).
- (iv) The following are the investments/contributions eligible for deduction –
 - (1) Premium paid on insurance on the life of the individual, spouse or child (minor or major) and in the case of HUF, any member thereof. This will include a life policy and an endowment policy.

In respect of policies issued before 1.4.2012

However, where the annual premium on insurance policies, other than a contract for deferred annuity, issued on or before 31.3.2012, exceeds 20% of the actual capital sum assured, only the amount of premium as does not exceed 20% will qualify for rebate.

For the purpose of calculating the actual capital sum assured under this clause,

- (a) the value of any premiums agreed to be returned or
- (b) the value of any benefit by way of bonus or otherwise, over and above the sum actually assured,

shall not be taken into account.

In respect of policies issued on or after 1.4.2012

However, the deduction under section 80C for premium or other payment made on insurance policy, other than a contract for a deferred annuity, shall be restricted to the 10% of the actual sum assured, in case the insurance policy is issued on or after 1st April, 2012.

Also, *Explanation* to section 80C(3A) has been introduced to provide that, in respect of the life insurance policies to be issued on or after 1st April, 2012, the actual capital sum assured shall mean the minimum amount assured under the policy on happening of the

insured event at any time during the term of the policy, not taking into account -

- (1) the value of any premium agreed to be returned; or
- (2) any benefit by way of bonus or otherwise over and above the sum actually assured which is to be or may be received under the policy by any person.

In effect, in case the insurance policy has varied sum assured during the term of policy then the minimum of the sum assured during the life time of the policy shall be taken into consideration for calculation of the "actual capital sum assured" for the purpose of section 80C, in respect of life insurance policies to be issued on or after 1st April, 2012.

In respect of policies issued on or after 1.4.2013

Premium paid in respect of a life insurance policy issued on or after 1st April, 2013, where the insurance is on the life of any person, who is –

- (1) *a person with disability or person with severe disability as referred to in section 80U; or*
- (2) *suffering from disease or ailment as specified in the rules made under section 80DDB,*

would qualify for deduction to the extent of 15% of minimum capital sum assured. In respect of other policies, the deduction of premium paid would continue to be restricted to 10% of minimum capital sum assured.

The following is a tabular summary of the exemption available under section 10(10D) and deduction allowable under section 80C vis-à-vis the date of issue of such policies -

	<i>Exemption u/s 10(10D)</i>	<i>Deduction u/s 80C</i>
<i>In respect of policies issued between 1.4.2003 and 31.3.2012</i>	<i>Any sum received under a LIP including the sum allocated by way of bonus is exempt. However, exemption would not be available if the premium payable for any of the years during the term of the policy exceeds 20% of "actual capital sum assured".</i>	<i>Premium paid to the extent of 20% of "actual capital sum assured".</i>
<i>In respect of policies issued on or after 1.4.2012 but before 1.4.2013</i>	<i>Any sum received under a LIP including the sum allocated by way of bonus is exempt. However, exemption would not be available if the premium payable for any of the years during the term of the policy exceeds 10% of "minimum capital sum assured" under the policy on the happening of the insured event at any time during the term of the policy.</i>	<i>Premium paid to the extent of 10% of "minimum capital sum assured"</i>

<i>In respect of policies issued on or after 1.4.2013</i>	(a) <i>Where the insurance is on the life of a person with disability or severe disability as referred to in section 80U or a person suffering from disease or ailment as specified under section 80DDB.</i>	
	<i>Any sum received under a LIP including the sum allocated by way of bonus is exempt. However, exemption would not be available if the premium payable for any of the years during the term of the policy exceeds 15% of "minimum capital sum assured" under the policy on the happening of the insured event at any time during the term of the policy.</i>	<i>Premium paid to the extent of 15% of "minimum capital sum assured"</i>
	(b) <i>Where the insurance is on the life of any person, other than mentioned in (a) above</i>	
	<i>Any sum received under a LIP including the sum allocated by way of bonus is exempt. However, exemption would not be available if the premium payable for any of the years during the term of the policy exceeds 10% of "minimum capital sum assured" under the policy on the happening of the insured event at any time during the term of the policy.</i>	<i>Premium paid to the extent of 10% of "minimum capital sum assured".</i>

Illustration 1

Compute the eligible deduction under section 80C for A.Y.2014-15 in respect of life insurance premium paid by Mr. Ganesh during the P.Y.2013-14, the details of which are given hereunder -

	<i>Date of issue of policy</i>	<i>Person insured</i>	<i>Actual capital sum assured (₹)</i>	<i>Insurance premium paid during 2013-14 (₹)</i>
(i)	1/4/2011	Self	2,00,000	50,000
(ii)	1/5/2012	Spouse	1,50,000	20,000
(iii)	1/6/2013	Handicapped Son (section 80U disability)	3,00,000	60,000

Solution

	Date of issue of policy	Person insured	Actual capital sum assured	Insurance premium paid during 2013-14	Deduction u/s 80C for A.Y.2014-15	Remark (restricted to % of sum assured)
(i)	1/4/2011	Self	2,00,000	50,000	40,000	20%
(ii)	1/5/2012	Spouse	1,50,000	20,000	15,000	10%
(iii)	1/6/2013	Handicapped Son (section 80U disability)	3,00,000	60,000	45,000	15%
				Total	1,00,000	

- (2) Premium paid to effect and keep in force a contract for a deferred annuity on the life of the assessee and/or his or her spouse or child, provided such contract does not contain any provision for the exercise by the insured of an option to receive cash payments in lieu of the payment of the annuity.

It is pertinent to note here that a contract for a deferred annuity need not necessarily be with an insurance company. It follows therefore that such a contract can be entered into with any person.

- (3) Amount deducted by or on behalf of the Government from the salary of a Government employee for securing a deferred annuity or making provisions for his spouse or children. The excess, if any, over one-fifth of the salary is to be ignored.
- (4) Contributions to any provident fund to which the Provident Funds Act, 1925 applies.
- (5) Contributions made to any Provident Fund set up by the Central Government and notified in his behalf (i.e., the Public Provident Fund established under the Public Provident Fund Scheme, 1968). Such contribution can be made in the name of any persons mentioned in (1) above. The maximum limit of investment is ₹ 1,00,000 in a year.
- (6) Contribution by an employee to a recognised provident fund.
- (7) Contribution by an employee to an approved superannuation fund
- (8) Subscription to any such security of the Central Government or any such deposit scheme as the Central Government as may notify in the Official Gazette.
- (9) Subscription to any Savings Certificates under the Government Savings Certificates Act, 1959 notified by the Central Government in the Official Gazette (i.e. National Savings Certificate (VIII Issue) issued under the Government Savings Certificates Act, 1959).
- (10) Contributions in the name of any person specified in (1) above for participation in the Unit-linked Insurance Plan 1971.
- (11) Contributions in the name of any person mentioned in (1) above for participation in any Unit linked Insurance Plan of the LIC Mutual Fund, referred to in section 10(23D) in this behalf.

- (12) Contributions to approved annuity plans of LIC (New Jeevan Dhara and New Jeevan Akshay, New Jeevan Dhara I and New Jeevan Akshay I, II and III) or any other insurer (Tata AIG Easy Retire Annuity Plan of Tata AIG Life Insurance Company Ltd.) as the Central Government may, by notification in the Official Gazette, specify in this behalf.
- (13) Subscription to any units of any mutual fund referred to in section 10(23D) or from the Administrator or the specified company under any plan formulated in accordance with such scheme notified by the Central Government;
- (14) Contribution by an individual to a pension fund set up by any Mutual Fund referred to in section 10(23D) or by the Administrator or the specified company as the Central Government may specify (i.e. UTI-Retirement Benefit Pension Fund set up by the specified company referred to in section 2(h) of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 as a pension fund).

For the purposes of (13) and (14) above –

- (i) “Administrator” means the Administrator as referred to in clause (a) of section 2 of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002.
 - (ii) “specified company” means a company as referred to in clause (h) of section 2 of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002.
- (15) Subscription to any deposit scheme or contribution to any pension fund set up by the National Housing Bank i.e., National Housing Bank (Tax Saving) Term Deposit Scheme, 2008.
 - (16) Subscription to any such deposit scheme of a public sector company which is engaged in providing long-term finance for construction, or purchase of houses in India for residential purposes or any such deposit scheme of any authority constituted in India by or under any law enacted either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages or for both. The deposit scheme should be notified by the Central Government. The Central Government has, vide *Notification No.2/2007 dated 11.1.2007*, specified the public deposit scheme of HUDCO, subscription to which would qualify for deduction under section 80C.
 - (17) Payment of tuition fees by an individual assessee at the time of admission or thereafter to any university, college, school or other educational institutions within India for the purpose of full-time education of any two children of the individual. This benefit is only for the amount of tuition fees for full-time education and shall not include any payment towards development fees or donation or payment of similar nature and payment made for education to any institution situated outside India.
 - (18) Any payment made towards the cost of purchase or construction of a new residential house property. The income from such property –
 - (i) should be chargeable to tax under the head “Income from house property”;
 - (ii) would have been chargeable to tax under the head “Income from house property” had it not been used for the assessee's own residence.

The approved types of payments are as follows:

- (i) Any installment or part payment of the amount due under any self-financing or other schemes of any development authority, Housing Board or other authority engaged in the construction and sale of house property on ownership basis; or
- (ii) Any installment or part payment of the amount due to any company or a cooperative society of which the assessee is a shareholder or member towards the cost of house allotted to him; or
- (iii) Repayment of amount borrowed by the assessee from:
 - (a) The Central Government or any State Government;
 - (b) Any bank including a co-operative bank;
 - (c) The Life Insurance Corporation;
 - (d) The National Housing Bank;
 - (e) Any public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes which is eligible for deduction under section 36(1)(viii);
 - (f) Any company in which the public are substantially interested or any cooperative society engaged in the business of financing the construction of houses;
 - (g) The assessee's employer, where such employer is an authority or a board or a corporation or any other body established or constituted under a Central or State Act;
 - (h) the assessee's employer where such employer is a public company or public sector company or a university established by law or a college affiliated to such university or a local authority or a co-operative society.
- (iv) Stamp duty, registration fee and other expenses for the purposes of transfer of such house property to the assessee.

Inadmissible payments: However, the following amounts do not qualify for rebate:

- (i) admission fee, cost of share and initial deposit which a shareholder of a company or a member of a co-operative society has to pay for becoming a shareholder or member; or
 - (ii) the cost of any addition or alteration or renovation or repair of the house property after the completion of the house or after the house has been occupied by the assessee or any person on his behalf or after it has been let out; or
 - (iii) any expenditure in respect of which deduction is allowable under section 24.
- (19) Subscription to equity shares or debentures forming part of any eligible issue of capital approved by the Board on an application made by a public company or as subscription to any eligible issue of capital by any public financial institution in the prescribed form.
- Eligible issue of capital means an issue made by a public company formed and registered in

India or a public financial institution and the entire proceeds of the issue are utilised wholly and exclusively for the purposes of any business referred to in section 80-IA(4).

A lock-in period of three years is provided in respect of such equity shares or debentures. In case of any sale or transfer of shares or debentures within three years of the date of acquisition, the aggregate amount of deductions allowed in respect of such equity shares or debentures in the previous year or years preceding the previous year in which such sale or transfer has taken place shall be deemed to be the income of the assessee of such previous year and shall be liable to tax in the assessment year relevant to such previous year.

A person shall be treated as having acquired any shares or debentures on the date on which his name is entered in relation to those shares or debentures in the register of members or of debenture-holders, as the case may be, of the public company.

- (20) Subscription to any units of any mutual fund referred to in section 10(23D)] and approved by the Board on an application made by such mutual fund in the prescribed form.

It is necessary that such units should be subscribed only in the eligible issue of capital of any company.

- (21) Investment in term deposit.

- (1) for a period of not less than five years with a scheduled bank; and
- (2) which is in accordance with a scheme framed and notified by the Central Government in the Official Gazette

now qualifies as an eligible investment for availing deduction under section 80C.

Scheduled bank means -

- (1) the State Bank of India constituted under the State Bank of India Act, 1955, or
- (2) a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959, or
- (3) a corresponding new bank constituted under section 3 of the -
 - (a) Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, or
 - (b) Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980, or
- (4) any other bank, being a bank included in the Second Schedule to the Reserve Bank of India Act, 1934.

- (22) Subscription to such bonds issued by NABARD (as the Central Government may notify in the Official Gazette).

- (23) five year time deposit in an account under Post Office Time Deposit Rules, 1981; and

- (24) deposit in an account under the Senior Citizens Savings Scheme Rules, 2004.

Termination of Insurance Policy or Unit Linked Insurance Plan or transfer of House Property or withdrawal of deposit:

Where, in any previous year, an assessee:

- (i) terminates his contract of insurance referred to in (1) above, by notice to that effect or

where where the contract ceases to be in force by reason of not paying the premium, by not reviving the contract of insurance, -

- (a) in case of any single premium policy, within two years after the date of commencement of insurance; or
- (b) in any other case, before premiums have been paid for two years; or
- (ii) terminates his participation in any Unit Linked Insurance Plan referred to in (10) or (11) above, by notice to that effect or where he ceases to participate by reason of failure to pay any contribution, by not reviving his participation, before contributions in respect of such participation have been paid for five years, or
- (iii) transfers the house property referred to in (18) above, before the expiry of five years from the end of the financial year in which possession of such property is obtained by him, or receives back, whether by way of refund or otherwise, any sum specified in (18) above,

then, no deduction will be allowed to the assessee in respect of sums paid during such previous year and the total amount of deductions of income allowed in respect of the previous year or years preceding such previous year, shall be deemed to be income of the assessee of such previous year and shall be liable to tax in the assessment year relevant to such previous year.

Further, where any amount is withdrawn by the assessee from his account under the Senior Citizens Savings Scheme or under the Post Office Time Deposit Rules before the expiry of a period of 5 years from the date of its deposit, the amount so withdrawn shall be deemed to be the income of the assessee of the previous year in which the amount is withdrawn. Accordingly, the amount so withdrawn would be chargeable to tax in the assessment year relevant to such previous year. The amount chargeable to tax shall also include that part of the amount withdrawn which represents interest accrued on the deposit. However, if any part of the amount so received or withdrawn (including the amount relating to interest) has been subject to tax in any of the earlier years, such amount shall not be taxed again.

Illustration 2

Mr. A, aged about 61 years, has earned a lottery income of ₹ 1,20,000 (gross) during the P.Y. 2013-14. He also has a business income of ₹ 30,000. He invested an amount of ₹ 10,000 in Public Provident Fund account and ₹ 24,000 in National Saving Certificates. What is the total income of Mr. A for the A.Y.2014-15?

Solution

Computation of total income of Mr. A for A.Y.2014-15

Particulars	₹	₹
Profits and gains from business or profession		30,000
Income from other sources - lottery income		1,20,000
Gross Total Income		1,50,000
Less: Deductions under Chapter VIA [See Note below]		
Under section 80C - Deposit in Public Provident Fund	10,000	
- Investment in National Saving Certificate	24,000	
	34,000	

11.11 Income Tax

Restricted to	30,000
Total Income	1,20,000

Note: Though the value of eligible investments is ₹ 34,000, however, deductions under chapter VIA cannot exceed the gross total income exclusive of long term capital gains, short term capital gains covered under section 111A, winnings of lotteries etc of the assessee.

Therefore, the maximum permissible deduction u/s 80C = ₹ 1,50,000 – ₹ 1,20,000 = ₹ 30,000.

Illustration 3

An individual assessee, resident in India, has made the following investments during the previous year 2013-14:

Particulars	₹
Contribution to the public provident fund	50,000
Investment in units of eligible mutual funds	40,000
Insurance premium paid on the life of the spouse (policy taken on 1.4.2011) (Assured value ₹ 1,00,000)	25,000

What is the deduction allowable under section 80C for A.Y.2014-15?

Solution

Computation of deduction under section 80C for A.Y.2014-15

Particulars	₹
Deposit in public provident fund	50,000
Investment in units of mutual funds	40,000
Insurance premium paid on the life of the spouse (Maximum 20% of the assured value ₹ 1,00,000, as the policy is taken before 1.4.2012)	20,000
Total	1,10,000
However, the maximum permissible deduction is restricted to	1,00,000

Note: As per section 80CCE, total deduction under section 80C, 80CCC and 80CCD(1) cannot exceed ₹ 1,00,000.

11.2.2 Deduction in respect of contribution to certain pension funds [Section 80CCC]

(i) Where an assessee, being an individual, has in the previous year paid or deposited any amount out of his income chargeable to tax to effect or keep in force a contract for any annuity plan of LIC of India or any other insurer for receiving pension from the fund referred to in section 10(23AAB), he shall be allowed a deduction in the computation of his total income.

(ii) For this purpose, the interest or bonus accrued or credited to the assessee's account shall not be reckoned as contribution.

(iii) The maximum permissible deduction is ₹ 1,00,000 (However, the overall limit of ₹ 1,00,000 prescribed in section 80CCE will continue to be applicable i.e. the maximum permissible deduction under sections 80C, 80CCC and 80CCD(1) put together is ₹ 1,00,000).

(iv) Where any amount standing to the credit of the assessee in a fund referred to in clause (23AAB) of section 10 in respect of which a deduction has been allowed, together with interest or bonus accrued or credited to the assessee's account is received by the assessee or his nominee on account of the surrender of the annuity plan in any previous year or as pension received from the annuity plan, such amount will be deemed to be the income of the assessee or the nominee in that previous year in which such withdrawal is made or pension is received. It will be chargeable to tax as income of that previous year.

(v) Where any amount paid or deposited by the assessee has been taken into account for the purposes of this section, a deduction under section 80C shall not be allowed with reference to such amount.

11.2.3 Deduction in respect of contribution to pension scheme of Central Government [Section 80CCD]

(i) A "New Restructured Defined Contribution Pension System" applicable to new entrants to Government service has been introduced. As per the scheme, it is mandatory for persons entering the service of the Central Government on or after 1st January, 2004, to contribute ten per cent their of salary every month towards their pension account. A matching contribution is required to be made by the Government to the said account. The benefit of this scheme is available to individuals employed by any other employer also on or after 1st January, 2004.

(ii) To give effect to the new pension scheme of the Central Government, a new section 80CCD has been inserted.

(iii) This section provides a deduction for the amount paid or deposited by an employee in his pension account subject to a maximum of 10% of his salary.

(iv) The contribution made by the Central Government or any other employer in the previous year to the said account of an employee, is allowed as a deduction in computation of the total income of the assessee. However, the deduction is restricted to 10% of the employee's salary.

(v) The entire employer's contribution would be included in the salary of the employee. However, deduction under section 80CCD would be restricted to 10% of salary.

(vi) This deduction is now extended also to self-employed individuals. The deduction in the case of a self-employed individual would be restricted to 10% of his gross total income in the previous year.

(vii) Further, the amount standing to the credit of the assessee in the pension account (for which deduction has already been claimed by him under this section) and accretions to such account, shall be taxed as income in the year in which such amounts are received by the assessee or his nominee on -

- (a) closure of the account or
- (b) his opting out of the said scheme or
- (c) receipt of pension from the annuity plan purchased or taken on such closure or opting out.

(viii) However, the assessee shall be deemed not to have received any amount in the previous year if such amount is used for purchasing an annuity plan in the same previous year.

(ix) No deduction will be allowed under section 80C in respect of amounts paid or deposited by the assessee, for which deduction has been allowed under section 80CCD(1).

11.2.4 Limit on deductions under sections 80C, 80CCC & 80CCD(1) [Section 80CCE]

This section restricts the aggregate amount of deduction under section 80C, 80CCC and 80CCD(1) to ₹ 1 lakh. It may be noted that the employer's contribution to pension scheme, allowable as deduction under section 80CCD(2) in the hands of the employee, would be outside the overall limit of ₹ 1 lakh stipulated under section 80CCE.

Illustration 4

The basic salary of Mr. A is ₹ 20,000 p.m. He is entitled to dearness allowance, which is 40% of basic salary. 50% of dearness allowance forms part of pay for retirement benefits. Both Mr. A and his employer contribute 15% of basic salary to the pension scheme referred to in section 80CCD. Explain the tax treatment in respect of such contribution in the hands of Mr. A.

Solution

Tax treatment in the hands of Mr.A in respect of employer's and own contribution to pension scheme referred to in section 80CCD

- Employer's contribution to such pension scheme would be treated as salary since it is specifically included in the definition of "salary" under section 17(1)(viii). Therefore, ₹ 36,000, being 15% of basic salary of ₹ 2,40,000, will be included in Mr. A's salary.
- Mr. A's contribution to pension scheme is allowable as deduction under section 80CCD(1). However, the deduction is restricted to 10% of salary. Salary, for this purpose, means basic pay plus dearness allowance, if it forms part of pay.

Therefore, "salary" for the purpose of deduction u/s 80CCD, in this case, would be –

Particulars	₹
Basic salary = ₹ 20,000 × 12 =	2,40,000
Dearness allowance = 40% of ₹ 2,40,000 = ₹ 96,000	
50% of Dearness Allowance forms part of pay = 50% of ₹ 96,000	<u>48,000</u>
Salary for the purpose of deduction under section 80CCD	<u>2,88,000</u>
Deduction under section 80CCD(1) = 10% of ₹ 2,88,000	28,800
(as against actual contribution of ₹ 36,000, being 15% of basic salary of ₹ 2,40,000)	

₹ 28,800 is allowable as deduction under section 80CCD(1). This would be taken into consideration and be subject to the overall limit of ₹ 1 lakh under section 80CCE.

- Employer's contribution to pension scheme would be allowable as deduction under section 80CCD(2), subject to a maximum of 10% of salary. Therefore, deduction under section 80CCD(2), would also be restricted to ₹ 28,800, even though the entire employer's contribution of ₹ 36,000 is included in salary under section 17(1)(viii). However, this deduction of employer's contribution of ₹ 28,800 to pension scheme would

be outside the overall limit of ₹ 1 lakh under section 80CCE i.e., this deduction would be over and above the other deductions which are subject to the limit of ₹ 1 lakh.

Illustration 5

The gross total income of Mr.X for the A.Y.2014-15 is ₹ 5,00,000. He has made the following investments/payments during the F.Y.2013-14 –

Particulars	₹
(1) Contribution to PPF	70,000
(2) Payment of tuition fees to Apeejay School, New Delhi, for education of his son studying in Class XI	45,000
(3) Repayment of housing loan taken from Standard Chartered Bank	25,000
(4) Contribution to approved pension fund of LIC	10,000

Compute the eligible deduction under Chapter VI-A for the A.Y.2014-15.

Solution

Computation of deduction under Chapter VI-A for the A.Y.2014-15

Particulars	₹
Deduction under section 80C	
(1) Contribution to PPF	70,000
(2) Payment of tuition fees to Apeejay School, New Delhi, for education of his son studying in Class XI	45,000
(3) Repayment of housing loan	<u>25,000</u>
	1,40,000
Deduction under section 80CCC	
(4) Contribution to approved pension fund of LIC	<u>10,000</u>
	<u>1,50,000</u>
As per section 80CCE, the aggregate deduction under section 80C, 80CCC and 80CCD(1) has to be restricted to ₹ 1 lakh	
Deduction allowable under Chapter VIA for the A.Y.2014-15	1,00,000

11.2.5 Deduction in respect of investment made under an equity savings scheme [Section 80CCG]

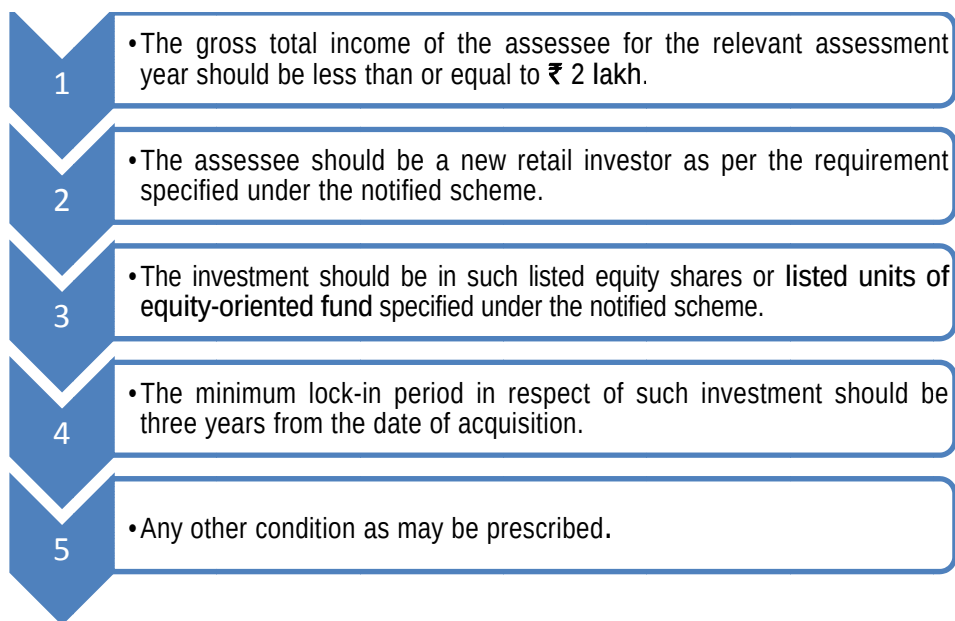
- (i) Deduction under this section would be available to a new retail investor, being a resident individual with gross total income of up to ₹ 12 lakh, for investment in listed equity shares or listed units of equity oriented fund, in accordance with a notified scheme¹.

Further, the deduction shall be allowed for three consecutive assessment years, beginning with the assessment year relevant to the previous year in which the listed

¹ At present, Rajiv Gandhi Equity Savings Scheme has been notified under section 80CCG [Notification No.51/2012 dated 23.11.2012].

equity shares or listed units of equity oriented fund were first acquired.

- (ii) Therefore, the conditions under section 80CCG for claiming deduction from A.Y.2014-15 would be –



- (iii) If the resident individual, after having claimed such deduction, fails to comply with any of the conditions in any previous year, say, he sells the shares or units before three years, then, the deduction earlier allowed shall be deemed to be the income of the previous year in which he fails to comply with the condition. The income shall, accordingly, be liable to tax in the assessment year relevant to such previous year.

Example

Mr. X and Mr. Y, new retail investors, have made the following investments in equity shares/units of equity oriented fund of Rajiv Gandhi Equity Savings Scheme for the P.Y.2013-14, P.Y.2014-15 & P.Y.2015-16 as below :

Particulars		P.Y.2013-14	P.Y.2014-15	P.Y.2015-16
Mr.X		₹	₹	₹
(i)	Investment in listed equity shares	20,000	45,000	32,000
(ii)	Investment in units of equity-oriented fund	40,000	-	11,000
(iii)	Gross Total Income (comprising of salary income and bank interest)	11,25,000	11,15,000	12,50,000
Deduction u/s 80CCG		25,000	22,500	Nil
Remark		(Restricted to 50% of ₹ 50,000)	(50% of ₹ 45,000)	(Not eligible since GTI > 12,00,000)

Mr. Y		₹	₹	₹
(i)	Investment in listed equity shares	25,000	-	30,000
(ii)	Investment in units of equity-oriented fund	15,000	40,000	25,000
(iii)	Sale of all units of equity oriented fund purchased in P.Y.2013-14 & P.Y.2014-15	-	-	70,000
(iii)	Gross Total Income (comprising of Salary income and bank interest)	10,50,000	12,15,000	11,50,000
Deduction under section 80CCG		20,000	Nil	25,000
Remark		(50% of ₹ 40,000)	(Since GTI > 12,00,000)	(Restricted to 50% of ₹ 50,000)
Amount liable to tax (on account of violation of condition) [See Note below]				7,500

Note – Since the deduction under section 80CCG was not allowed during the P.Y.2014-15 on account of the Gross Total Income exceeding ₹ 12 lakhs, no amount relating to that year can be subject to tax in the P.Y.2015-16 being the year of violation of condition, even though the units were sold within 3 years. However, a deduction of ₹ 7,500 (50% of ₹ 15,000) was allowed under section 80CCG in respect of investment of ₹ 15,000 in units of equity oriented fund in the P.Y.2013-14. Since such units have been sold in the P.Y.2015-16, the condition under section 80CCG has been violated and ₹ 7,500 would be subject to tax in the P.Y.2015-16.

11.2.6 Deduction in respect of medical insurance premium [Section 80D]

- (i) As per section 80D, in case of an individual, a deduction is allowed in respect of premium paid to effect or keep in force an insurance on the health of self, spouse and dependent children or any contribution made to the Central Government Health Scheme, up to a maximum of ₹ 15,000 in aggregate. A further deduction of ₹ 15,000 is also allowed in case the premium is paid for the health insurance taken for the health of parents.

An increased deduction of ₹ 20,000 (instead of ₹ 15,000) shall be allowed in case any of the persons mentioned above is a senior citizen i.e. an individual resident in India of the age of 60 years or more at any time during the relevant previous year.

Further, deduction would be allowed only if the payment of insurance premium is made in any mode other than cash.

- (ii) Section 80D provides that deduction to the extent of ₹ 5,000 shall be allowed in respect payment made on account of preventive health check-up of self, spouse, dependent children or parents made during the previous year. However, the said deduction of ₹ 5,000 is within the overall limit of ₹ 15,000 or ₹ 20,000, as the case may be.

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- (iii) In effect, the maximum deduction allowable under this section in any assessment year shall be to the extent of ₹ 15,000 for self, spouse and dependent children (₹ 20,000 in case any of the persons are senior citizen) in respect of the following payments made -
- (1) to effect or keep in force an insurance on the health of self, spouse or dependent children.
 - (2) on account of contribution to the Central Government Health Scheme *or such other health scheme as may be notified by the Central Government*.
 - (3) on account of preventive health check-up of self, spouse or dependent children.
- (iv) A further deduction up to ₹ 15,000 (₹ 20,000 in case either of parents are senior citizens) is allowable –
- (1) to effect or keep in force an insurance on the health of parents.
 - (2) on account of preventive health check-up of parents.
- (v) The maximum deduction allowable in respect of expenditure on preventive health check-up of self, spouse, dependent children and parents would be ₹ 5,000.
- (vi) Further it is provided that, for claiming such deduction under section 80D, the payment can be made:
- (1) by any mode, including cash, in respect of any sum paid on account of preventive health check-up;
 - (2) by any mode other than cash, in all other cases.

Illustration 6

Mr. A, aged 40 years, paid medical insurance premium of ₹ 12,000 during the P.Y.2013-14 to insure his health as well as the health of his spouse. He also paid medical insurance premium of ₹ 17,000 during the year to insure the health of his father, aged 63 years, who is not dependent on him. He contributed ₹ 2,400 to Central Government Health Scheme during the year. He has incurred ₹ 3,000 in cash on preventive health check-up of himself and his spouse and ₹ 4,000 by cheque on preventive health check-up of his father. Compute the deduction allowable under section 80D for the A.Y.2014-15.

Solution

Deduction allowable under section 80D for the A.Y.2014-15

	Particulars	₹	₹
		Actual Payment	Maximum deduction allowable
A.	Premium paid and medical expenditure incurred for self and spouse		
(i)	Medical insurance premium paid for self and spouse	12,000	12,000
(ii)	Contribution to CGHS	2,400	2,400
(iii)	Exp. on preventive health check-up of self & spouse	3,000	600
		17,400	15,000

B.	Premium paid and medical expenditure incurred for father, who is a senior citizen		
(i)	Mediclaime premium paid for father, who is over 60 years of age	17,000	17,000
(ii)	Expenditure on preventive health check-up of father	4,000	3,000
		21,000	20,000
	Total deduction under section 80D (15,000 + 20,000)		35,000

Notes:

- (1) The total deduction under A.(i), (ii) and (iii) above should not exceed ₹ 15,000. Therefore, the expenditure on preventive health check-up for self and spouse would be restricted to ₹ 600, being (₹ 15,000 – ₹ 12,000 – ₹ 2,400).
- (2) The total deduction under B. (i) and (ii) above should not exceed ₹ 20,000. Therefore, the expenditure on preventive health check-up for father would be restricted to ₹ 3,000, being (₹ 20,000 – ₹ 17,000).
- (3) In this case, the total deduction allowed on account of expenditure on preventive health check-up of self, spouse and father is ₹ 3,600 (i.e., ₹ 600 + ₹ 3,000), which is less than the maximum permissible limit of ₹ 5,000.

Illustration 7

Mr. Y, aged 40 years, paid medical insurance premium of ₹ 12,000 during the P.Y.2013-14 to insure his health as well as the health of his spouse and dependent children. He also paid medical insurance premium of ₹ 21,000 during the year to insure the health of his father, aged 67 years, who is not dependent on him. He contributed ₹ 2,400 to Central Government Health Scheme during the year. Compute the deduction allowable under section 80D for the A.Y.2014-15.

Solution

Deduction allowable under section 80D for the A.Y.2014-15

	Particulars	₹
(i)	Medical insurance premium paid for self, spouse and dependent children	12,000
(ii)	Contribution to CGHS	2,400
(iii)	Mediclaime premium paid for father, who is over 60 years of age (₹ 21,000 but restricted to ₹ 20,000, being the maximum allowable)	20,000
		34,400

Note – The total deduction under (i) and (ii) above should not exceed ₹ 15,000. In this case, since the total of (i) and (ii) (i.e., ₹ 14,400) does not exceed ₹ 15,000, the same is fully allowable under section 80D.

However, had the medical insurance premium paid for self, spouse and children been ₹ 14,000 instead of ₹ 12,000, then, the total of ₹ 16,400 (i.e., ₹ 14,000 + ₹ 2,400) under (i) and (ii) above would be restricted to ₹ 15,000. In such a case, the total deduction allowable under section 80D would be ₹ 35,000 [i.e., ₹ 15,000 [(i) & (ii)] + ₹ 20,000 (iii)].

(vii) In the case of a HUF, deduction is allowed under this section in respect of premium paid to insure the health of any member of the family. The maximum deduction available to a HUF would be ₹ 15,000 and in case any member is a senior citizen, ₹ 20,000.

(viii) The other conditions to be fulfilled are that such premium should be paid by any mode, other than cash, in the previous year out of his income chargeable to tax. Further, the medical insurance should be in accordance with a scheme made in this behalf by -

- (a) the General Insurance Corporation of India and approved by the Central Government in this behalf; or
- (b) any other insurer and approved by the Insurance Regulatory and Development Authority.

11.2.7 Deduction in respect of maintenance including medical treatment of a dependent disabled [Section 80DD]

(i) Section 80DD provides deduction to an assessee, who is a resident in India, being an individual or Hindu undivided family. Any amount incurred for the medical treatment (including nursing), training and rehabilitation of a dependant, being a person with disability, or any amount paid or deposited under a scheme framed in this behalf by the Life Insurance Corporation or any other insurer or the Administrator or the Specified Company as referred to in section 2(h) of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002, for the maintenance of a dependant, being a person with disability, qualifies for deduction.

(ii) The benefit of deduction under this section is also available to assessee incurring expenditure on maintenance including medical treatment of persons suffering from autism, cerebral palsy and multiple disabilities.

(iii) The quantum of deduction is ₹ 50,000 and in case of severe disability (i.e. person with 80% or more disability) the deduction shall be ₹ 1,00,000.

(iv) The term 'dependent' has been defined to include in the case of an individual, the spouse, children, parents, brothers and sisters of the individual and in the case of a Hindu Undivided Family (HUF), a member thereof, who is wholly or mainly dependent on the assessee and has not claimed any deduction under section 80U in the computation of his income.

(v) For claiming the deduction, the assessee shall have to furnish a copy of the certificate issued by the medical authority under the Persons with Disability (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 along with the return of income under section 139.

(vi) Where the condition of disability requires reassessment, a fresh certificate from the medical authority shall have to be obtained after the expiry of the period mentioned in the original certificate in order to continue to claim the deduction.

Illustration 8

Mr. X is a resident individual. He deposits a sum of ₹ 25,000 with Life Insurance Corporation every year for the maintenance of his handicapped grandfather who is wholly dependent upon him. The disability is one which comes under the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995. A copy of the certificate from the medical authority is submitted. Compute the amount of deduction available under section 80DD for the A.Y. 2014-15.

Solution

Since the amount deposited by Mr. X was for his grandfather, he will not be allowed any deduction under section 80DD. The deduction is available if the individual assessee incurs any expense for a dependant disabled relative. Grandfather does not come within the definition of dependant relative.

Illustration 9

What will be the deduction if Mr. X had made this deposit for his dependant father?

Solution

Since the expense was incurred for a dependant disabled relative, Mr. X will be entitled to claim a deduction of ₹ 50,000 under section 80DD, irrespective of the amount deposited. In case his father has severe disability, the deduction would be ₹ 1,00,000.

11.2.8 Deduction in respect of medical treatment etc. [Section 80DDB]

(i) This section provides deduction to an assessee, who is resident in India, being an individual and Hindu undivided family. Any amount actually paid for the medical treatment of such disease or ailment as may be specified in the rules made in this behalf by the Board for himself or a dependent, in case the assessee is an individual or for any member of a HUF, in case the assessee is a HUF will qualify for deduction.

(ii) The amount of deduction under this section shall be equal to the amount actually paid or ₹ 40,000, whichever is less, in respect of that previous year in which such amount was actually paid. In case the amount is paid in respect of a senior citizen, i.e., a resident individual of the age of 60 years or more at any time during the relevant previous year, then the deduction would be the amount actually paid or ₹ 60,000, whichever is less.

(iii) The term 'dependent' includes in the case of an individual, the spouse, children, parents, brothers and sisters of the individual and in the case of a Hindu undivided family (HUF), a member of the HUF, who is wholly or mainly dependent on such individual or HUF for his support and maintenance.

(iv) No such deduction shall be allowed unless the assessee furnishes with a return of income, a certificate in such form, as may be prescribed, from a neurologist, an oncologist, a urologist, a hematologist, an immunologist or such other specialist, as may be prescribed, working in a Government hospital.

(v) The term "Government hospital" will also include approved hospitals for the treatment of Government servants.

(vi) The deduction under this section shall be reduced by the amount received, if any, under an insurance from an insurer, or reimbursed by an employer, for the medical treatment of the assessee or the dependent.

11.2.9 Deduction in respect of interest loan taken for higher education [Section 80E]

(i) Section 80E provides deduction to an individual-assessee in respect of any interest on loan paid by him in the previous year out of his income chargeable to tax.

(ii) The loan must have been taken for the purpose of pursuing his higher education or for

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the purpose of higher education of his or her relative i.e. spouse or children of the individual or the student for whom the individual is the legal guardian.

(iii) "Higher education" means any course of study (including vocational studies) pursued after passing the Senior Secondary Examination or its equivalent from any school, board or university recognised by the Central Government or State Government or local authority or by any other authority authorized by the Central Government or State Government or local authority to do so. Therefore, interest on loan taken for pursuing any course after Class XII or its equivalent, will qualify for deduction under section 80E.

(iv) The loan must have been taken from any financial institution or approved charitable institution.

(v) The deduction is allowed in computing the total income in respect of the initial assessment year (i.e. the assessment year relevant to the previous year, in which the assessee starts paying the interest on the loan) and seven assessment years immediately succeeding the initial assessment year or until the interest is paid in full by the assessee, whichever is earlier.

(vi) "Approved charitable institution" means an institution established for charitable purposes and approved by the prescribed authority under section 10(23C) or an institution referred to in section 80G(2)(a).

(vii) "Financial institution" means –

- (1) a banking company to which the Banking Regulation Act, 1949 applies (including a bank or banking institution referred to in section 51 of the Act); or
- (2) any other financial institution which the Central Government may, by notification in the Official Gazette, specify in this behalf.

Illustration 10

Mr. B has taken three education loans on April 1, 2013, the details of which are given below:

	Loan 1	Loan 2	Loan 3
For whose education loan was taken	B	Son of B	Daughter of B
Purpose of loan	MBA	B. Sc.	B.A.
Amount of loan (₹)	5,00,000	2,00,000	4,00,000
Annual repayment of loan (₹)	1,00,000	40,000	80,000
Annual repayment of interest (₹)	20,000	10,000	18,000

Compute the amount deductible under section 80E for the A.Y.2014-15.

Solution

Deduction under section 80E is available to an individual assessee in respect of any interest paid by him in the previous year in respect of loan taken for pursuing his higher education or higher education of his spouse or children. Higher education means any course of study pursued after senior secondary examination.

Therefore, interest repayment in respect of all the above loans would be eligible for deduction.

Deduction under section 80E = ₹ 20,000 + ₹ 10,000 + ₹ 18,000 = ₹ 48,000.

11.2.10 Additional deduction in respect of interest on loan taken for residential house property [New Section 80EE]

(i) Clause (b) of section 24 provides for deduction of interest payable on capital borrowed for acquisition, construction, repairs, renewal and reconstruction of property while computing income under the head "Income from house property".

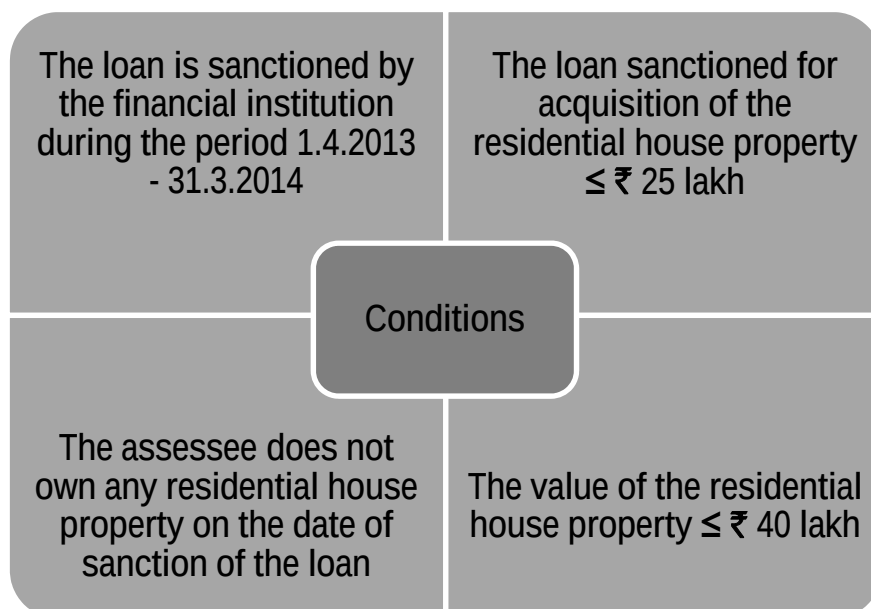
(ii) In case of capital borrowed for acquisition or construction of self-occupied property, or a property which cannot actually be occupied by the owner by reason of the fact that owing to his employment, business or profession carried on at any other place, he has to reside at that other place in a building not belonging to him, the amount of deduction under section 24(b) is restricted to ₹1,50,000.

(iii) Taking into account the need for affordable housing, a new section 80EE has been inserted to provide an additional benefit for first-home buyers relating to deduction in respect of interest on loan taken for residential house property.

(iv) New section 80EE provides for deduction of interest payable on loan taken by an individual-assessee from any financial institution (i.e., bank or banking institution or housing finance company formed and registered in India) for the purpose of acquisition of a residential house property, while computing his total income.

(v) The deduction under section 80EE shall not exceed ₹1 lakh and shall be allowed in computing the total income of the individual for the A.Y.2014-15 and in a case where the deduction for the previous year relevant to the said assessment year is less than ₹1 lakh, the balance amount shall be allowed in the A.Y.2015-16.

(vi) The deduction shall be subject to the following conditions:-



(vii) Further, where a deduction under this section is allowed for any assessment year, in respect of interest on housing loan, deduction shall not be allowed in respect of such interest under any other provision of the Income-tax Act, 1961, for the same or any other assessment year.

Illustration 11

Mr. A purchased a residential house property for self-occupation at a cost of ₹ 30 lakh on 1.6.2013, in respect of which he took a housing loan of ₹ 24 lakh from Bank of India@11% p.a. on the same date. Compute the eligible deduction in respect of interest on housing loan for A.Y.2014-15 and A.Y.2015-16 under the provisions of the Income-tax Act, 1961, assuming that the entire loan was outstanding as on 31.3.2015 and he does not own any other house property.

Solution

Particulars		₹
For A.Y.2014-15		
(i)	Deduction under section 24(b) ₹ 2,20,000 [₹ 24,00,000 × 11% × 10/12] Restricted to	1,50,000
(ii)	Deduction under section 80EE (₹ 2,20,000 – ₹ 1,50,000)	70,000

For A.Y.2015-16		
(i)	Deduction under section 24(b) ₹ 2,64,000 [₹ 24,00,000 × 11%] Restricted to	1,50,000
(ii)	Deduction under section 80EE (₹ 1,00,000 – ₹ 70,000, allowed as deduction in P.Y.2013-14)	30,000

Note - Mr. A is entitled to deduction under section 80EE, in addition to deduction under section 24(b) since –

- (1) the loan is sanctioned by Bank of India, being a financial institution, during the period between 1.4.2013 and 31.3.2014;
- (2) the loan amount sanctioned is less than ₹ 25 lakh;
- (3) the value of the house property is less than ₹ 40 lakh;
- (4) he does not own any other residential house property.

11.2.11 Deduction in respect of donations to certain funds, charitable institutions etc. [Section 80G]

(i) Where an assessee pays any sum as donation to eligible funds or institutions, he is entitled to a deduction, subject to certain limitations, from the gross total income.

(ii) The following table gives the details of the institutions and funds to which donations can be made for the purpose of claiming deduction under section 80G, the qualifying amount and the deductions allowable -

Eligible institutions / funds	Permissible deduction
1	2
1. The National Defence Fund set up by the Central Government.	100%
2. The Jawaharlal Nehru Memorial Fund.	50%
3. Prime Minister's Drought Relief Fund.	50%
4. Prime Minister's National Relief Fund.	100%
5. Prime Minister's Armenia Earthquake Relief Fund.	100%
6. The Africa (Public Contributions-India) Fund.	100%
7. <i>The National Children's Fund.</i>	100%
8. Indira Gandhi Memorial Trust.	50%
9. Rajiv Gandhi Foundation.	50%
10. The National Foundation for Communal Harmony.	100%
11. Approved University or educational institution of national eminence.	100%
12. Maharashtra Chief Minister's Earthquake Relief Fund.	100%
13. Any fund set up by the State Government of Gujarat exclusively for providing relief to the victims of the Gujarat earthquake.	100%
14. Any Zila Saksharta Samiti for primary education in villages and towns and for literacy and post-literacy activities	100%
15. National Blood Transfusion Council or any State Blood Transfusion Council whose sole objective is the control, supervision, regulation or encouragement of operation and requirements of blood banks.	100%
16. Any State Government Fund set up to provide medical relief to the poor.	100%
17. The Army Central Welfare Fund or Indian Naval Benevolent Fund or Air Force Central Welfare Fund established by the armed forces of the Union for the welfare of past and present members of such forces or their dependents.	100%
18. The National Illness Assistance Fund.	100%
19. The Chief Minister's Relief Fund or Lieutenant Governor's Relief Fund.	100%
20. The National Sports Fund set up by the Central Government.	100%

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21. The National Cultural Fund set up by the Central Government.	100%
22. The Fund for Technology Development and Application set up by the Central Government.	100%
23. National Trust for welfare of persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities.	100%
24. Any Institution or Fund established in India for charitable purposes fulfilling certain prescribed conditions under section 80G(5)	50% subject to qualifying limit
25. The Government or any local authority for utilisation for any charitable purpose other than the purpose of promoting family planning.	50% subject to qualifying limit
26. An authority constituted in India or under any other law enacted either for dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages	50% subject to qualifying limit
27. Any Corporation established by the Central Government or any State Government for promoting the interests of the members of a minority community.	50% subject to qualifying limit
28. The Government or to any approved local authority, institution or association for promotion of family planning.	100% subject to qualifying limit
29. Notified temple, mosque, gurdwara, church or other place of historic, archaeological or artistic importance or which is a place of public worship of renown throughout any State or States.	50% subject to qualifying limit
30. Sum paid by a company as donation to the Indian Olympic Association or any other association/institution established in India, as may be notified by the Government for the development of infrastructure for sports or games, or the sponsorship of sports and games in India.	100% subject to qualifying limit
- (iii) The conditions mentioned in item No. 24 above are as follows:
- (1) The institution or fund is:
- (a) constituted as a public charitable trust, or
 - (b) registered under the Societies Registration Act, 1960 or under any corresponding law or under section 25 of the Companies Act, 1956², or
 - (c) a University established by law or

² Section 8 of the Companies Act, 2013

- (d) any other educational institution recognized by the Government or
 - (e) an institution financed wholly or in part by the Government or a local authority.
- (2) Where such Institution or Fund derives any income, such income should not be liable to inclusion in its total income under the provisions of section 10(23AA), 10(23C) or 11 or 12.

The Institution, referred to in the above clauses of section 10 are as follows :

- (i) Regimental fund or Non-public Fund established by the armed forces of the Union for the welfare of its members and their dependants [Section 10(23AA)]
- (ii) The Prime Minister Fund (Promotion of Folk Art) [Section 10(23C)]
- (iii) The Prime Minister Aid to Students Fund [Section 10(23C)]
- (iv) National Foundation for communal harmony [Section 10(23C)]
- (v) Charitable Trusts and Institutions [Sections 11 and 12].

However, it may be noted that the assessee will not lose the benefit of deduction if :

- (a) subsequent to the donation, any part of the income of the Institution has become chargeable to tax due to non-compliance with any of the provisions of section 11 or section 12 or section 12A.
 - (b) as a result of the operation of section 11(1)(c), exemption under section 11 or section 12 is denied to the institution.
- (3) No part of the income or assets of the Institution or Fund is transferable or applicable at any time for any purposes other than charitable purpose. Such charitable purpose however does not include any purpose the whole or substantially the whole of which is of a religious nature.

For the purposes of this section, an association or institution having as its object the control, supervision, regulation or encouragement in India of such games or sports as the Central Government may, by notification in the Official Gazette, specify in this behalf, shall be deemed to be an institution established in India for a charitable purpose.

- (4) The Institution or Fund is not expressed to be for the benefit of any particular religious community or caste. An institution or fund established for the benefit of women and children or of Scheduled Castes, Backward classes or Scheduled Tribes is not however to be treated as an institution or fund for the benefit of a religious community or caste.
- (5) The Institution or Fund maintains regular accounts of its receipt and expenditure.

(iv) Section 80G(4) clarifies that the limits prescribed therein will apply with reference to aggregate amount of donations qualifying for deduction and not with reference to the quantum of deduction admissible. For applying the qualification limit, all the eligible donations should be aggregated and the sum total should be limited to 10% of the adjusted gross total income. The excess shall be ignored in computing the aggregate in respect of which deduction is allowable.

Adjusted gross total income means the gross total income as reduced by the following:

- (1) amount of deductions under sections 80C to 80U (but not including section 80G),

- (2) Any income on which income tax is not payable,
- (3) Long term capital gains and
- (4) Income referred to in sections 115A, 115AB, 115AC, 115AD, 115BB and 115D.
- (v) Where an assessee has claimed and has been allowed any deduction under this section in respect of any amount of donation, the same amount will not qualify for deduction under any other provision of the Act for the same or any other assessment year [Sub-section (5A)].
- (vi) Where an institution or fund incurs expenditure of a religious nature for an amount not exceeding 5% of its total income in that previous year, such institution or fund shall be deemed to be a fund or institution to which the provisions of this section apply.
- (vii) Donations in kind shall not qualify for deduction.
- (viii) No deduction shall be allowed in respect of donation of any sum exceeding ₹ 10,000 unless such sum is paid by any mode other than cash.
- (ix) The deduction under section 80G can be claimed whether it has any nexus with the business of the assessee or not.
- (x) In respect of donations made after 31.3.1992 to any institution or fund, such institution or fund must be approved by the Commissioner in accordance with the rules made in this behalf.
- (xi) As per *Circular No.2/2005 dated 12.1.2005*, in cases where employees make donations to the Prime Minister's National Relief Fund, the Chief Minister's Relief Fund or the Lieutenant Governor's Relief Fund through their respective employers, it is not possible for such funds to issue separate certificate to every such employee in respect of donations made to such funds as contributions made to these funds are in the form of a consolidated cheque. An employee who makes donations towards these funds is eligible to claim deduction under section 80G. It is, hereby, clarified that the claim in respect of such donations as indicated above will be admissible under section 80G of the Income-tax Act, 1961 on the basis of the certificate issued by the Drawing and Disbursing Officer (DDO)/Employer in this behalf.

11.2.12 Deduction in respect of rent paid [Section 80GG]

- (i) This section provides for deduction in respect of rent paid.
- (ii) The following conditions have to be satisfied for claiming deduction under section 80GG -
 - (1) The assessee should not be receiving any house rent allowance exempt under section 10(13A).
 - (2) The expenditure incurred by him on rent of any furnished or unfurnished accommodation should exceed 10% of his total income arrived at after all deductions under Chapter VI A except section 80GG.
 - (3) The accommodation should be occupied by the assessee for the purposes of his own residence.
 - (4) The assessee should fulfil such other conditions or limitations as may be prescribed, having regard to the area or place in which such accommodation is situated and other relevant considerations.

- (5) The assessee or his spouse or his minor child or an HUF of which he is a member should not own any accommodation at the place where he ordinarily resides or perform duties of his office or employment or carries on his business or profession; or
- (6) If the assessee owns any accommodation at any place other than that referred to above, such accommodation should not be in the occupation of the assessee and its annual value is not required to be determined under section 23(2)(a) or section 23(4)(a).
- (7) The assessee should file a declaration in Form 10BA, confirming the details of rent paid and fulfillment of other conditions, with the return of income.
- (iii) The deduction admissible will be the least of the following:
 - (1) Actual rent paid minus 10% of the total income of the assessee before allowing the deduction, or
 - (2) 25% of such total income (arrived at after making all deductions under Chapter VI A but before making any deduction under this section), or
 - (3) Amount calculated at ₹ 2,000 p.m.

Total income for the above purpose will not include long term capital gains, if any, and any income referred to in sections 115A to 115D.

Illustration 12

An assessee, whose total income is ₹ 46,000, paid house rent at ₹ 1,200 p.m. in respect of residential accommodation occupied by him at Mumbai. Compute the deduction allowable under section 80GG.

Solution

The deduction under section 80GG will be computed as follows:

- (i) Actual rent less 10 per cent of total income

$$14,400 \text{ minus } \frac{(10 \times 46,000)}{100} = ₹ 9,800(A)$$

- (ii) 25 per cent of total income

$$\frac{25 \times 46,000}{100} = ₹ 11,500(B)$$

- (iii) Amount calculated at ₹ 2,000 p.m. = ₹ 24,000(C)

Deduction allowable (least of A, B and C) = ₹ 9,800

11.2.13 Deduction in respect of donations for scientific research and rural development [Section 80GGA]

- (i) Section 80GGA grants deduction in respect of the donations made for scientific research or rural development by any assessee not having income chargeable under the head "Profits and gains of business or profession".
- (ii) The following donations would qualify for deduction under this section -

(1) Any sum paid by the assessee in the previous year to a research association which has, as its object, the undertaking of scientific research or to a University, college or other institution to be used for scientific research; and

(2) Any sum paid by the assessee in the previous year to an association or institution which has as its object the undertaking of any programme of rural development to be used for carrying out any programme of rural development approved by the prescribed authority for purposes of section 35CCA or to an institution or association which has as its object the training of persons for implementing programmes of rural development.

It is, however, essential that in respect of both the aforesaid donations, the association or institution to which the donation is given must be approved by the prescribed authority; in the case of donation for scientific research, the donation must be to the institution approved under section 35(1)(ii) whereas in the case of donation for rural development the institution or association must be approved by the prescribed authority under section 35CCA(2).

(3) Any sum paid to a Research Association which has as its object the undertaking of research in social science or statistical research, University, College or other institution to be used for research in social science or statistical research.

Such Research Association, University, College or institution must be approved under section 35(1)(iii).

(4) Any sum paid to a public sector company or a local authority or to an association or institution approved by the National Committee for carrying out any eligible project or scheme.

However, the assessee must furnish a certificate referred to in section 35AC from such public sector company or local authority or association or institution.

The expression "National Committee" and "eligible project or scheme" shall have the meanings respectively assigned to them in the Explanation to section 35AC.

Note – It has been clarified that the deduction to which an assessee is entitled in respect of any sum paid to a Research association, university, college or other institution or to an association or institution for carrying out the programme of rural development, or to a public sector company, or to a local authority or to an association or institution for carrying out the eligible project or scheme referred to in section 35AC, respectively, shall not be denied merely on the ground that subsequent to the payment of such sum by the assessee the approval granted or, as the case may be, the notification has been withdrawn.

(5) Any sum paid to a rural development fund set up and notified under section 35CCA.

(6) Any sum paid by the assessee in the previous year to National Urban Poverty Eradication Fund (NUPEF).

(iii) Restrictions on deduction -

(1) No deduction under this section would be allowed in the case of an assessee whose gross total income includes income which is chargeable under the head "Profits and gains of business or profession."

(2) Where a deduction under this section is claimed and allowed for any assessment year, deduction shall not be allowed in respect of such payment under any provision of this Act for

the same or any other assessment year.

(3) No deduction shall be allowed in respect of donation of any sum exceeding ₹ 10,000 unless such sum is paid by any mode other than cash.

11.2.14 Deduction in respect of contributions given by companies to political parties [Section 80GGB]

(i) This section provides for deduction of any sum contributed in the previous year by an Indian company to any political party or an electoral trust. *However, no deduction shall be allowed in respect of any sum contributed by way of cash.*

(ii) For the purposes of this section, the word “contribute” has the same meaning assigned to it under section 293A of the Companies Act, 1956³, which provides that -

- (a) a donation or subscription or payment given by a company to a person for carrying on any activity which is likely to effect public support for a political party shall also be deemed to be contribution for a political purpose;
- (b) the expenditure incurred, directly or indirectly, by a company on advertisement in any publication (being a publication in the nature of a souvenir, brochure, tract, pamphlet or the like) by or on behalf of a political party or for its advantage shall also be deemed to be a contribution to such political party or a contribution for a political purpose to the person publishing it.

(iii) “Political party” means a political party registered under section 29A of the Representation of the People Act, 1951.

Illustration 13

During the P.Y.2013-14, ABC Ltd., an Indian company,

- (1) *contributed a sum of ₹ 2 lakh to an electoral trust; and*
- (2) *incurred expenditure of ₹ 25,000 on advertisement in a brochure of a political party.*

Is the company eligible for deduction in respect of such contribution/expenditure, assuming that the contribution was made by cheque? If so, what is the quantum of deduction?

Solution

An Indian company is eligible for deduction under section 80GGB in respect of any sum contributed by it in the previous year to any political party or an electoral trust. Further, the word “contribute” in section 80GGB has the meaning assigned to it in section 293A of the Companies Act, 1956, and accordingly, it includes the amount of expenditure incurred on advertisement in a brochure of a political party.

Therefore, ABC Ltd. is eligible for a deduction of ₹ 2,25,000 under section 80GGB in respect of sum of ₹ 2 lakh contributed to an electoral trust and ₹ 25,000 incurred by it on advertisement in a brochure of a political party.

It may be noted that there is a specific disallowance under section 37(2B) in respect of expenditure incurred on advertisement in a brochure of a political party. Therefore, the expenditure of ₹ 25,000 would be disallowed while computing business income/gross total

³ Section 182 of the Companies Act, 2013

income. However, the said expenditure incurred by an Indian company is allowable as a deduction from gross total income under section 80GGB.

11.2.15 Deduction in respect of contributions given by any person to political parties [Section 80GGC]

(i) This section provides for deduction of any sum contributed in the previous year by any person to a political party or an electoral trust. *However, no deduction shall be allowed in respect of any sum contributed by way of cash.*

(ii) However, the deduction will not be available to a local authority and an artificial juridical person, wholly or partly funded by the Government.

(iii) "Political party" means a political party registered under section 29A of the Representation of the People Act, 1951.

11.3 Deduction in respect of incomes

11.3.1 Deductions in respect of profits and gains from undertakings or enterprises engaged in infrastructure development, etc. [Section 80-IA]

(i) **Applicability:** Section 80-IA(1) provides a ten year tax holiday to an assessee, whose gross total income includes any profits and gains derived by an undertaking or enterprise from an eligible business i.e., business referred to in sub-section (4), namely :

- (1) Infrastructure facility - Any enterprise carrying on the business of :
- (a) developing
 - (b) operating and maintaining; or
 - (c) developing, operating and maintaining any infrastructure facility.

Conditions: However, such enterprise must fulfill the following conditions :

- (i) It must be owned by a company registered in India or by a consortium of such companies or by an authority or a board or a corporation or any other body established or constituted under any Central or State Act.
- (ii) It has entered into an agreement with the Central or a State Government or a local authority or statutory body for (i) developing or (ii) operating and maintaining, or (iii) developing, operating and maintaining a new infrastructure facility.
- (iii) It starts operating and maintaining such infrastructure facility on or after 1-4-1995.
- (iv) However, where an enterprise which developed such infrastructure facility transfers it to another enterprise on or after 1-4-1999, and such transferee enterprise operates and maintains it according to the agreement drawn up with the Government, etc., this section will apply to the transferee enterprise for the unexpired period of deduction (which was available to the first enterprise).

Meaning of "infrastructure facility": For this purpose, 'infrastructure facility' means :

- (i) a road, including toll road, a bridge or a rail system;
- (ii) a highway project including housing or other activities being an integral part of the

highway project;

- (iii) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system; and
- (iv) a port, airport, inland waterway or inland port or navigational channel in the sea.

Note – 1. Structures at the ports for storage, loading and unloading etc. will be included in the definition of port for the purpose of section 80-IA, if the concerned port authority has issued a certificate that the said structures form part of the port.

2. Effluent treatment and conveyance system is a part of water treatment system and would accordingly, qualify as an infrastructure facility for the purpose of section 80-IA.

3. The CBDT has, vide *Circular No. 4/2010 dated 18.5.2010*, clarified that widening of an existing road by constructing additional lanes as a part of a highway project by an undertaking would be regarded as a new infrastructure facility for the purpose of section 80-IA(4)(i). However, simply relaying of an existing road would not be classifiable as a new infrastructure facility for this purpose.

(2) **Telecom undertakings:** Any undertaking providing telecommunication services, whether basic or cellular, including radio paging, domestic satellite service or network of trunking (NOT), broadband network and internet services on or after 1 April, 1995 but on or before 31 March, 2005.

Meaning of “domestic satellite”: ‘Domestic satellite’ has been defined by sub-section (12)(a) as “a satellite owned and operated by an Indian company for providing telecommunication services.”

(3) **Industrial parks / Special Economic Zones:** Any undertaking which develops, develops and operates, or maintains and operates an industrial park or develops, or develops and operates, or maintains and operates, a special economic zone.

Conditions:

- (i) The undertaking begins to operate an industrial park or special economic zone in accordance with the scheme framed and notified by the Central Government.
- (ii) The scheme is notified by the Government for the period beginning on 1-4-1997 and ending on (i) 31-3-2011 for industrial parks and (ii) 31.3.2006 for SEZs.

Rule 18C lays down the following eligibility criteria for Industrial Parks to claim benefit under section 80-IA (4)(iii) -

- (1) The undertaking should begin to develop, develop and operate or maintain and operate an industrial park any time during the period from 1.4.2006 to 31.3.2009.
- (2) The undertaking and the Industrial Park should be notified by the Central Government under the Industrial Park Scheme, 2008.
- (3) The undertaking should continue to fulfill the conditions envisaged in the Industrial Park Scheme, 2008.
- (iii) However, where an undertaking develops an industrial park on or after 1.4.1999 or a special economic zone on or after 1.4.2001 and transfers the operation and maintenance to another undertaking (transferee undertaking), the deduction to the transferee

undertaking shall be available for the remaining period in the ten consecutive assessment years, in such a manner as would have been available to the transferor undertaking, as if the operation and maintenance were not so transferred to the transferee undertaking.

- (4) Power undertakings: Any undertaking which
- (i) is set up in any part of India for the generation or generation and distribution of power. However, such undertaking must begin to generate power at any time during the period between 1.4.1993 and 31.3.2014.
 - (ii) starts transmission or distribution by laying a network of new transmission or distribution lines at any time during the period from 1.4.1999 and 31.3.2014. However, the deduction shall be allowed only in respect of profits derived from the laying of such network of new lines for transmission or distribution.
 - (iii) undertakes substantial renovation and modernisation of the existing network of transmission or distribution lines at any time during the period beginning on 1.4.2004 and ending on 31.3.2014.

'Substantial renovation and modernisation' means an increase in the plant and machinery in the network of transmission or distribution lines by at least fifty per cent of the book value of such plant and machinery as on 1st April, 2004.

Telecom and Power undertakings should fulfill the following conditions:

- (a) It is not formed by splitting up or reconstruction of a business already in existence. However, this condition shall not apply in the case of an undertaking which is formed as a result of reconstruction, re-establishment or revival of the business of any undertaking which has been discontinued in any previous year due to extensive damage or destruction of any building, machinery, plant or furniture owned by the assessee and used for the purposes of such business. Further, the reason for damage or destruction is due to any natural calamity or other unforeseen circumstances such as the following:
 - (i) Flood, typhoon, hurricane, cyclone, earthquake or other natural calamity, or
 - (ii) riot or civil disturbance, or
 - (iii) accidental fire or explosion, or
 - (iv) enemy action or action taken in combat,and such business is re-established or revived within 3 years from the end of such previous year.
- (b) The undertaking should not be formed by the transfer of machinery or plant previously used for any purpose.

However, these conditions do not apply in case of transfer, either in whole or in part, of machinery or plant previously used by a State Electricity Board. This is irrespective of whether or not such transfer is in pursuance of the splitting up or reconstruction of such State Electricity Board or reorganisation of the State Electricity Board under Part XIII of the Electricity Act, 2003.

Also, this condition shall not apply to second-hand machinery or plant imported by the assessee if the following conditions are fulfilled:

- (i) Such machinery or plant was not used in India prior to the date of installation by the assessee.
- (ii) No deduction on account of depreciation was allowed to any person prior to the date of installation by the assessee.

Further, where the total value of any plant or machinery previously used and now transferred to the new business does not exceed 20% of the total value of the machinery or plant used in the new business, such plant or machinery will be considered as new for this purpose.

(5) Undertakings owned by an Indian company and set up for reconstruction or revival of a power generating plant

- (i) Clause (v) provides that the benefit under this section is available to an undertaking owned by an Indian company and set up for reconstruction or revival of a power generating plant.
- (ii) Such Indian company should be formed before 30.11.2005 with majority equity participation by public sector companies for the purposes of enforcing the security interest of the lenders to the company owning the power generating plant.
- (iii) Such Indian company should have been notified before 31.12.2005 by the Central Government for the purposes of this clause.
- (iv) Such undertaking should begin to generate or transmit or distribute power before 31.3.2011.

(ii) Rate of Deduction

(1) The amount of deduction available will be 100% of the profits and gains derived from such business for ten consecutive assessment years commencing at any time during the periods specified in (iii) below.

(2) However, in case of telecom undertakings covered under (2) above, the deduction will be 100% for the first 5 assessment years and thereafter 30% for the further 5 assessment years.

(iii) Period of tax holiday/concession

(1) The assessee has the option to claim deduction for any 10 consecutive assessment years out of 15 years beginning from the year in which the undertaking or the enterprise develops or begins to operate the eligible business.

(2) The assessee may also claim deduction for 10 out of 15 years beginning from the year in which an undertaking undertakes substantial renovation and modernization of the existing transmission or distribution lines.

(3) In case of an infrastructure facility being a public facility like –

- (i) a road, including a toll road, bridge or rail system; or
- (ii) a highway project including housing or other activities which are an integral part of the highway project; or
- (iii) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system,

the assessee can claim deduction for any 10 consecutive assessment years out of 20 years beginning from the year of operation.

(iv) Other provisions

(1) For the purpose of computing deduction under this section, the profits and gains of the eligible business shall be computed as if such eligible business were the only source of income of the assessee during the relevant previous years [Sub-section (5)].

(2) Where housing or other activities are an integral part of a highway project and the profits and gains have been calculated in accordance with the section, the profits shall not be liable to tax if the following conditions have been fulfilled:

- (a) The profit has been transferred to a special reserve account; and
- (b) the same is actually utilised for the highway project excluding housing and other activities before the expiry of 3 years following the year of transfer to the reserve account;
- (c) The amount remaining unutilised shall be chargeable to tax as income of the year in which the transfer to the reserve account took place [Sub-section (6)].

(3) The deduction shall be allowed to the industrial undertaking only if the accounts of the industrial undertaking for the relevant previous year have been audited by a chartered accountant and the assessee furnishes the audit report in the prescribed form, duly signed and verified by such accountant along with his return of income [Sub-section (7)].

(4) Where any goods or services held for the purposes of the eligible business are transferred to any other business carried on by the assessee, or vice versa, and if the consideration for such transfer does not correspond with the market value of the goods or services then the profits and gains of the eligible business shall be computed as if the transfer was made at market value. However, if, in the opinion of the Assessing Officer, such computation presents exceptional difficulties, the Assessing Officer may compute the profits on such reasonable basis as he may deem fit [Sub-section (8)].

(5) The deductions claimed and allowed under this section shall not exceed the profits and gains of the eligible business. Further, where deduction is claimed and allowed under this section for any assessment year no deduction in respect of such profits will be allowed under any other section under this chapter [Sub-section (9)].

(6) The Assessing Officer is empowered to make an adjustment while computing the profit and gains of the eligible business on the basis of the reasonable profit that can be derived from the transaction, in case the transaction between the assessee carrying on the eligible business under section 80-IA and any other person is so arranged that the transaction produces excessive profits to the eligible business [Sub-section (10)].

(7) The section empowers the Central Government to declare any class of industrial undertaking or enterprise as not being entitled to deduction under this section. The denial of exemption shall be with effect from such date as may be specified in the notification issued in the Official Gazette [Sub-section (11)].

(8) In the case of any amalgamation or demerger, by virtue of which the Indian company carrying on the eligible business is transferred to another Indian company, deduction under

this section will be available as follows:

- (a) No deduction will be available to the amalgamating company or the demerged company, as the case may be, in the year of amalgamation/demerger.
- (b) The provisions of this section will apply to the amalgamated/resulting company as they would have applied to the amalgamating/demerged company if the amalgamation/demerger had not taken place [Sub-section (12)].

However, such transfer of benefit of deduction to the amalgamated/resulting company would not be available in respect of any enterprise or undertaking which is transferred in a scheme of amalgamation or demerger effected on or after 1.4.2007 [Sub-section (12A)].

- (9) The deduction under section 80-IA would not be available in respect of any SEZ notified on or after 1.4.2005 in accordance with the Industrial Park Scheme, 2002 and notified schemes for SEZs, referred to in section 80-IA(4)(c)(iii) [Sub-section (13)].

- (10) The tax holiday under section 80-IA would not be available in relation to a business referred to in sub-section (4) which is in the nature of a works contract awarded by any person (including the Central or State Government) and executed by the undertaking or enterprise referred to in section 80-IA(1).

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

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

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

- (iii) Developer means -

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

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

A developer includes –

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

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

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

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

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

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

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

(ix) Where any goods or services held for the purposes of eligible business are transferred to any other business carried on by the assessee or, where any goods held for any other business are transferred to the eligible business and, in either case, if the consideration for such transfer as recorded in the accounts of the eligible business does not correspond to the market value thereof, then the profits eligible for deduction shall be computed by adopting market value for such goods or services. In case of exceptional difficulty in this regard, the profits shall be computed by the Assessing Officer on a reasonable basis.

Where due to the close connection between the assessee and the other person or for any other reason, it appears to the Assessing Officer that the profits of eligible business is increased to more than the ordinary profits, the Assessing Officer shall compute the amount of profits on a reasonable basis for allowing the deduction. The Assessing Officer is empowered to make an adjustment while computing the profit and gains of the eligible business on the basis of the reasonable profit that can be derived from the transaction, in case the transaction between the assessee carrying on the eligible business under section 80-IAB and any other person is so arranged that the transaction produces excessive profits to the eligible business .

(x) The deduction under this section should not exceed the profits of such eligible business of the undertaking or the enterprise.

(xi) Further, where any amount of profits of an undertaking or enterprise is allowed as deduction under this section, no deduction under any other provision of Chapter VI-A is allowable in respect of such profits.

(xii) The Central Government may notify that the benefit conferred by this section shall not apply to any class of industrial undertaking or enterprise with effect from any specified date.

(xiii) Where any undertaking of an Indian company which is entitled to the deduction under this section is transferred before the expiry of the period of deduction to another Indian company in a scheme of amalgamation or demerger, no deduction shall be admissible to the amalgamating or demerged company for the previous year in which the amalgamation or demerger takes place and the amalgamated or the resulting company shall be entitled to the deduction as if the amalgamation or demerger had not taken place.

11.3.3 Deductions in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings, etc. [Section 80-IB]

(i) Applicability

This section will be applicable to assesses, whose gross total income includes any profits and gains derived from any of the following business activities -

- (1) An industrial undertaking including a small scale industrial undertaking (SSI)
- (2) A ship
- (3) A hotel, multiplex theatre or convention centre.
- (4) Any company carrying on scientific and industrial research and development
- (5) An undertaking which begins commercial production or refining of mineral oil or commercial production of natural gas in licensed blocks.
- (6) An undertaking engaged in construction and development of housing projects approved by a local authority
- (7) An industrial undertaking deriving profits from the business of setting up and operating a cold chain facility for agricultural produce.
- (8) An undertaking deriving profits from the business of processing, preservation and packaging of fruits or vegetables or meat and meat products or poultry or marine or dairy products or from the integrated business of handling, storage and transportation of foodgrains.
- (9) An undertaking operating and maintaining a hospital in a rural area.

(ii) Conditions to be fulfilled, amount of deduction and period of deduction

The rate and period of deduction and the conditions required to be satisfied by the different categories of businesses are given below:

(1) Industrial undertakings [Sub-sections (2), (3), (4) and (5)]

Conditions: In order to be eligible to claim deduction under section 80-IB, an industrial undertaking must fulfill the following conditions:

- (i) It is not formed by splitting up, or the reconstruction of, an existing business.
- (ii) It is not formed by the transfer to a new business of any plant or machinery previously used for any other purpose.

In order to satisfy this condition, the total value of the plant or machinery so transferred should not exceed 20% of the value of the total plant or machinery used in the new business.

For the purpose of this condition, machinery or plant would not be regarded as previously used if it had been used by any person other than the assessee provided the following conditions are satisfied:

- (a) such plant or machinery was not used in India at any time prior to the date of its installation by the assessee;
- (b) the plant or machinery was imported into India from a foreign country;

- (c) no deduction in respect of depreciation of such plant or machinery has been allowed to any person at any time prior to the date of installation by the assessee.
- (iii) It manufactures or produces any article or thing (except those specified in the Eleventh Schedule) or operates a cold storage plant, in any part of India. However, in the case of an SSI, restriction regarding goods specified in the Eleventh Schedule shall not apply.
- (iv) In case of a manufacturing industrial unit, it should employ 10 or more workers (if manufacture is carried on with the aid of power), or 20 or more workers (if manufacture is carried on without the use of power).

Rate and period of deduction: The rate and period of deduction for different categories of industrial undertakings are given below :

- (i) The amount of deduction for an industrial undertaking will be 25% of the profits and gains derived from such industrial undertaking for a period of 10 consecutive assessment years starting with the initial assessment year, i.e. the assessment year relevant to the previous year in which the industrial undertaking begins to manufacture or produce articles or things. In the case of a company, the rate of deduction will be 30%. Again, where the assessee is a co-operative society, the period of 10 consecutive years will become 12 consecutive assessment years.

However, in order to claim the amount of deduction specified here, the assessee must fulfil the following conditions:

- (a) It must have begun to manufacture or produce articles or things or operate the plants at any time between 1-4-1991 and 31-3-1995, or such further period as specified by the Central Government in the Official Gazette with respect to such class of industries.
- (b) In case of an SSI, the period specified for the above purpose is 1-4-1995 and 31-3-2002.
“Small-scale industrial undertaking” means an industrial undertaking which is, as on the last day of the previous year, regarded as a small-scale industrial undertaking under section 11B of the Industrial (Development and Regulation) Act, 1951.
- (ii) In case of the following categories of industrial undertakings, the amount and period of deduction will be 100% of the profits and gains derived from the industrial undertaking for the initial 5 assessment years and thereafter 25% of such profits and gains (in case of a company, the rate is 30%):

- (a) an industrial undertaking located in an industrially backward State specified in the Eighth Schedule. In this case, the total period of deduction should not exceed 10 consecutive assessment years provided the industrial undertaking begins manufacture or production of articles or things or operation of cold storage plant between 1-4-1993 and 31-3-2004. Where the industrial undertaking is a co-operative society, the deduction will be available for 12 assessment years (instead of 10), including the initial assessment year [Sub-section (4)]

However, the terminal date for setting up of industrial undertakings in the State of Jammu and Kashmir is 31.3.2012. A negative list has also been provided in Part C of the Thirteenth Schedule to specify the commodities which should not be manufactured or produced by such undertakings. The list includes Cigarettes/cigars of tobacco, manufactured tobacco and substitutes, distilled/brewed alcoholic drinks and aerated branded beverages and their concentrates.

The Eighth Schedule specifies the following to be industrially backward States and Union Territories: (1) Arunachal Pradesh (2) Assam (3) Goa (4) Himachal Pradesh (5) Jammu & Kashmir (6) Manipur (7) Meghalaya (8) Mizoram (9) Nagaland (10) Sikkim (11) Tripura (12) Andaman and Nicobar Islands (13) Dadra and Nagar Haveli (14) Daman & Diu (15) Lakshadweep (16) Pondicherry.

In case of notified industries in the North-eastern region of India, the amount of deduction will be 100% of the profits and gains for 10 consecutive assessment years. However, no such deduction shall be allowed to any undertaking or enterprise which is eligible for claiming benefit under section 80-IC.

“North-eastern region” means the region comprising the States of Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim and Tripura.

- (b) an industrial undertaking located in such industrially backward districts of Category A or B, as the Central Government may, having regard to the prescribed guidelines, specify in the Official Gazette.

In case of Category A industries, the total period of deduction is 10 consecutive assessment years (except in case of a co-operative society where it is 12 years) provided the undertaking begins manufacture or production of articles or things or operation of cold storage plant between 1-10-1994 and 31-3-2004.

In case of Category B industries, the total period of deduction is 8 consecutive assessment years (except in case of a co-operative society where it is 12 years) provided the undertaking begins manufacture or production of articles or things or operation of cold storage plant between 1-10-1994 and 31-3-2004.

(2) Ships [Sub-section (6)]

Conditions: In order to claim deduction under this section, the following conditions must be fulfilled:

- (i) It should be owned by an Indian company and should be wholly used for its business purposes.
- (ii) It was not owned or used in Indian territorial waters by any person resident in India prior to the date of its acquisition by the Indian company.
- (iii) It was brought into use by the Indian company at any time between 1.4.1991 and 31.3.1995.

Rate and period of deduction: The amount of deduction will be 30% of the profits and gains derived from such a ship for a period of 10 consecutive assessment years including the initial assessment year i.e., the assessment year relevant to the previous year in which the ship is first bought into use.

(3) Hotels [Sub-section (7)]

Conditions: In order to claim deduction under this section, the following conditions must be fulfilled:

- (i) The business of the hotel is not formed by splitting up, or the reconstruction of, an existing business or by the transfer to the new business of a building previously used as

a hotel or of any plant or machinery previously used for any purpose.

- (ii) The business of the hotel is owned and carried on by a company registered in India with a paid up capital of not less than ₹ 5,00,000.
- (iii) The hotel is approved by the prescribed authority.

Rate and period of deduction: The rate and period of deduction for different categories of hotels are given below:

- (i) In case of hotels located in a hilly area or a rural area or a place of pilgrimage or such other place as the Central Government, having regard to the need for development of infrastructure for tourism in any place or such other considerations, may specify in the Official Gazette, the amount of deduction will be 50% of the profits and gains derived from such business.

The deduction will be available for a period of 10 consecutive assessment years beginning with the initial assessment year i.e. the assessment year relevant to the previous year in which the business of the hotel starts functioning.

In order to claim the deduction, the hotel must start functioning at any time between 1-4-1990 and 31-3-1994 or between 1-4-1997 and 31-3-2001, and should be approved by the prescribed authority for the purpose of deduction under this clause.

However, hotels situated within the municipal jurisdiction of Calcutta, Chennai, Mumbai and Delhi which has started functioning between 1-4-1997 and 31-3-2001 would not be eligible for this deduction.

“Hilly area” means any area located at a height of one thousand metres or more above the sea level.

“Place of pilgrimage” means a place where any temple, mosque, gurudwara, church or other place of public worship of renown throughout any State or States is situated.

“Rural area” means any area other than -

- (a) an area which is comprised within the jurisdiction of a municipality or a cantonment board which has a population of not less than 10,000 according to the preceding census of which relevant figures have been published before the first day of the previous year; or
 - (b) an area within such distance not being more than 15 kilometers from the local limits of any municipality or cantonment board referred to in sub-clause (i), as the Central Government may, having regard to the stage of development of such area including the extent of, and scope for, urbanisation of such area and other relevant considerations specify in this behalf by notification in the Official Gazette.
- (ii) In case of hotels located in any place other than those specified in (i) above, the amount of deduction will be 30% of the profits and gains derived from such business.

The deduction will be available for a period of 10 consecutive assessment years beginning with the initial assessment year.

In order to claim the deduction, the hotel must start functioning at any time between 1-4-1991 and 31-3-1995 or between 1-4-1997 and 31-3-2001, and should be approved by the prescribed authority for the purpose of deduction under this clause. However, hotels situated within the municipal jurisdiction of Calcutta, Chennai, Mumbai and Delhi which have started functioning between 1-4-1997 and 31-3-2001 would not be eligible for this deduction.

(4) Companies carrying on scientific and industrial research and development [Sub-sections (8) & (8A)]

- (i) The company is registered in India.
- (ii) The company has the main object of scientific and industrial research and development.
- (iii) The company is approved by the prescribed authority at any time before 1-4-1999.

Rate and period of deduction: Deduction will be calculated at 100% of the profits and gains from such business for 5 assessment years including the initial assessment year.

Sub-section (8A) provides for deduction in case of a company carrying on scientific research and development if such company fulfils the following conditions:

- (i) It is registered in India.
- (ii) It has the main object of scientific and industrial research and development.
- (iii) It is for the time being approved by the prescribed authority at any time after 31.3.2000 but before 1.4.2007.
- (iv) It fulfils such other conditions as may be prescribed.

The amount of deduction shall be 100% of the profits and gains of such business.

The deduction will be available for a period of 10 consecutive assessment years starting with the initial assessment year i.e. the assessment year relevant to the previous year in which the company is approved by the prescribed authority.

(5) Undertakings engaged in commercial production or refining of mineral oil or commercial production of natural gas in licensed blocks [Sub-section (9)]

Conditions: In order to claim deduction under the section, the undertaking should be engaged in commercial production or refining of mineral oil or commercial production of natural gas in licensed blocks.

The following further conditions should be fulfilled –

- (1) In case of an undertaking engaged in commercial production of mineral oil -
 - (i) Where such operations are carried out in the North Eastern Region, it has begun commercial production before 1.4.1997.
 - (ii) Where such operations are carried out in any part of India, it begins commercial production on or after 1.4.1997.

A sunset clause for tax holiday in respect of certain undertakings engaged in commercial production of mineral oil has now been inserted. Accordingly, the above deduction for commercial production of mineral oil will not be available for blocks licensed under a contract awarded after 31.3.2011 under the New Exploration Licensing Policy or in pursuance of any law for the time being in force or by the Central or a State Government in any other manner.

- (2) In case of an undertaking engaged in refining of mineral oil, it begins refining of mineral oil on or after 1-10-1998 but not later than 31.3.2012.

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(3) In case of an undertaking engaged in commercial production of natural gas in licensed blocks –

(1) the blocks are licensed under the VIII Round of bidding for award of exploration contracts ("NELP-VIII") under the New Exploration Licensing Policy announced by the Government of India vide Resolution No.O-19018/22/95-ONG.DO.VL, dated 10th February, 1999; or

(2) the blocks are licensed under the IV Round of bidding for award of exploration contracts for Coal Bed Methane blocks

and begins commercial production of natural gas on or after 1st April, 2009.

Note – All blocks licensed under a single contract to be treated as a single "undertaking"

For the purposes of claiming deduction under sub-section (9), all blocks licensed under a single contract, which has been awarded -

(1) under the New Exploration Licensing Policy announced by the Government of India vide Resolution No.O-19018/22/95-ONG.DO.VL, dated 10.2.1999 or

(2) in pursuance of any law for the time being in force or

(3) by Central or a State Government in any other manner

shall be treated as a single "undertaking".

This definition of "undertaking" will be applicable both in relation to mineral oil and natural gas.

Rate and period of deduction: The deduction will be allowed at 100% of the profits and gains from such business for 7 consecutive assessment years including the initial assessment year i.e. the assessment year relevant to the previous year in which the undertaking commences the commercial production or refining of mineral oil.

(6) Housing projects [Sub-section (10)]

Conditions: In order to be eligible to claim deduction under section 80-IB, an undertaking developing and building housing projects must fulfil the following conditions:

(i) The undertaking has commenced or commences development and construction of the housing project on or after 1.10.1998. The housing project should be completed within 4 years from the end of the financial year in which the project is approved by the local authority. In respect of projects approved by the local authority before 1.4.2004, the construction should be completed on or before 31.3.2008. On account of the large scale widespread downturn and the consequent slump in the housing sector, the period for completion of housing projects to qualify for tax benefit under section 80-IB has been extended from 4 years to 5 years from the end of the financial year in which the housing project is approved by the local authority, in case of housing projects approved on or after 1.4.2005. For this purpose, the date of approval would be the date on which the building plan is first approved by the local authority and the date of completion of the housing project would be the date on which the completion certificate is issued by such authority.

(ii) The projects must be approved before 31.3.2008 by a local authority.

(iii) The project is on a plot of land which is at least one acre.

In order to encourage the reconstruction and redevelopment of slum dwellings, the conditions that the construction should be completed within 4 years and that the minimum plot size should be one acre have been relaxed. The relaxation is in respect of housing projects carried out in accordance with a scheme framed by the Central Government or a State Government for reconstruction or redevelopment of existing buildings in areas declared to be slum areas. Such a scheme should be notified by the Board in this behalf.

(iv) The residential unit has a maximum built-up area of 1000 sq.ft. (if such residential unit is situated in Delhi or Mumbai or within 25 km from the municipal limits of these cities) or 1500 sq.ft. at any other place.

(v) the built-up area of the shops and other commercial establishments included in the housing project should not exceed five percent. of the aggregate built-up area of the housing project or 2000 sq. ft., whichever is less.

The expression "built-up area" has been defined to mean the inner measurements of the residential unit at the floor level, including the projections and balconies, as increased by the thickness of the walls but not including the common areas shared with other residential units.

The above restrictions regarding built-up area of shops and other commercial establishments have been relaxed in respect of housing projects approved on or after 1.4.2005. The permissible built-up area of shops and other commercial establishments included in the housing project has been increased from 5% of the aggregate built-up area or 2,000 sq. feet, whichever is lower, to 3% of the aggregate built-up area of the housing project or 5,000 sq. ft., whichever is higher.

However, these benefits are not available in respect of a housing project approved by the local authority before 1st April, 2005.

(vi) The undertaking which develops and builds the housing project shall not be allowed to allot more than one residential unit in the housing project to the same person, not being an individual. Where the person is an individual, no other residential unit in such housing project should be allotted to any of the following persons:-

- (1) the individual himself or spouse or minor children of such individual;
- (2) the Hindu undivided family in which such individual is the karta
- (3) any person representing such individual, the spouse or minor children of such individual or the Hindu undivided family in which such individual is the karta.

Rate and period of deduction: The deduction will be allowed at 100% of the profits derived from such project in any previous year relevant to any assessment year.

Note – The main aim of the tax concession under section 80-IB(10) is to provide tax benefit to the person undertaking the investment risk i.e. the actual developer. However, any person undertaking pure contract risk is not entitled to the tax benefit. Accordingly, the benefit under sub-section (10) would not be available to any undertaking which executes the housing project as a works contract awarded by any other person (including the Central or State Government).

(7) Cold chain facilities for agricultural produce [Sub-section (11)]

Conditions: In order to claim deduction under this section, the assessee must fulfil the following conditions:

- (i) The industrial undertaking should be deriving profit from the business of setting up and operating a cold chain facility for agricultural produce.
- (ii) The undertaking must begin to operate such facility on or after 1-4-1999 but before 1-4-2004.

For the purposes of this section, "cold chain facility" means a chain of facilities for storage or transportation of agricultural produce under scientifically controlled conditions including refrigeration and other facilities necessary for the preservation of such produce.

Rate and period of deduction: The amount of deduction will be 100% of the profits and gains derived from such industrial undertaking for a period of 5 consecutive assessment years starting with the initial assessment year i.e. the assessment year relevant to the previous year in which the industrial undertaking begins to operate the cold chain facility. Thereafter, the deduction allowable is 25% of such profits and gains (30% in case of a company) for the next 5 assessment years.

Where the assessee is a co-operative society, the period of 10 consecutive years will become 12 consecutive assessment years.

(8) Undertakings engaged in handling of foodgrains etc. [Sub-section (11A)]

Conditions: In order to claim deduction, the undertaking should fulfill the following conditions:

- (i) It should be deriving profits from the business of processing, preservation and packaging of fruits or vegetables or from the integrated business of handling, storage and transportation of foodgrains.
- (ii) It should begin to operate such business on or after 1.4.2001.
- (iii) The benefit of deduction under sub-section (11A) has now been extended to an undertaking deriving profit from the business of processing, preservation and packaging of meat or meat products or poultry or marine or dairy products, if it begins to operate such business on or after 1.4.2009.

Rate and period of deduction: The amount of deduction shall be 100% of the profits and gains derived from such business for 5 assessment years beginning with the initial assessment year i.e. the assessment year relevant to the previous year in which the undertaking begins such business. Thereafter, the deduction allowable is 25%. In the case of a company, the rate of 25% shall be substituted by 30%. The total period of deduction should not exceed 10 consecutive assessment years.

(9) Undertakings operating and maintaining a hospital in a rural area [Sub-section (11B)]

- (i) The profits derived by an undertaking from the business of operating and maintaining a hospital in a rural area is eligible for a deduction of hundred per cent of such profits and gains.
- (ii) The deduction is available for a period of five consecutive assessment years beginning from the initial assessment year (i.e. assessment year relevant to the previous year in which the undertaking begins to provide medical services).
- (iii) The undertaking would be eligible for the deduction if such hospital -
 - (a) is constructed during the period beginning on the 1st October, 2004 and ending on 31st March, 2008;

- (b) has at least one hundred beds for patients; and
- (c) is constructed in accordance with the regulations in force of the local authority.
- (iv) Further, for claiming the deduction, the assessee has to file along with the return of income, an audit report in the prescribed form and in the prescribed manner, duly signed and verified by a chartered accountant.

(10) Undertakings operating and maintaining a hospital located anywhere in India, other than the excluded area [Sub-section (11C)]

- (i) Sub-section (11C) provides a five year tax holiday to hospitals set up in other than the excluded areas. Excluded area means the area comprising the urban agglomerations of Greater Mumbai, Delhi, Kolkata, Chennai, Hyderabad, Bangalore and Ahmedabad, the districts of Faridabad, Gurgaon, Ghaziabad, Gautam Budh Nagar and Gandhi Nagar and the city of Secunderabad.
- (ii) To be eligible for this benefit, the hospital should be constructed and should start functioning between 1.4.08 to 31.3.2013. Further, it should have at least 100 beds for patients. For claiming this benefit, it is necessary that the audit report signed and verified by a Chartered Accountant certifying that deduction has been correctly claimed should be filed along with the company's return of income.
- (iii) The construction of the hospital should be in accordance with the regulations or bye-laws of the local authority. The hospital shall be deemed to have been constructed on the date on which a completion certificate in respect of such construction is issued by the local authority concerned.

(iii) Other Provisions

- (1) For the purpose of computing deduction under this section, the profits and gains of the eligible business shall be computed as if such eligible business were the only source of income of the assessee during the relevant previous years.
- (2) The accounts of the industrial undertaking for the relevant previous year should be audited by a chartered accountant and the assessee should furnish the audit report in the prescribed form, duly signed and verified by such accountant along with the return of income.
- (3) Where any goods held for the purposes of the eligible business are transferred to any other business carried on by the assessee, or *vice versa*, and if the consideration for such transfer does not correspond with the market value of the goods, then, the profits and gains of the eligible business shall be computed as if the transfer was made at market value. However, if, in the opinion of the Assessing Officer, such computation presents exceptional difficulties, the Assessing Officer may compute the profits on such reasonable basis as he may deem fit.
- (4) The deduction claimed and allowed under this section shall not exceed the profits and gains of the eligible business. Further, where deduction is claimed and allowed under this section for any assessment year, no deduction in respect of such profits will be allowed under any other section under this Chapter.
- (5) Where it appears to the Assessing Officer that the assessee derives more than ordinary profits from the eligible business due to close connection between him and any other person,

or due to any other reason, the Assessing Officer may consider such profits as may be reasonable for the purpose of computing deduction under this section. The Assessing Officer is empowered to make an adjustment while computing the profit and gains of the eligible business on the basis of the reasonable profit that can be derived from the transaction, in case the transaction between the assessee carrying on the eligible business under section 80-IB and any other person is so arranged that the transaction produces excessive profits to the eligible business.

(6) The section empowers the Central Government to declare any class of industrial undertaking or enterprise as not being entitled to deduction under this section. The denial of exemption shall be with effect from such date as may be specified in the notification issued in the Official Gazette.

(7) In the case of any amalgamation or demerger, by virtue of which the Indian company carrying on the eligible business is transferred to another Indian company, deduction under this section will be available as follows:

- (a) No deduction will be available to the amalgamating company or the demerged company, as the case may be, in the year of amalgamation/demerger.
- (b) The provisions of this section will apply to the amalgamated/resulting company as they would have applied to the amalgamating/demerged company, if the amalgamation/demerger had not taken place.

11.3.4 Special provisions in respect of certain undertakings or enterprises in certain special category States [Section 80-IC]

(i) This section allows tax holiday to the new undertakings or existing undertakings on their substantial expansion in the states of Himachal Pradesh, Uttarakhand, Sikkim and North-Eastern States.

(ii) For this purpose, substantial expansion means increase in the investment in plant and machinery by at least 50% of the book value of the plant and machinery (before taking depreciation in any year), as on the first day of the previous year in which the substantial expansion is undertaken.

(iii) The tax holiday in the states of Himachal Pradesh and Uttarakhand will be 100% for the first five assessment years and 25% (30% in the case of a company) for the next five assessment years.

(iv) However, tax holiday in the states of Sikkim and North-Eastern States will be 100% for ten assessment years commencing from the initial assessment year.

(v) For the purpose of exemption, two classifications have been made and the Thirteenth Schedule and Fourteenth Schedule have been inserted in the Income-tax Act. The said Schedules specify the list of articles and the States for the purposes of availing deduction under this section.

(vi) The first classification is applicable to undertakings or enterprises which manufacture or produce any article or thing, not being any article or thing specified in the 13th Schedule (namely, tobacco, aerated beverages, pollution causing paper and paper products etc.) in any export processing zone or integrated infrastructure development centre or industrial growth centre or industrial estate or industrial park or software technology park or industrial areas or

theme park in these States as notified by the Board.

(vii) The second classification is applicable to those undertakings or enterprises which manufacture or produce article or thing specified in the 14th Schedule only in these States without any specification of the specified zone, area etc.

(viii) The period during which the undertakings in different States should begin or should have begun to manufacture or produce are given hereunder -

Himachal Pradesh and Uttarakhand	From 7.1.03 and ending before 1.4.2012
Sikkim	From 23.12.02 and ending before 1.4.2007
North-Eastern States	From 24.12.97 and ending before 1.4.2007

(ix) No benefit to these undertakings will be available under any of the sections in Chapter VIA in relation to the profits and gains of such undertakings.

(x) While computing the total period of 10 years the period for which the benefit under section 80IB has already been availed, if any, shall also be included.

(xi) The other conditions such as that it should not be formed by splitting or reconstruction of a business already in existence, or by transfer to a new business of plant and machinery previously used for any purpose are the same as are applicable for claiming benefit under section 80IA.

(xii) Where any goods or services held for the purposes of the eligible business are transferred to any other business carried on by the assessee, or vice versa, and if the consideration for such transfer does not correspond with the market value of the goods or services then the profits and gains of the eligible business shall be computed as if the transfer was made at market value. However, if, in the opinion of the Assessing Officer, such computation presents exceptional difficulties, the Assessing Officer may compute the profits on such reasonable basis as he may deem fit.

(xiii) The deductions claimed and allowed under this section shall not exceed the profits and gains of the eligible business. Further, where deduction is claimed and allowed under this section for any assessment year no deduction in respect of such profits will be allowed under any other section under this chapter.

(xiv) The Assessing Officer is empowered to make an adjustment while computing the profit and gains of the eligible business on the basis of the reasonable profit that can be derived from the transaction, in case the transaction between the assessee carrying on the eligible business under section 80-IC and any other person is so arranged that the transaction produces excessive profits to the eligible business.

11.3.5 Tax holiday in respect of profits and gains from the business of hotel or business of building, owning and operating a convention centre in NCR [Section 80-ID]

(i) Section 80-ID provides for a deduction of 100% of profits and gains derived by an undertaking from the eligible business i.e. business of hotel or business of building, owning and operating a convention centre in a specified area, for a period of 5 consecutive assessment years beginning from the year in which such hotel starts functioning or convention centre starts operating on a commercial basis.

- (ii) However, such hotel or convention centre should be constructed at any time during the period from 1.4.2007 to 31.7.2010.
- (iii) Specified area means the National Capital Territory of Delhi and the districts of Faridabad, Gurgaon, Gautam Budh Nagar and Ghaziabad. This is to boost the construction activity in NCR in view of the upcoming Common Wealth Games in 2010.
- (iv) The benefit of this five year tax holiday has now been extended to new two, three or four star hotels located in specified districts having a World Heritage Site. The specified districts are Agra, Jalgaon, Aurangabad, Kancheepuram, Puri, Bharatpur, Chhatarpur, Thanjavur, Bellary, South 24 Parganas, Chamoli, Raisen, Gaya, Bhopal, Panchmahal, Kamrup, Goalpara, Nagaon, North Goa, South Goa, Darjeeling and Nilgiri. For availing this benefit, the hotel should be constructed and should start functioning between 1.4.08 to 31.3.2013.
- (v) "Convention centre" means a building of a prescribed area comprising of convention halls to be used for the purpose of holding conferences and seminars, being of such size and number and having such other facilities and amenities, as may be prescribed.

Rule 18DE prescribes the following conditions to be fulfilled by a convention centre in order to be eligible for deduction under section 80-ID:

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

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

- (a) an amphitheatre and landscaped open spaces for outdoor conference or seminar related activities;
 - (b) a kitchen, dining facility, cafeteria or restaurant only to support events in the convention centre.
- (vi) "Hotel" means a hotel of two-star, three-star or four-star category as classified by the Central Government;

- (vii) Such business should not be formed by the splitting up, or the reconstruction, of a business already in existence. It should not be formed by the transfer to a new business of a building previously used as a hotel or convention center. Further, it should not be formed by the transfer to a new business of machinery or plant previously used for any purpose exceeding 20% of the total value of machinery and plant used in the business.
- (viii) For this purpose, any machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose if the following conditions are fulfilled:
 - (a) such machinery or plant was not at any time used in India;
 - (b) such machinery or plant is imported into India from any country outside India; and
 - (c) no deduction on account of depreciation has been allowed in respect of such machinery or plant to any person earlier.
- (ix) The profits and gains from the eligible business should be computed as if such eligible business were the only source of income of the assessee during the relevant assessment year.
- (x) The deduction under this section should not exceed the profits of such eligible business of the undertaking.
- (xi) The deduction shall be allowed only if the accounts are audited by a Chartered Accountant, who is also required to certify that the deduction has been correctly claimed. Further, the audit report should be furnished along with the return of income.
- (xii) Further, where any amount of profits of an undertaking or enterprise is allowed as deduction under this section, no deduction under any other provision of Chapter VI-A or section 10AA is allowable in respect of such profits.
- (xiii) Where any goods or services held for the purposes of eligible business are transferred to any other business carried on by the assessee or, where any goods held for any other business are transferred to the eligible business and, in either case, if the consideration for such transfer as recorded in the accounts of the eligible business does not correspond to the market value thereof, then the profits eligible for deduction shall be computed by adopting market value for such goods or services. In case of exceptional difficulty in this regard, the profits shall be computed by the Assessing Officer on a reasonable basis.
- (xiv) Similarly, where due to the close connection between the assessee and the other person or for any other reason, it appears to the Assessing Officer that the profits of eligible business is increased to more than the ordinary profits, the Assessing Officer shall compute the amount of profits on a reasonable basis for allowing the deduction. The Assessing Officer is empowered to make an adjustment while computing the profit and gains of the eligible business on the basis of the reasonable profit that can be derived from the transaction, in case the transaction between the assessee carrying on the eligible business under section 80-ID and any other person is so arranged that the transaction produces excessive profits to the eligible business .
- (xv) The Central Government may notify that the benefit conferred by this section shall not apply to any class of undertaking with effect from any specified date.

11.3.6 Tax holiday in respect of profits and gains from eligible business of certain undertakings in North-Eastern States [Section 80-IE]

- (i) This section provides for an incentive to an undertaking which has during the period between 1st April, 2007 and 1st April, 2017, begun or begins, in any of the North-Eastern States (i.e., the States of Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim and Tripura) -
 - (1) to manufacture or produce any eligible article or thing;
 - (2) to undertake substantial expansion to manufacture or produce any eligible article or thing;
 - (3) to carry on any eligible business.
- (ii) Eligible article or thing means the article or thing other than the following -
 - (a) goods falling under Chapter 24 of the First Schedule to the Central Excise Tariff Act, 1985 which pertains to tobacco and manufactured tobacco substitutes;
 - (b) pan masala as covered under Chapter 21 of the First Schedule to the Central Excise Tariff Act, 1985;
 - (c) plastic carry bags of less than 20 microns; and
 - (d) goods falling under Chapter 27 of the First Schedule to the Central Excise Tariff Act, 1985 produced by petroleum oil or gas refineries.
- (iii) Substantial expansion means increase in the investment in the plant and machinery by at least 25% of the book value of plant and machinery (before taking depreciation in any year), as on the first day of the previous year in which the substantial expansion is undertaken.
- (iv) Eligible business means the business of -
 - (a) hotel (not below two star category);
 - (b) adventure and leisure sports including ropeways;
 - (c) providing medical and health services in the nature of nursing home with a minimum capacity of 25 beds;
 - (d) running an old-age home;
 - (e) operating vocational training institute for hotel management, catering and food craft, entrepreneurship development, nursing and para-medical, civil aviation related training, fashion designing and industrial training;
 - (f) running information technology related training centre;
 - (g) manufacturing of information technology hardware; and
 - (h) Bio-technology.
- (v) Where the gross total income of an assessee includes any profits and gains derived by such an undertaking, a deduction of 100% of the profits and gains derived from such business for 10 consecutive assessment years commencing with the initial assessment year shall be allowed in computing the total income of the assessee. Initial assessment

year means the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or things, or completes substantial expansion.

- (vi) However, the following conditions have to be fulfilled by the undertaking for claiming benefit of deduction under this section -
 - (1) It should not be formed by splitting up, or the reconstruction, of a business already in existence (except in circumstances provided in section 33B)
 - (2) It should not be formed by the transfer to a new business of machinery or plant previously used for any purpose exceeding 20% of the total value of machinery and plant used in the business.
- (vii) For this purpose, any machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose if the following conditions are fulfilled:
 - (a) such machinery or plant was not at any time used in India;
 - (b) such machinery or plant is imported into India from any country outside India; and
 - (c) no deduction on account of depreciation has been allowed in respect of such machinery or plant to any person earlier.
- (viii) Where deduction has been allowed under this section in computing the total income of the assessee, no deduction shall be allowed under any other section contained in Chapter VIA or section 10AA in relation to the profits and gains of the undertaking.
- (ix) Further, no deduction shall be allowed to any undertaking under this section, where the total period of deduction inclusive of the period of deduction under this section, or under section 80-IC or under the second proviso to sub-section (4) of section 80-IB, as the case may be, exceeds 10 assessment years.
- (x) The profits and gains from the eligible business should be computed as if such eligible business were the only source of income of the assessee during the relevant assessment year.
- (xi) The deduction under this section should not exceed the profits of such eligible business of the undertaking.
- (xii) The deduction shall be allowed only if the accounts are audited by a Chartered Accountant, who is also required to certify that the deduction has been correctly claimed. Further, the audit report should be furnished along with the return of income.
- (xiii) Where any goods or services held for the purposes of eligible business are transferred to any other business carried on by the assessee or, where any goods held for any other business are transferred to the eligible business and, in either case, if the consideration for such transfer as recorded in the accounts of the eligible business does not correspond to the market value thereof, then the profits eligible for deduction shall be computed by adopting market value for such goods or services. In case of exceptional difficulty in this regard, the profits shall be computed by the Assessing Officer on a reasonable basis.

The Assessing Officer is empowered to make an adjustment while computing the profit and gains of the eligible business on the basis of the reasonable profit that can be

derived from the transaction, in case the transaction between the assessee carrying on the eligible business under section 80-IE and any other person is so arranged that the transaction produces excessive profits to the eligible business.

- (xiv) Similarly, where due to the close connection between the assessee and the other person or for any other reason, it appears to the Assessing Officer that the profits of eligible business is increased to more than the ordinary profits, the Assessing Officer shall compute the amount of profits on a reasonable basis for allowing the deduction.
- (xv) The Central Government may notify that the benefit conferred by this section shall not apply to any class of undertaking with effect from any specified date.
- (xvi) Where any undertaking of an Indian company which is entitled to the deduction under this section is transferred before the expiry of the period of deduction to another Indian company in a scheme of amalgamation or demerger, no deduction shall be admissible to the amalgamating or demerged company for the previous year in which the amalgamation or demerger takes place and the amalgamated or the resulting company shall be entitled to the deduction as if the amalgamation or demerger had not taken place.

11.3.7 Deduction in respect of profits and gains from business of collecting and processing of bio-degradable waste [Section 80JJA]

- (i) This section provides for deduction in respect of profits and gains from the business of collecting and processing bio-degradable waste.
- (ii) The deduction is allowable where the gross total income of an assessee includes any profits and gains derived from any of the following businesses -
 - (1) collecting and processing or treating of bio-degradable waste for generating power, or
 - (2) producing bio-fertilizers, bio-pesticides or other biological agents, or
 - (3) producing bio-gas, or
 - (4) making pellets or briquettes for fuel or organic manure.
- (iii) The deduction allowable under this section is an amount equal to the whole of such profits and gains for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which the business commences.

11.3.8 Deduction in respect of employment of new workmen [Section 80JJAA]

- (i) Section 80JJAA provides that, with effect from A.Y.2014-15, the deduction thereunder shall be available to *an Indian Company deriving profits from manufacture of goods in its factory*.
- (ii) Where the gross total income of such Indian company includes any profits and gains derived from the manufacture of goods in a factory, it would be allowed a deduction of an amount equal to 30% of additional wages paid to the new regular workmen employed by the assessee *in such factory*, in the previous year, for three assessment years including the assessment year relevant to the previous year in which such employment is provided.
- (iii) *However, the deduction shall not be available if the factory is hived off or transferred from another existing entity or acquired by the assessee-company as a result of amalgamation with another company.*

(iii) The following conditions have to be fulfilled in order to be eligible for the deduction provided in the section:

- (1) The assessee should be an Indian company.
- (2) Its gross total income should include profits and gains *from manufacture of goods in a factory*.
- (3) *The factory should not be hived off or transferred from another existing entity or acquired by the assessee-company as a result of amalgamation with another company.*
- (4) The assessee should furnish along with the return of income a report of a chartered accountant in the prescribed form giving the prescribed particulars.
- (5) In case of a new *factory*, in the first previous year, it employs more than 100 regular workmen. Additional wages would mean the wages paid to new regular workmen in excess of 100 workmen employed during the previous year.
- (6) In the case of an existing *factory*, the number of regular workmen employed during the relevant previous year is equal to at least 110% of the regular workmen employed in such *factory* as on the last day of the preceding year. If not, the additional wages would be Nil.

(iv) **Meaning of “Regular Workmen”**- The section defines regular workmen as not including:

- (1) a casual workman; or
- (2) a workman employed through contract labour; or
- (3) any other workman employed for a period of less than 300 days during the previous year.

11.3.9 Deduction in respect of certain income of Offshore Banking Units and International Financial Services Centre [Section 80LA]

(i) This section is applicable to the following assesseees -

- (a) a scheduled bank having an Offshore Banking Unit in a SEZ; or
- (b) any bank, incorporated by or under the laws of a country outside India, and having an Offshore Banking Unit in a SEZ; or
- (c) a Unit of an International Financial Services Centre (IFSC).

(ii) The deduction will be allowed on account of the following income included in the gross total income of such assesseees -

- (a) income from an Offshore Banking Unit in a SEZ; or
- (b) income from the business referred to in section 6(1) of the Banking Regulation Act, 1949, with -
 - (1) an undertaking located in a SEZ or
 - (2) any other undertaking which develops, develops and operates or develops, operates and maintains a SEZ; or
- (c) income from any Unit of the IFSC from its business for which it has been approved for setting up in such a Centre in a SEZ.

- (iii) The deduction allowable from such income is -
 - (a) 100% of such income for 5 consecutive assessment years beginning with the assessment year relevant to the previous year in which –
 - (1) the permission under section 23(1)(a) of the Banking Regulation Act, 1949 was obtained; or
 - (2) the permission or registration under the SEBI Act, 1992 was obtained; or
 - (3) the permission or registration under any other relevant law was obtained.
 - (b) Thereafter, 50% of such income for the next 5 consecutive assessment years.
- (iv) The following conditions have to be fulfilled for claiming deduction under this section-
 - (a) The report of a Chartered Accountant in Form no.10CCF certifying that the deduction has been correctly claimed in accordance with the provisions of this section, should be submitted along with the return of income.
 - (b) A copy of the permission obtained under section 23(1)(a) of the Banking Regulation Act, 1949 should also be furnished along with the return of income.

11.3.10 Deduction in respect of income of co-operative societies [Section 80P]

- (i) Under this section, certain specified income of a co-operative society would be allowed as a deduction, provided such income is included in the gross total income of the society.
- (ii) The following items of income would be fully allowed as deduction -
 - (1) income from the business of banking or providing credit facilities to its members; or
 - (2) income from a cottage industry; or
 - (3) income from the marketing of the agricultural produce grown by its members; or
 - (4) income derived from the purchase of agricultural implements, seeds, livestock or other articles intended for agriculture or for the purpose of supplying them to its members; or
 - (5) income from processing without the aid of power, of the agricultural produce of its members; or
 - (6) the business income of labour co-operative societies and societies engaged in fishing and other allied pursuits, such as catching, curing, processing, preserving, storing and marketing of fish or the purchase of materials and equipment in connection therewith for the purpose of supplying them to their members. However, the exemption in respect of this type of income will be available only in the case of those co-operative societies which, under their rules and by-laws, restrict the voting rights to members who constitute the labour force or who actually carry on the fishing or other allied activities, the co-operative credit societies which provide financial assistance to the society and the State Government.
- (iii) This section also provides that in case of a co-operative society being a primary society engaged in supplying milk, oilseeds, fruits or vegetables raised by its members to a federal milk co-operative society or the Government or a local authority or a Government company or a corporation established by or under a Central, State or Provincial Act (being a company or

corporation engaged in supplying milk, oilseeds, fruits or vegetables, as the case may be, to the public), the whole of the amount of profits and gains of such business would be exempt from tax by way of deduction from the gross total income of the co-operative society.

(iv) Further, a co-operative society which is engaged in activities other than or in addition to those mentioned above, is not liable to pay any income tax on the first ₹ 50,000 of its business income arising from other activities. The limit is ₹ 1,00,000 in the case of consumer co-operative societies. Thus, a co-operative society which is engaged in any business activity besides any of the business activities mentioned in (1) to (6) of (ii) above would not be liable to pay any income tax on the whole of its income derived from any of the activities specified and also on the first ₹ 1,00,000 or ₹ 50,000, as the case may be, of its business income from activities other than those aforesaid.

(v) Any income arising to a co-operative society by way of any interest and dividends derived from its investments with any other co-operative society is deductible in full under this section.

(vi) Any income arising to a co-operative society by way of 'Interest on securities' or 'Income from house property' (chargeable under section 22) is fully deductible under this section where the gross total income of the co-operative society does not exceed ₹ 20,000 and it is not a housing society or an urban consumer's society or a society carrying on transport business or a society engaged in the performance of any manufacturing operations with the aid of power. Thus, a majority of small co-operative societies would not have to pay any income-tax.

(vii) The income derived by a co-operative society from the letting out of godowns or warehouses for storage, processing or facilitating the marketing of commodities is fully allowable as deduction.

(viii) Further, where the co-operative society is also entitled to the deduction available under section 80-IA, the deduction under this section shall be allowed with reference to the gross total income as reduced by the deduction allowable under section 80-IA.

(ix) The benefit under section 80P has been withdrawn in respect of all co-operative banks, other than primary agricultural credit societies (i.e. as defined in Part V of the Banking Regulation Act, 1949) and primary co-operative agricultural and rural development banks (i.e. societies having its area of operation confined to a taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities). This is for the purpose of treating co-operative banks at par with other commercial banks, which do not enjoy similar tax benefits. The scope of the definition of 'income' as given in section 2(24) has accordingly been widened to include within its ambit, the profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members.

(x) Regional Rural Banks not eligible for deduction under section 80P: The CBDT has, through Circular No. 6/2010 dated 20.9.2010, reiterated that Regional Rural Banks are not eligible for deduction under section 80P of the Income-tax Act, 1961 from the assessment year 2007-08 onwards. It has also been clarified that the Circular No. 319 dated 11-1-1982 deeming any Regional Rural Bank to be cooperative society stands withdrawn for application with effect from A.Y.2007-08.

This is consequent to the amendment in section 80P by the Finance Act, 2006, providing

specifically that w.e.f. 1-4-2007, the provisions of section 80P will not apply to any co-operative bank other than a Primary Agricultural Credit Society or a Primary Cooperative Agricultural and Rural Development Bank. The same has been further clarified by this circular.

11.3.11 Deduction in respect of royalty income, etc., of authors of certain books other than text books [Section 80QQB]

- (i) Under section 80QQB, deduction of up to a maximum ₹ 3,00,000 is allowed to an individual resident in India in respect of income derived as author i.e., the deduction shall be the income derived as author or ₹ 3,00,000, whichever is less.
- (ii) This income may be received either by way of a lumpsum consideration for the assignment or grant of any of his interests in the copyright of any book.
- (iii) Such book should be a work of literary, artistic or scientific nature, or of royalties or copyright fees (whether receivable in lump sum or otherwise) in respect of such book.
- (iv) However, this deduction shall not be available in respect of royalty income from textbook for schools, guides, commentaries, newspapers, journals, pamphlets and other publications of similar nature.
- (v) Where an assessee claims deduction under this section, no deduction in respect of the same income may be claimed under any other provision of the Income-tax Act, 1961.
- (vi) For the purpose of calculating the deduction under this section, the amount of eligible income (before allowing expenses attributable to such income) shall not exceed 15% of the value of the books sold during the previous year. However, this condition is not applicable where the royalty or copyright fees is receivable in lump sum in lieu of all rights of the author in the book.
- (vii) For claiming the deduction, the assessee shall have to furnish a certificate in the prescribed manner in the prescribed format, duly verified by the person responsible for making such payment, setting forth such particulars as may be prescribed.
- (viii) Where the assessee earns any income from any source outside India, he should bring such income into India in convertible foreign exchange within a period of six months from the end of the previous year in which such income is earned or within such further period as the competent authority may allow in this behalf for the purpose of claiming deduction under this section.
- (ix) The competent authority shall mean the Reserve Bank of India or such other authority as is authorised under any law for the time being in force for regulating payments and dealings in foreign exchange.

11.3.12 Deduction in respect of royalty on patents [Section 80RRB]

- (i) This section allows deduction to a resident individual in respect of income by way of royalty of a patent registered on or after 1.4.03 up to an amount of ₹ 3 lakhs.
- (ii) This deduction shall be available only to a resident individual who is registered as the true and first inventor in respect of an invention under the Patents Act, 1970, including the co-owner of the patent.
- (iii) This exemption shall be restricted to the royalty income including consideration for

transfer of rights in the patent or for providing information for working or use thereof in India.

(iv) The exemption shall not be available on any consideration for sale of product manufactured with the use of the patented process or patented article for commercial use.

(v) In respect of any such income which is earned from sources outside India, the deduction shall be restricted to such sum as is brought to India in convertible foreign exchange within a period of 6 months or extended period as is allowed by the competent authority (Reserve Bank of India). For claiming this deduction the assessee shall be required to furnish a certificate in the prescribed form signed by the prescribed authority, alongwith the return of income.

(vi) No deduction in respect of such income will be allowed under any other provision of the Income-tax Act, 1961.

(vii) Where the patent is subsequently revoked or the name of the assessee was excluded from the patents register as patentee in respect of that patent, the deduction allowed during the period shall be deemed to have been wrongly allowed and the assessment shall be rectified under the provisions of section 155.

(viii) The period of 4 years for rectification shall be reckoned from the end of the previous year in which the order of the revocation of the patent is passed.

11.3.13 Deduction in respect of interest on deposits in savings accounts [Section 80TTA]

(i) Section 80TTA provides that in case the gross total income of an assessee, being an individual or a Hindu Undivided Family, includes any income by way of an interest on deposits in a saving account (not being time deposits, which are deposits repayable on expiry of fixed periods), deduction up to ₹ 10,000 in aggregate shall be allowed while computing the total income of such assessee. Such deduction shall be allowed in case the saving account is maintained with:

- (1) a banking company to which the Banking Regulation Act, 1949, applies (including any bank or banking institution referred to in section 51 of that Act);
- (2) a co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank); or
- (3) a post office.

(ii) However, if the aforesaid income is derived from any deposit in a savings account held by, or on behalf of, a firm, an AOP/BOI, no deduction shall be allowed in respect of such income in computing the total income of any partner of the firm or any member of the AOP or any individual of the BOI.

(iii) In effect, the deduction under this section shall be allowed only in respect of the income derived in form of the interest on the saving bank deposit (other than time deposits) made by the individual or Hindu Undivided Family directly.

Illustration 13

Mr. Gurnam, aged 62 years, earned professional income (computed) of ₹ 5,50,000 during the year ended 31.03.2014. He has earned interest of ₹ 14,500 on the saving bank account with

11.59 Income Tax

State Bank of India during the year. Compute the total income of Mr. Gurnam for the assessment year 2014-15 from the following particulars:

- (i) Life insurance premium paid to Birla Sunlife Insurance in cash amounting to ₹ 25,000 for insurance of life of his dependent parents. The insurance policy was taken on 15.07.2012 and the sum assured on life of his dependent parents is ₹ 1,25,000.
- (ii) Life insurance premium of ₹ 25,000 paid for the insurance of life of his major son who is not dependent on him. The sum assured on life of his son is ₹ 1,75,000 and the life insurance policy was taken on 18.04.2011.
- (iii) Life insurance premium paid by cheque of ₹ 22,500 for insurance of his life. The insurance policy was taken on 08.09.2012 and the sum assured is ₹ 2,00,000.
- (iv) Subscription to long-term infrastructure bonds amounting to ₹ 25,000.
- (v) Premium of ₹ 16,000 paid by cheque for health insurance of self and his wife.
- (vi) ₹ 1,500 paid in cash for his health check-up and ₹ 4,500 paid in cheque for health check-up for his parents.
- (vii) Paid interest of ₹ 6,500 on loan taken from bank for MBA course pursued by his daughter.
- (viii) A sum of ₹ 15,000 donated in cash to an institution approved for purpose of section 80G for promoting family planning.

Solution

Computation of total income of Mr. Gurnam for the Assessment Year 2014-15

Particulars	₹	₹	₹
Professional Income (computed)			5,50,000
Interest on saving bank deposit			<u>14,500</u>
Gross Total Income			5,64,500
Less: Deduction under Chapter VIA			
Under section 80C (See Note 1)			
Life insurance premium paid for life insurance of:			
- major son	25,000		
- self ₹ 22,500 restricted to 10% of ₹ 2,00,000	<u>20,000</u>	45,000	
Under section 80D (See Note 3)			
Premium paid for health insurance of self and wife by cheque	16,000		
Payment made for health check-up:			
- Self ₹ 1,500			
- His Parents ₹ <u>4,500</u>			
₹ <u>6,000</u> restricted to	<u>5,000</u>	21,000	

Under section 80E			
For payment of interest on loan taken from bank for MBA course of his daughter		6,500	
Under section 80TTA (See Note 5)			
Interest on savings bank account ₹ 14,500 restricted to		<u>10,000</u>	<u>82,500</u>
Total Income			<u>4,82,000</u>

Notes:

- (1) As per section 80C, no deduction is allowed in respect of premium paid for life insurance of parents whether they are dependent or not. Therefore, no deduction is allowable in respect of ₹ 15,000 paid as premium for life insurance of dependent parents of Mr. Gurnam.

As per the amendment made by Finance Act, 2012, deduction shall be allowed in respect of premium paid for life insurance only to the extent of 10% of sum assured in respect of insurance policy issued after 01.04.2012. In case the insurance policy is issued before 01.04.2012, deduction of premium paid on life insurance policy shall be allowed up to 20% of sum assured.

Therefore in the present case, deduction of ₹ 25,000 is allowable in respect of life insurance of Mr. Gurnam's son since the insurance policy was issued before 01.04.2012 and the premium amount is less than 20% of ₹ 1,75,000. However, in respect of premium paid for life insurance policy of Mr. Gurnam himself, deduction is allowable only up to 10% of ₹ 2,00,000 since, the policy was issued after 01.04.2012 and the premium amount exceeds 10% of sum assured.

- (2) Deduction under section 80CCF for subscription to long-term infrastructure fund was allowed up to A.Y. 2012-13. Therefore, no deduction for the same is allowable for A.Y. 2014-15.
- (3) As per section 80D, in case the premium is paid in respect of health of a person specified therein and for health check-up of such person who is a senior citizen i.e., aged 60 years or more, deduction shall be allowed up to ₹ 20,000. Further, deduction up to ₹ 5,000 in aggregate shall be allowed in respect of health check-up of self, spouse, children and parents. In order to claim deduction under section 80D, the payment for health-check up can be made in any mode including cash. However, the payment for health insurance premium has to be paid in any mode other than cash.

Therefore, in the present case, deduction of ₹ 16,000 is allowed in respect of premium paid for health insurance of self and wife, since Mr. Gurnam is a senior citizen and the payment is made by cheque. Also, the aggregate value of premium paid for health insurance and the payment for health check-up is ₹ 17,500 (₹ 16,000 + ₹ 1,500), which is less than ₹ 20,000. Further, deduction up to a maximum of ₹ 5,000 is allowable in respect of health check-up of self and his parents. This implies that ₹ 3,500 is allowable for health check-up of parents which falls within the additional limit of ₹ 20,000 for mediclaim premium and expenditure on preventive health check-up of parents.

- (4) No deduction shall be allowed under section 80G in case the donation is made in cash of a sum exceeding ₹ 10,000. Therefore, no deduction is allowed under section 80G in respect of donation made to institution approved therein.

- (5) As per section 80TTA, deduction shall be allowed from the gross total income of an individual or Hindu Undivided Family in respect of income by way of interest on deposit in the savings account included in the assessee's gross total income, subject to a maximum of ₹ 10,000. Therefore, a deduction of ₹ 10,000 is allowable from the gross total income of Mr. Gurnam, though the interest from savings bank account is ₹ 14,500.

11.4 Other Deductions

Deduction in the case of a person with disability [Section 80U]

- (i) Section 80U harmonizes the criteria for defining disability as existing under the Income-tax Rules with the criteria prescribed under the Persons with Disability (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995.
- (ii) This section is applicable to a resident individual, who, at any time during the previous year, is certified by the medical authority to be a person with disability. A deduction of ₹ 50,000 in respect of a person with disability and ₹ 1,00,000 in respect of a person with severe disability (having disability over 80%) is allowable under this section.
- (iii) The benefit of deduction under this section has also been extended to persons suffering from autism, cerebral palsy and multiple disabilities.
- (iv) The assessee claiming a deduction under this section shall furnish a copy of the certificate issued by the medical authority in the form and manner, as may be prescribed, along with the return of income under section 139, in respect of the assessment year for which the deduction is claimed.
- (v) Where the condition of disability requires reassessment, a fresh certificate from the medical authority shall have to be obtained after the expiry of the period mentioned on the original certificate in order to continue to claim the deduction.

Inter-Relationship between Accounting and Taxation

Are accounting principles and accounting standards recognized under taxation laws? Apparently, this question seems to be very simple. However, when you delve into the depth of the question, you may find that there are conflicting answers – Yes and No. The answer may be yes or no depending on the specific issue in taxation in respect of which the question is raised. In this chapter, we have tried to make an effort to analyse the different facets of this question and find an appropriate answer.

This chapter gives a macro view of the inter-relationship between accounting and taxation. It spells out the extent of recognition of the accounting principles by the judicial forums in settling tax disputes, the extent of convergence and divergence between Accounting Standards and the income-tax law, the treatment of income-tax expense under Accounting Standards, the relevance of method of accounting under income-tax law, the differences in the method of accounting of tax, duty etc. in valuation of stock as per Accounting Standard and the income-tax law, the requirement of compulsory maintenance of prescribed books of account under the income-tax law and the relevance of profit and loss account prepared under the Companies Act, 1956 for levy of Minimum Alternate Tax (MAT). First of all, let us understand the extent of recognition of the accounting principles by the judicial forums while settling tax disputes.

12.1 Recognition of accounting principles by judicial forums while settling tax disputes

Various judicial authorities in the country, including the Supreme Court of India, have recognized the accounting principles and accounting standards laid down by the ICAI while deciding tax disputes. There have also been instances when Courts have purposefully synchronized the Statements/Guidance Notes/Accounting Standards issued by the Institute while deciding about certain issues from the taxation point of view. However, there have also been occasions when appellate and judicial forums have not followed the accounting principles and Accounting Standards in the context of determining certain issues under the tax laws. This is for the reason that the courts, having recognized the authenticity of accounting principles and Accounting Standards, have felt that in the matter of computation of income, effect should be given to the specific provisions of the tax laws.

In *Challapalli Sugars Ltd. v CIT* 98 ITR 167, the Supreme Court, while deciding the question of expenditure during construction period, held that interest paid on monies borrowed during construction period should be capitalized. While laying down this principle, the Supreme Court observed that it would be necessary to ascertain the connotation of the expression 'actual cost' in

accordance with the normal rules of accounting. Accordingly, the Apex Court held that the actual cost will include the interest paid on monies borrowed during the construction period.

In *Tuticorin Alkali Chemicals and Fertilizers Ltd. v. CIT* 227 ITR 172, the Supreme Court referred to the *Challapalli Sugars Ltd's* case and observed that the ICAI is a recognized authority on accounting principles and its view has to be respected. However, while dealing with the question of taxability of interest income from investment of borrowed funds prior to commencement of business, the Court did not follow the research publication and Accounting Standard of the Institute and held that the income was taxable under the head "Income from other sources" as it arose from an independent source of income not connected with the construction activities or business activities. The Supreme Court observed that though the Court had very often referred to accounting practice for ascertainment of profits, when the question was whether a receipt of money was taxable or not or whether certain deductions from that receipt were permissible in law or not, the question had to be decided according to the principles of taxation laws and not only in accordance with accountancy practice.

When a similar issue came up before the Supreme Court again in *CIT v. Bokaro Steel Ltd.* 236 ITR 315, the Supreme Court followed the relevant Accounting Standard and held that rent of quarters given to contractors and charges for plant and machinery given to contractors for use in construction work and interest from advances made to contractors for facilitating the construction work should be deducted from the cost of construction on the ground that these receipts were inextricably linked with the setting up of the capital structure of the company and hence should be viewed as capital receipts which would go to reduce the cost of construction.

The Madhya Pradesh High Court has, in *CIT v. State Bank of Indore* (2005) 146 Taxman 65, observed that the amount of bad debts should be debited to the provision for bad and doubtful debts account and only if such amount is more than the credit balance in the provision for bad and doubtful debts account, the excess is eligible for deduction under section 36(1)(vii). As per generally accepted accounting principles, the allowability of deduction in respect of bad debts is clearly governed by the method of accounting as explained by the High Court in *CIT v. State Bank of Indore*.

The above judicial pronouncements and other similar cases indicate that accounting concepts are now being increasingly recognized for the purpose of tax laws.

12.2 Accounting Standards and Income-tax law - Convergence and Divergence

Now, we shall study the points of similarity and differences between the principles laid down under the Accounting Standards and income-tax law.

The significant points of divergence are as follows -

(1) AS 2 [Valuation of Inventories]

AS 2 recognises Exclusive method of inventory valuation whereas section 145A of the Income-tax Act, 1961 prescribes Inclusive method of inventory valuation. These two methods have been discussed in detail in para 12.5 of this Chapter.

(2) AS 6 [Depreciation Accounting]

(i) The basis for provision of depreciation as per this Accounting Standard is the estimated useful life of an asset. However, under the Income-tax Act, 1961, the useful life of an asset is not relevant. The concept of "block of assets" is applicable and the rates of depreciation are higher under the Income-tax Act, 1961 with the objective of providing incentive to the assessee. Further, incentive is also provided by way of additional depreciation in respect of new plant and machinery installed by assessee engaged in the manufacture or production of any article or thing or in the business of generation or generation and distribution of power.

(ii) The Accounting Standard provides for allowance of depreciation on revalued amount in the case of revaluation. Under the Income-tax Act, 1961, depreciation is allowed only on the written down value of block of assets. Revaluation is not recognized for income-tax purposes.

(iii) For the purpose of claiming depreciation under section 32, the asset, in respect of which the depreciation is claimed, must have been used for the purpose of business or profession. However, use of asset is not a pre-condition for provision of depreciation under AS 6.

(3) AS 11 [Accounting for the Effects of Changes in Foreign Exchange Rates]

As per AS 11, exchange differences relating to a liability incurred for the purpose of acquiring fixed assets, which are carried in terms of historical cost, cannot be adjusted in the carrying amount of the respective fixed assets. The exchange difference has to be charged to profit and loss account. However, section 43A requires such exchange differences to be adjusted against the actual cost of the asset. Such adjustment has to be made in the year in which the actual payment is made irrespective of the method of accounting followed by the assessee.

However, it may be noted that in the case of companies, the exchange difference relating to acquisition of a depreciable capital asset can be adjusted against the cost of the asset, at the option of the enterprise¹. Such option is irrevocable and has to be applied to all such foreign currency monetary items.

(4) AS 13 [Accounting for Investments]

As per this Standard, long-term investments should be carried at cost and provision should be made to recognize a decline other than temporary in the value of long-term investments. Such reduction should be determined and made for each investment individually. However, under the Income-tax Act, 1961 there is no provision to recognize a decline in the value of investments. Only if the investments are disposed off, the profit/loss on account of the same is recognized. In *Kerala Small Industries Development Corporation Ltd. v. CIT (2004) 270 ITR 0452*, the assessee had written off ₹ 80 lacs, representing investment in shares of co-operative societies, in its profit and loss account considering the fact that the said co-operative societies were either defunct or under liquidation. The High Court observed that any loss on shares representing investment of the assessee cannot be termed as trading/revenue loss. Further, the High Court observed that the reduction in the value of shares was effected through book entries only and there was no actual

¹ Necessary process is being followed to make this option applicable to non-corporate entities also.

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

Note – All entities are encouraged to follow AS-30 [Financial Instruments: Recognition and Measurement] in respect of shares held as investments.

(5) AS 14 [Accounting for Amalgamations]

As per this Standard, amalgamation expenses incurred by the transferee company should be debited to profit and loss account where the amalgamation is in the nature of merger and to Goodwill/Capital reserve account where the amalgamation is in the nature of purchase. Under section 35DD of the Income-tax Act, 1961, deduction of one-fifth of such expenditure is allowed for five successive previous years, beginning with the previous year in which amalgamation takes place. Further, the Income-tax Act, 1961 does not distinguish between amalgamation in the nature of merger and amalgamation in the nature of purchase.

(6) AS 18 [Related Party Disclosures]

This Standard prescribes disclosure of related party relationships and transactions between a reporting enterprise and its related parties. It does not prescribe any accounting requirement. However, under the Income-tax Act, 1961, a specific disallowance has been provided. Under section 40A(2), where the assessee incurs any expenditure in respect of which a payment has been or is to be made to a relative or associate concern, so much of the expenditure as is considered to be excessive or unreasonable shall be disallowed by the Assessing Officer. Further, the transfer pricing provisions in the Income-tax Act, 1961, provide for application of “arm’s length price” for determining the income from an international transaction with an associated enterprise or a specified domestic transaction.

For the meanings of international transaction, specified domestic transaction and arm length price, please refer to Chapter-16 on Transfer Pricing.

(7) AS 19 [Leases]

The leases are classified into finance leases and operating leases as per this Standard. A finance lease is a lease that transfers substantially all risks and rewards incidental to ownership of an asset. In operating lease, only the right to use the asset is transferred. Depreciation on leased asset is allowable as per AS 6 in the hands of the lessee in case of a finance lease. However, AS 6 will have no implication on the allowance of depreciation on assets under the provisions of the Income-tax Act, 1961. The owner of the asset (i.e., the lessor) is entitled to depreciation under section 32 of the Income-tax Act, 1961, if the asset is used in the course of his business. This has been clarified by *Circular No.2 dated 9.2.2001. The Apex Court, in I.C.D.S. Ltd. v. CIT (2013) 350 ITR 527, held that section 32 requires that the asset must be used in the course of business. It did not mandate actual usage by the assessee itself. Therefore, the lessor is entitled to claim depreciation since he is using the asset in the course of his leasing business.*

Lease rentals from finance lease are apportioned between finance income and reduction of lease receivable outstanding in the books of the lessor as per AS 19. Only finance income is credited to the profit and loss account whereas the full lease rental is treated as income for tax purposes. Similarly, in the books of the lessee, lease rental is apportioned between finance charges and reduction of liability. Only the finance charges are debited to the profit and loss account whereas the full lease rental is deductible for tax purposes.

(8) AS 26 [Intangible Assets]:

As per para 56 of AS 26 "Intangible Assets", some expenditures are incurred to provide future economic benefits to an enterprise but no intangible asset or other asset is acquired or created that can be recognized. In this case, the expenditure is recognized as an expense when it is incurred, for example, preliminary expenses. However, section 35D provides for amortization of preliminary expenses over a period of five years.

(9) AS 28 [Impairment of Assets]

As per this Standard, if the carrying amount of an asset exceeds its recoverable value, the excess is impairment loss. Such loss should be provided for in the statement of profit and loss. It must be noted that impairment provision is in addition to the depreciation provided as per AS-6. However, there is no such provision for impairment loss under the income-tax law.

The significant points of convergence are as follows -

(1) AS 2 [Valuation of Inventories]

As per AS 2, inventory has to be valued at lower of cost and net realizable value. This method is also recognized for income-tax purposes in case of a going concern. Only in a case where the fundamental accounting assumption of going concern no longer holds good, the closing stock has to be valued at market price. The Supreme Court, in *ALA Firm v. CIT (1991) 189 ITR 285*, held that when a firm is dissolved and the business is discontinued, closing stock taken over by the partner has to be valued at market value and not at cost. The principle involved in this case is that the fundamental accounting assumption of going concern cannot be applied for valuing stock-in-trade at the time of dissolution.

(2) AS 9 [Revenue Recognition]

This standard provides that revenue recognition should be postponed if there is significant uncertainty regarding collectability. This principle has been recognized for tax purposes also by the Supreme Court in the case of *UCO Bank v. CIT 237 ITR 889*, where it was held that interest on sticky loans would not accrue if the same was not recoverable. The decision of the Allahabad High Court in *CIT v. U.P. Financial Corporation (2005) 143 Taxman 47* that interest accrual should be postponed where suits for recovery of interest-bearing loans are pending, is also in consonance with this principle enunciated in AS 9.

12.3 Treatment of income-tax expense under Accounting Standards

AS-3 and AS-22 provides for the accounting treatment of income-tax expense. In particular, AS-22 on "Accounting for taxes on income" is very important in this regard and hence has been discussed in some length. Let us try to understand the accounting treatment of income-tax expense as per these Standards.

(1) AS 3 [Cash flow statement]: As per this Standard, cash flow on account of income-tax has to be shown as an operating activity unless it can be specifically identified with an investing or financing activity. If income-tax paid is segregated between these activities, then total tax paid should also be disclosed. Income-tax paid should be shown net of TDS.

(2) AS 22 [Accounting for taxes on income]: Accounting for taxes on income should be in accordance with AS 22, irrespective of whether such taxes are imposed by an Indian law or by the law of a foreign country. Prior to AS 22, corporates were making a provision for the actual tax liability calculated in accordance with the Income-tax Act, 1961 (i.e., current tax). The accounting effect for differences between taxable income and accounting income was not given. In the case of a loss-making entity, no provision for taxation was made. Neither was any entry passed for accounting for tax savings as a result of the loss. However, such treatment is not permitted under AS 22. As per AS 22, the amount to be included in respect of income-tax in the profit and loss account should be the current tax plus or minus the deferred tax.

Current tax is the tax determined in accordance with the provisions of the Income-tax Act, 1961. Deferred tax is the tax effect of timing differences. There is always a difference between the accounting income and the taxable income. AS 22 requires classification of these differences into permanent differences and timing differences.

Permanent differences: Permanent differences are those differences which originate in one period and do not reverse subsequently. These differences will not at all reverse in subsequent periods. These differences do not result in deferred tax assets (DTAs) or deferred tax liabilities (DTLs). Such differences are on account of -

- (i) Recognition of revenues/gains/expenses/loses in the profit and loss account but not for income-tax computation. One example is goodwill, which is amortised in accounts. However, the same is not a deductible expense while computing income-tax. Another example is unrealised exchange gain, which is credited to profit and loss account but not taxed as income.
- (ii) Recognition of revenues/gains/expenses/losses for income-tax purposes but not in the profit and loss account for accounting purposes. One example is expenditure in respect of which weighted deduction is allowable under the Income-tax Act, 1961, namely, contribution made for research in social science or statistical research or any other research, which is eligible for a deduction of 125% under section 35 of the Income-tax Act, 1961. The excess deduction of 25% is not recognized in the profit and loss account but considered for computation of taxable income.

It may be noted that no accounting adjustments are necessary for tax effects of permanent differences.

Timing differences: Timing differences are the differences between the accounting income and the taxable income that originate in one period and are capable of reversal in one or more subsequent periods. The words 'capable of reversal' means that there are chances of reversal, however good or remote they may be. It does not, however, indicate 100% certainty of reversal.

Timing differences arise only in respect of incomes/expenses which are considered both in the profit and loss account as well as for computation of taxable income, although, in different periods. Some examples of timing differences are given below -

- (1) Expenses debited to profit and loss account but allowed for tax purposes in subsequent years, for example -
 - (i) Expenditure covered by section 43B of the Income-tax Act, 1961, which are allowed only in the year of actual payment. However, in the previous year in which the expenditure is

incurred, it can be claimed as deduction, provided it is paid on or before the due date for filing the return of income.

- (ii) Any interest, royalty, fees for technical services payable outside India or in India to a non-resident, on which tax has not been deducted at source and hence, disallowed during the previous year. However, the same has been allowed for tax purposes in the subsequent year when such tax is deducted and paid.
- (iii) Any interest, commission or brokerage, fees for professional services or fees for technical services payable to a resident, on which tax has not been deducted at source and hence disallowed during the previous year. However, the same has been allowed in the subsequent year when such tax is deducted and paid.
- (iv) Provisions made for liabilities in the books of account. However, deduction is allowed under the Income-tax Act, 1961 in the subsequent years when the liability crystallizes e.g., provision for warranties.
- (v) Preliminary expense written off completely in the year in which they are incurred as per AS 26 but allowed to be amortised over 5 years for tax purposes as per section 35D.
- (2) Difference between depreciation as per books of account and depreciation allowable for tax purposes under section 32.
- (3) A deduction which is allowed for tax purposes on the basis of a deposit made, for example, tea/coffee/rubber development account scheme under section 33AB and site restoration fund under section 33ABA. The withdrawal from such deposit is debited to the profit and loss account in the subsequent years.
- (4) Income credited to profit and loss account in a particular year but brought to tax in a later year. For example, where a capital asset is converted into stock in trade, the capital gains would be charged to tax only in the previous year in which the stock in trade is sold.

A timing difference may result in a deferred tax asset or a deferred tax liability.

A deferred tax asset arises on account of –

- (i) Recognition of revenue/gain in an earlier period for tax purpose, but in a later period for accounting purpose.
e.g. operating lease rentals, in a case where the amount received in an earlier year is high, the same would be recognized as income for tax purpose. However, for accounting purpose, the recognition would be deferred since such lease rentals are recognized on a straight line basis as per AS-19.
- (ii) Recognition of expenses/losses in an earlier period for accounting purpose, but in a later period for tax purpose.
e.g. (i) Expenditure in relation to which section 43B applies, in respect of which payments have not been made on or before the due date for filing the return of income. Such expenditure will be allowed for tax purposes in the year of actual payment.
(ii) Preliminary expenses written off during the year in the profit and loss account but deferred over a period of 5 years for tax purposes as per section 35D.

A deferred tax liability arises on account of -

- (i) Recognition of revenue/gain in an earlier period for accounting purpose, but in a later period for tax purpose -
e.g. conversion of a capital asset into stock-in trade – recognized in the year of conversion for accounting purpose but only in the year of sale of stock-in-trade for tax purpose.
- (ii) Recognition of expenses/losses in an earlier period for tax purpose, but in a later period for accounting purpose -
e.g. Depreciation, since the tax depreciation is higher than the depreciation as per accounting books on account of the higher rates of depreciation under the Income-tax Act.

The tax effect of timing difference i.e. deferred tax should be treated in the following manner –

- (i) the deferred tax should form part of the tax expenses in the profit and loss account; and
- (ii) it should be accounted as a deferred tax asset (DTA)/deferred tax liability (DTL) in the balance sheet.

The criteria for recognizing DTAs are -

- (i) In a case where there are unabsorbed losses/depreciation under the tax laws –
DTA should be recognized only to the extent there is virtual certainty supported by convincing evidence that adequate future taxable income will be available against which DTAs can be realised. Virtual certainty means certain for all practical purposes. Mere forecasts of performance would not satisfy this criterion. Further, virtual certainty is not a matter of perception. It has to be backed up by convincing evidence i.e. evidence available at the reporting date in concrete form e.g. a profitable binding export order, cancellation of which would attract high penalty in the hands of the defaulting person. Future profitability projections would not, in isolation, be taken as convincing evidence, even though they may be submitted to an outside agency like a bank and accepted by them.
- (ii) In any other case (i.e. where there are no unabsorbed losses/depreciation under tax laws) –
DTA should be recognized and carried forward only to the extent there is reasonable certainty that adequate future taxable income would be available against which DTAs can be realised.

Accounting treatment for DTA

The accounting treatment for DTA is as shown hereunder -

- (i) Entry to be passed in the year in which timing difference originates -

DTA A/c Dr.
To Profit and Loss A/c

(This is the entry to be passed when the DTA is recognized on meeting the virtual certainty/reasonable certainty criteria, as the case may be. The amount to be debited to

the DTA a/c and credited to the profit and loss A/c is the amount arrived at by multiplying the timing difference with the tax rate applicable for the year)

(ii) Entry to be passed in the subsequent years -

The carrying amount of DTAs has to be reviewed at each balance sheet date. The carrying amount of a DTA has to be written down to the extent that it is no longer reasonably certain or virtually certain, as the case may be, that adequate future taxable income would be available to realize the DTA. Reversal of a previous write-down may be done to the extent it becomes reasonably certain or virtually certain, as the case may be, that adequate future taxable income would be available.

Therefore, in the subsequent years, there should be a review as to whether the recognition criteria is met. If the same is not met, the entire balance should be written off. If the recognition criteria is met, the closing balance of DTA has to be valued applying the tax rate for that year on the unreversed timing difference. The unreversed timing difference is the difference between the timing difference at the beginning of the financial year and the reversal during the year.

Profit and Loss A/c Dr.

To DTA A/c

(This is the entry to be passed in the subsequent years to account for the difference between the opening and closing balance in the DTA a/c which represents reversal of timing difference during the year)

Let us understand these entries with the help of an example –

XYZ Ltd., a domestic company, prepares its accounts on 31st March every year. The company has incurred a loss of ₹ 5,00,000 during the year ended 31.3.2012 and made profits of ₹ 3,00,000 and ₹ 3,50,000 during the years 2012-13 and 2013-14, respectively. The rate of income-tax applicable to the company for all the three assessment years (i.e. A.Y.2012-13, A.Y.2013-14 & A.Y.2014-15) is 30% plus education cess@2% plus secondary and higher education cess@1%. Surcharge is not applicable since the total income does not exceed ₹ 1 crore. The business loss can be carried forward for 8 years. On 31.3.2012, it was virtually certain, supported by convincing evidence, that the company would have adequate taxable income in the future years against which unabsorbed losses can be set-off. You are required to pass accounting entries, assuming that there is no other difference between taxable income and accounting income.

Draft Profit and loss account for the years ended

Particulars	31.3.2012	31.3.2013	31.3.2014
Profit/Loss before giving effect to tax	(5,00,000)	3,00,000	3,50,000
Current tax @ 30.9% of ₹ 1,50,000			(46,350)
Deferred tax			
- Tax effect of timing differences originating during the year [5,00,000 × 30.9%]	1,54,500		

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- Tax effect of timing differences reversing during the year ending -			
31.3.2012 – [3,00,000 × 30.9%]		(92,700)	(61,800)
31.3.2013 – [2,00,000 × 30.9%]			
Profit/Loss after giving effect to tax	(3,45,500)	2,07,300	2,41,850

Entry to be passed for the year ending 31.3.2012

DTA A/c Dr 1,54,500
 To Profit and loss A/c 1,54,500

(DTA on account of tax saving due to carry forward of losses)

Entry to be passed for the year ending 31.3.2013

Profit and loss A/c Dr 92,700
 To DTA A/c 92,700

(Reversal of DTA on account of set-off of brought forward loss against current year income)

Entry to be passed for the year ending 31.3.2014

Profit and loss A/c Dr 61,800
 To DTA A/c 61,800

(Reversal of DTA on account of set-off of brought forward loss against current year income)

Accounting treatment for DTL

The accounting treatment for DTL is as shown hereunder –

- (i) Entry to be passed in the year in which timing difference originates -

Profit and Loss A/c Dr.
 To DTL A/c

(This is the entry to be passed when the DTL is recognized. The amount to be credited to the DTL A/c and debited to the profit and loss account is the amount arrived at by multiplying the timing difference with the tax rate applicable for the year)

- (ii) Entry to be passed in the subsequent years -

DTL A/c Dr.
 To Profit and Loss A/c

(This is the entry to be passed in the subsequent years to account for the difference between the opening and closing balance in the DTL A/c which represents reversal of timing difference during the year. For arriving at the closing balance, the unreversed timing difference should be multiplied by the tax rate applicable for that year)

12.4 Relevance of Method of Accounting under the Income-tax Act, 1961

Having studied the areas of convergence and divergence between Accounting Standards and income-tax laws and how income-tax expense is dealt with in the Accounting Standards, let us proceed to study how the method of accounting assumes importance under the Income-tax Act, 1961.

Section 145 deals with the 'Method of Accounting'. This section provides that the income chargeable under the head "Profits and gains of business or profession" and "Income from other sources" have to be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee (It may be noted that the hybrid method is not permitted under the Income-tax Act, 1961). Therefore, the method of accounting is not relevant in computing income under the heads "Salaries", "Income from house property" and "Capital gains". The income under these heads have to be computed solely on the basis of the provisions contained in the Income-tax Act, 1961. Even in the case of the two heads of income where this section applies *i.e.*, profits and gains of business or profession and income from other sources, wherever specific provisions are made for inclusion of particular income or for disallowance of particular expenditure on cash or accrual basis, then income shall be so computed irrespective of the method of accounting employed. For example, as per section 43B, certain expenditure like taxes, duties etc. are allowable only in the year of payment, irrespective of the previous year in which the liability to pay such sum arose according to the method of accounting regularly employed by the assessee. However, in the case of an assessee following mercantile system of accounting, such expenditure can be claimed as deduction on "due" basis, provided the payment has been made on or before the due date of furnishing the return of income.

The assessee is also required to follow the Accounting Standards notified by the Central Government. The Central Government may notify in the Official Gazette, from time to time, Accounting Standards to be followed by any class of assessee or in respect of any class of income. The Government has, so far, notified two Accounting Standards (TASs) to be followed by all assessee following mercantile system of accounting. Accounting Standard I (TAS I) is on "Disclosure of Accounting policies" and Accounting Standard II (TAS II) is on "Disclosure of prior period and extraordinary items and changes in accounting policies". These standards are more or less on the same pattern as AS 1 and AS 5 issued by the ICAI.²

TAS I [Disclosure of Accounting Policies]: This standard requires disclosure of all significant accounting policies adopted in the preparation and presentation of financial statements. The disclosure of the significant accounting policies should form part of the financial statements. Further, all significant accounting policies should normally be disclosed in one place.

Disclosure of any change in an accounting policy, which has a material effect in the previous year or in the years subsequent to the previous years, is required. Further, the impact of, and the adjustments resulting from, such change, if material, is required to be shown in the financial statements of the period in which such change is made to reflect the effect of such

² The recently issued Exposure Drafts on Revised AS 1 and AS 5 are, however, different from the existing AS 1 and AS 5. Hence, TAS I and TAS II may not be in tandem with the Exposure Drafts on Revised AS 1 and AS 5.

change. In case the effect of such change is not ascertainable, wholly or in the part, the same should be indicated. If a change is made in the accounting policies which has no material effect on the financial statements for the previous year but which is reasonably expected to have a material effect in any year subsequent to previous year, the fact of such change is required to be appropriately disclosed in the previous year in which the change is adopted.

Accounting policies adopted by an assessee should be such as to represent a true and fair view of the state of affairs of the business, profession or vocation in the financial statements prepared and presented on the basis of such accounting policies. For this purpose, the significant accounting considerations governing the selection and application of accounting policies are following, namely:—

- (i) **Prudence:** Provisions should be made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information;
- (ii) **Substance over form:** The accounting treatment and presentation in financial statements of transactions and events should be governed by their substance and not merely by the legal form;
- (iii) **Materiality:** Financial statements should disclose all material items, the knowledge of which might influence the decision of the users of the financial statements.

If the fundamental accounting assumptions relating to Going Concern, Consistency and Accrual are followed in financial statements, specific disclosure in respect of such assumptions is not required. If a fundamental accounting assumption is not followed, such fact should be disclosed.

Meaning of the terms used in this standard

- (a) “Accounting policies” means the specific accounting principles and the methods of applying those principles adopted by the assessee in the preparation and presentation of financial statements;
- (b) “Accrual” refers to the assumption that revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate;
- (c) “Consistency” refers to the assumption that accounting policies are consistent from one period to another;
- (d) “Financial Statements” means any statement to provide information about the financial position, performance and changes in the financial position of an assessee and includes balance sheet, profit and loss account and other statements and explanatory notes forming part thereof;
- (e) “Going concern” refers to the assumption that the assessee has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the business, profession or vocation and intends to continue his business, profession or vocation for the foreseeable future.

TAS II [Disclosure of Prior Period and Extraordinary items and Changes in Accounting Policies]: This standard requires separate disclosure of prior period items in the profit and

loss account in the previous year, along with their nature and amount, in a manner so that their impact on profit or loss in the previous year can be perceived.

Similarly, disclosure of extraordinary items of the enterprise during the previous year as part of the income in the profit and loss account is required. The nature and amount of each such item should be separately disclosed in a manner so that their relative significance and effect on the operating results of the previous year can be perceived.

This standard imposes a condition that a change in an accounting policy should be resorted to only if the adoption of a different accounting policy is required by statute or if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements by assessee.

Any change in an accounting policy which has a material effect is required to be disclosed. The impact of, and the adjustments resulting from such change, if material, has to be shown in the financial statements of the period in which such change is made to reflect the effect of such change. Where the effect of such change is not ascertainable, wholly or in part, the same should be indicated. If a change is made in the accounting policies which has no material effect on the financial statements for the previous year but which is reasonably expected to have a material effect in years subsequent to the previous years, the fact of such change has to be appropriately disclosed in the previous year in which the change is adopted.

A change in an accounting estimate that has a material effect in previous year has to be disclosed and quantified. Further, any change in an accounting estimate which is reasonably expected to have a material effect in years subsequent to the previous year shall also be disclosed. If a question arises as to whether a change is a change in accounting policy or a change in an accounting estimate, such a question has to be referred to the CBDT for decision.

Meaning of the terms used in this standard

- (a) "Accounting estimate" means an estimate made for the purpose of preparation of financial statements which is based on the circumstances existing at the time when the financial statements are prepared;
- (b) "Accounting policies" means the specific accounting principles and the method of applying those principles adopted by the assessee in the preparation and presentation of financial statements;
- (c) "Extraordinary items" means gains or losses which arise from events or transactions which are distinct from the ordinary activities of the business and which are both material and expected not to recur frequently or regularly. Extraordinary items includes material adjustments necessitated by circumstances which though related to years preceding to the previous years are determined in the previous year;

However, the income or expenses arising from the ordinary activities of the business or profession or vocation of an assessee, though abnormal in amount or infrequent in occurrence, will not qualify as extraordinary item;

- (d) "Financial Statements" means any statement to provide information about the financial position, performance and changes in the financial position of an assessee and includes

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balance sheet, profit and loss account and other statements and explanatory notes forming part thereof;

- (e) "Prior period items" means material charges or credits which arise in the previous year as a result of errors or omissions in the preparation of the financial statements of one or more previous years; However, the charge or credit arising on the outcome of a contingency, which at the time of occurrence could not be estimated accurately will not constitute the correction of an error but a change in estimate and such an item will not be treated as a prior period item.

Therefore, TAS-I and TAS-II have been specifically recognized under the Income-tax Act, 1961. These accounting standards have to be followed by all assesseees following mercantile system of accounting.

Draft Tax Accounting Standards (TASs) recommended by the Accounting Standards Committee for computation of taxable income under the Income-tax Act, 1961

The Accounting Standards Committee, constituted by the CBDT in December 2010, submitted its final report in October, 2012 and recommended the adoption of 14 'Tax Accounting Standards' ("TAS") for computing income under the provisions of the Income-tax Act, 1961 in an objective and precise manner.

The Committee was set up to study and give its recommendations on:

- (1) Harmonization of accounting standards issued by the ICAI with the direct tax laws in India and notification of accounting standards to be adopted under section 145(2) with relevant modifications.*
- (2) The method of determining book profit for the purpose of MAT in case of companies migrating to IFRS in the initial year of adoption and thereafter; and*
- (3) Appropriate amendments required in the Income-tax Act, 1961 in view of transition to Ind-AS regime.*

The Committee, however, focused its recommendations only on harmonization of TAS with the provisions of the Act. The main recommendations of the Committee were:

- (1) TAS to be made applicable only for computation of taxable income and there should be no requirement to maintain separate books of accounts.*
- (2) TAS to be applicable to all categories of taxpayers (without income/ turnover threshold).*
- (3) TAS to be in accord with the provisions of the Act. In case of any conflict, provisions of the Act to prevail.*
- (4) Transitional provisions, wherever required, to be notified along with the TAS.*
- (5) Appropriate modification in the return of income to ensure compliance with the provisions of TAS by the taxpayer. For tax audit cases, the Form 3CD also to be modified to require a tax auditor to certify that the computation of taxable income is made in accordance with the provisions of TAS.*

The Committee examined all the Accounting Standards issued by the ICAI and found that some of the accounting standards are not relevant for the computation of taxable income

under the Act. The Committee noted that some of the accounting standards which were selected for harmonisation with the provisions of the Act mainly relate to disclosure requirements in the financial statements, whilst some others contain matters that are dealt with in the Act. The Committee further noted that the Act already contains detailed provisions on the issues covered by a few accounting standards, for eg. AS 6 Depreciation Accounting. In view of this, the Committee decided that such accounting standards need not be examined for the purpose of harmonisation with the provisions of the Act:

The Committee deliberated whether the accounting standards issued by the ICAI could be notified under section 145(2) of the Act without modifications. The Committee noted that the accounting standards to be notified under Section 145(2) would need to be harmonised with the provisions of the Act. Further, the Committee was of the view that the notified accounting standards should lay down the specific provisions, which would enable computation of taxable income with certainty and clarity. To ensure horizontal equity and uniformity, the notified accounting standards should eliminate alternatives, to the extent possible. The Committee, therefore, decided to draft separate accounting standards for the purpose of notification under Section 145(2) and term such separate accounting standards as TAS.

The Committee, after due deliberations, formulated the drafts of the Tax Accounting Standards (TASs) on the following issues based on the corresponding Accounting Standard issued by the ICAI after making changes to harmonise the same with the provisions of the Act:

1. Disclosure of Accounting Policies	(Corresponding to AS-1)
2. Valuation of Inventories	(Corresponding to AS- 2)
3. Events Occurring After the Previous Year	(Corresponding to AS-4)
4. Prior Period Expense	(Corresponding to AS- 5)
5. Construction Contracts	(Corresponding to AS- 7)
6. Revenue Recognition	(Corresponding to AS- 9)
7. Accounting for Tangible Fixed Assets	(Corresponding to AS- 10)
8. The Effects of Changes in Foreign Exchange Rates	(Corresponding to AS-11)
9. Government Grants	(Corresponding to AS-12)
10. Securities	(Corresponding to AS-13)
11. Borrowing Costs	(Corresponding to AS-16)
12. Leases	(Corresponding to AS-19)
13. Intangible Assets	(Corresponding to AS- 26)
14. Provisions, Contingent Liabilities and Contingent Assets	(Corresponding to AS- 29)

Best Judgment Assessment

Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee or where the method of accounting or accounting standards have not been regularly followed by the assessee, the Assessing Officer may make an assessment in the manner provided in section 144. The assessment made under section 144 is known as "Best Judgement Assessment" as the Assessing Officer, in spite of non-compliance and non-co-operation of the assessee, is expected to make the assessment to the best of his judgement.

Bona fide change in the method of accounting: It is open to the assessee to make a change in the method of accounting if the change does not involve any *mala fide* motive and the assessee regularly follows the changed method of accounting. However, the change should not result in adoption of hybrid method of accounting.

The Supreme Court held, by a majority judgment in *State Bank of Travancore vs. C.I.T. (1985) 50 CTR 290 (SC)*, that in the case of a bank following mercantile basis of accounting, it is the income which has really accrued or arisen to the assessee that is taxable. Whether the income has really accrued or arisen to the assessee must be judged in the light of the reality of the situation. The concept of real income would apply where there has been a surrender of income, which, in theory may have accrued but in the reality of the situation no income had resulted because the income did not really accrue. Where a debt has become bad, deduction can be claimed after complying with the provisions of the Act. Where the Act applies, the concept of real income should not be so read as to defeat the provisions of the Act. The conduct of the parties in treating the income in a particular manner is material evidence of the fact whether income has accrued or not. Mere improbability of recovery, where the conduct of the assessee is unequivocal, cannot be treated as the evidence of the fact that income has not resulted or accrued to the assessee.

An assessee is entitled to change his regular method of accounting by another regular method [*Snow White Food Products Co. Ltd. vs. CIT (No. 2) (1983) 141 ITR 847*]. Where it is found that if an assessee has changed his regular method of accounting by another recognised method and has followed the latter method regularly thereafter it is not open to the revenue authorities to go into the question of *bonafides* of the introduction and continuance of the change. Only in the year where a change in the method of accounting is introduced for the first time, it is to be examined by the revenue authorities, whether the change introduced was meant to be regularly followed. The Calcutta High Court held, in *Seth Chemical Works vs. C.I.T. (1983) 140 ITR 507*, that where an assessee is allowed to change his method of accounting from an assessment year, he has to compute his income on the changed basis only and not on the old basis.

Stock valuation method adopted should not only be consistent but should also be correct for being accepted by tax authorities. The Supreme Court, in *CIT v. British Paints (India) Ltd. (1988) ITR 44*, held that the Assessing Officer is empowered to substitute the correct method in the place of the wrong method adopted by the assessee in valuing closing stock. The Court observed that the wrong method cannot be accepted just because it was consistently followed. Therefore, the Court held that the Assessing Officer was justified in substituting the incorrect method by a correct method.

In *CIT vs. Carborundum Universal Limited (1984) 149 ITR 759*, the company was regularly valuing its stock under total cost method, which excluded certain expenses which were to be included under the former method. The change was *bona fide* and was intended to be followed by the company consistently in the future. The company wanted to apply the new method in the first year of adoption for the valuation of closing stock only and retain the valuation of opening stock of the relevant year as per the old method. This was of course detrimental to the revenue in that year. The question as to whether the company could do so went before the Madras High Court. It was held that (i) since the change in the method of valuation of stock was *bona fide* and intended to be

followed year after year, the company was entitled to change the method of valuation, (ii) merely because the change was detrimental to the revenue, the assessee could not be denied the right to change, since this detriment would be ironed out in the coming years, (iii) if the assessee was forced to apply the new method of valuation to the opening stock then also it will mean change in the valuation of previous year's closing stock and so on necessitating modification of earlier assessments. This in effect would mean that the assessee would not be able to change the method at all, (iv) so long as the method of valuation adopted by the assessee got recognition from the practising accountants and the commercial world, the adoption of that method could not be quashed by the revenue unless the adoption of that method was found to be not *bona fide* or restricted for a particular year.

12.5 Valuation of Inventory [Section 145A vs. AS 2]

As per section 145A of the Income-tax Act, 1961, the valuation of purchase and sale of goods and inventory for the purposes of determining the income chargeable under the head "Profits and gains of business or profession" has to be-

- a) in accordance with the method of accounting regularly employed by the assessee; and
- b) further adjusted to include the amount of any tax, duty, cess or fee, by whatever name called, actually paid or incurred by the assessee to bring the goods to the place of its location and condition as on the date of valuation.

The intention of section 145A is to ensure that the sale of goods and purchase of goods are grossed up by including the excise duty, tax, cess, etc., Inventory should also be grossed up in the same manner. However, the CENVAT credit, if any available towards such duty paid should not be taken into account.

There are two methods for accounting of tax, duty etc. while preparing accounts. They are the Inclusive method and the Exclusive method. Under the Inclusive method, the amounts are grossed up whereas under the Exclusive method, the figures are shown net of CENVAT credit. Section 145A requires assessee to follow only the Inclusive method, whereas AS 2 on "Valuation of Inventories" requires adoption of Exclusive method. Let us try to understand the effect of following the inclusive method and exclusive method with the help of an example –

Particulars	Amount
Opening stock of raw material	Nil
Cost of raw material purchased inclusive of CENVAT credit	₹ 5,00,000
CENVAT credit available	₹ 20,000
Excise duty (Gross)	₹ 35,000
Manufacturing expenses	₹ 15,000
Sale value of finished goods	₹ 6,25,000
Closing stock of raw material	15% of purchases

TRADING ACCOUNT

[Where Inclusive method is adopted as per the requirement of section 145A]

	₹		₹
To Raw material consumed		By Sales	6,25,000
Raw material purchased	5,00,000		
Less: Closing stock of raw materials	<u>75,000</u>		
	4,25,000		
To Manufacturing expenses	15,000		
To Excise duty (35,000 – 20,000)	15,000		
To Gross profit	<u>1,70,000</u>		
	6,25,000		6,25,000

TRADING ACCOUNT

[Where Exclusive method is adopted as per the requirement of AS 2]

	₹		₹
To Raw material consumed		By Sales	6,25,000
Raw material purchased	4,80,000		
Less: Closing stock of raw materials	<u>72,000</u>		
	4,08,000		
To Manufacturing expenses	15,000		
To Excise duty	35,000		
To Gross profit	<u>1,67,000</u>		
	6,25,000		6,25,000

Section 145A requires the assessee to follow the Inclusive method, which results in higher profits. However, it is significant to note that if a higher value of closing stock is shown in a particular year, the same will be the opening stock in the next year. Therefore, the increase in profits in one year would be compensated by a reduction in profits in the subsequent year. In short, the effect of adopting the inclusive method under section 145A would be to prepone the booking of profits to the preceding year. The tax collection would also be preponed resulting in earlier accrual of revenue to the Government. This would happen in a case where there is a progressive increase in the closing stock every year.

Under the Inclusive method, in the example given above, the closing stock is shown at ₹ 75,000 and the excise duty claim of ₹ 35,000 is reduced by the entire CENVAT credit of ₹ 20,000 available. If CENVAT credit is availed by the assessee only to the extent of consumption of raw material, the net effect would be the same. The excise duty of ₹ 3,000 (being 4% of Closing Stock of ₹ 75,000) attributable to closing stock is included in the closing stock value. Therefore, a sum of ₹ 17,000 attributable to raw material consumed (being 4% of raw material consumed of ₹ 4,25,000) should be reduced from ₹ 35,000. This would facilitate the assessee to get a deduction of ₹ 18,000 towards the excise duty for this year. In such a case, the gross profit will be ₹ 1,67,000 which is same as arrived at by following the Exclusive method recommended by AS 2. The Guidance Note on Tax Audit under section 44AB has suggested this approach. Section 145A becomes tax neutral if this approach is adopted. This is explained in the computation shown hereunder -

TRADING ACCOUNT
[Where Inclusive method is adopted]

	₹		₹
To Raw material consumed		By Sales	6,25,000
Raw material purchased	5,00,000		
Less: Closing stock of raw materials	<u>75,000</u>		
	4,25,000		
To Manufacturing expenses	15,000		
To Excise duty (35,000 – 17,000)	18,000		
To Gross profit	<u>1,67,000</u>		
	<u>6,25,000</u>		<u>6,25,000</u>

12.6 Relevance of profit and loss account prepared in accordance with the provisions of Parts II of Schedule VI to the Companies Act, 1956³ for computing book profits for levy of MAT [Section 115JB]

In the case of corporate assessee, if the income-tax payable on the total income as computed under the Income-tax Act, 1961, is less than 18.5% of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable by the assessee on such total income (book profit) shall be the amount of income-tax at the rate of 18.5%.

As per the proviso to section 211(2) of the Companies Act, 1956⁴, certain companies like insurance companies, banking companies, companies engaged in generation or supply of electricity etc., are allowed to prepare their profit and loss account in accordance with the form specified in or under the Act governing such class of company. For the purpose of computation of book profits, such companies are required to prepare their profit and loss account for the relevant previous year in accordance with the provisions of the Act governing such company. Companies, other than companies referred to in the proviso to section 211(2) of the Companies Act, 1956, shall continue to prepare their profit and loss account for the relevant previous year in accordance with the provisions of Part II of Schedule VI to the Companies Act, 1956.

However, any income accruing or arising to a company from life insurance business referred to in section 115B would not be subject to MAT.

The profit and loss account prepared for section 115JB(2) and annual accounts including profit and loss account prepared and placed before the Annual General Meeting should be based on the same accounting policies and accounting standards. Further, the method and rates for calculating the depreciation should also be the same. The net profit as per the profit and loss account would be increased/decreased by the amounts as provided for in the *Explanation* to section 115JB to arrive at the book profit for levy of MAT.

³ Schedule III to the Companies Act, 2013

⁴ Second Proviso to section 129(1) of the Companies Act, 2013

12.7 Conclusion

Having studied the extent of recognition of accounting principles and standards by judicial forums while settling tax disputes and also the similarities and differences in the accounting treatment as per the Accounting Standards and income-tax law, it is now possible to answer the question raised in the beginning of this Chapter i.e. Are accounting principles and accounting standards recognized under taxation laws? As pointed out in the beginning, we can now see that the answer may be yes or no depending on the particular issue in respect of which the question is raised. The treatment of income-tax expense under the Accounting Standards, particularly AS 22, which illustrates the treatment of differences between accounting income and taxable income, has also been explained in some length in this chapter. This chapter also gives a bird's eye view of the relevance of the method of accounting and the significance of Inclusive and Exclusive method of accounting of tax, duty etc. while valuing stock. Finally, the relevance of profit and loss account prepared under the Companies Act, 1956 for levy of MAT has also been explained to help in further understanding of the inter-relationship between accounting and taxation.

Assessment of Various Entities

13.1 Assessment of Companies

13.1.1 Meaning of 'Company' for purposes of income-tax: Under the Income-tax Act, 1961, the term "company" has a much wider meaning than what has been given to it under the Companies Act. The company is considered as a 'person' for all purposes of assessment proceedings [Section 2(iii)].

Section 2(17) of the Income-tax Act, 1961 defines a company for income-tax purposes. Accordingly, 'company' means (1) any Indian company (as defined in Section 2(26)) or (2) any body corporate, incorporated by or under the laws outside India or (3) any institution, association or body assessable as a company either under the Indian Income-tax Act, 1922 or for any assessment year commencing on or before 1st April, 1970, or (4) any institution, association, or body, whether incorporated or not and whether Indian or non-Indian which is declared by general or special order of the CBDT to be a company.

13.1.2 Tax Liability: A company is a juristic person and becomes a body corporate upon the issue of the certificate of incorporation; it is a legal person separate and distinct from the share holders. The legal personality of a company created by the statute can also be modified by legal fiction. For the purpose of income-tax, even an unincorporated association may be declared by the Board to be a company and, consequently, what is not a legal entity in the eyes of law may be assessable as a company. Even companies which have no share capital and those which are limited by guarantee are companies for purposes of the Income-tax Act, 1961 even though the general framework of the Act mainly contemplates companies with share capital. A chamber of commerce or any association without a profit motive and registered under section 25 of the Companies Act, 1956¹ would be a company for income-tax purposes. The tax-liability of such non-profit making associations arises in respect of the profits from specific services to their members under section 28(iii). A company incorporated for a purpose other than that of carrying on a business, a company in liquidation, a statutory corporation, the Government of any State carrying on a trade or business would be deemed to be a company within the meaning of the Income-tax Act, 1961 for the purposes of levy and collection of tax on the business profits assessable to Income-tax. However, an assessment cannot be made on a company after it has ceased to exist and has been struck off the register of companies. Holding companies and their subsidiaries have to be separately assessed in respect of their profits since they are separate and distinct legal entities.

¹ Section 8 of the Companies Act, 2013

- ◆ **Piercing the corporate veil:** Since the law does not prescribe any minimum number of shares to be held by a shareholder nor a maximum, even a one-man company is a distinctly assessable legal entity as much as any other company. However the income-tax authorities are entitled to examine the genuineness and the true nature of the connected transactions of such a company. A company being a separate legal entity, the mere fact that only one individual is beneficially interested in all the shares and that the company, in effect, acts as his agent or nominee will not, by itself make its income the income of the shareholder. However, the Assessing Officer can tax the shareholders after examining the genuineness of such one-man companies on the basis of the true nature of the transaction e.g., when dividends are disguised as loans, when the company is doing the business of the individual who controls it.

As the Supreme Court has observed in *CIT vs. Shri Meenakshi Mill Ltd. (1967) 63 ITR 609*, "It is true that from the juristic point of view, the company is a legal personality entirely distinct from its members, and the company is capable of enjoying rights and being subjected to duties which are not the same as those enjoyed or borne by its members. However, in certain exceptional cases, the Court is entitled to lift the veil of corporate entity and to pay regard to the economic realities behind the legal facade. For example, the Court has power to disregard the corporate entity if it is used for tax evasion or to circumvent a tax obligation".

A foreign company or association which desires that the status of a 'company' be accorded to it, for purposes of assessment under the Income-tax Act, 1961, must apply to the CBDT for such a status to be vested in it. Generally, the Board agrees to grant such a status to every foreign body corporate or association possessing the usual characteristics of a company limited by shares and having a separate legal personality recognised by the laws of the country in which the body corporate or association has its registered office. However, since the purpose in obtaining the status of company obviously is to obtain a reduction in the rate of tax at which the body corporate or association would be otherwise taxed, before any foreign body corporate or association is invested with the status of a company, the CBDT would examine the loss of revenue that such a concession would involve.

- ◆ **Liability of shareholders distinct:** Since the company itself is chargeable to tax on its income as a distinct taxable entity, it pays the tax in the discharge of its own liability and not on behalf of or as the agents of the shareholders as was held by the Supreme Court in *Howrah Trading Co. Ltd. vs. CIT (1959) 36 ITR 216* and *Purshotamdas vs. CIT (1963) 48 ITR 206*. Consequently, the shareholders whether corporate or non-corporate, are liable to tax in respect of the gross dividend (other than dividends referred to in section 115-O) without any credit for the tax assessed in the hands of the company unless a specific provision is made in the Act to the contrary. Where the tax payable by the shareholders is deducted at source from the dividends or other items of income under sections 192 to 195, the tax is deemed to have been deducted and paid by the company on behalf of the recipient shareholders of the income and credit for same shall be given to them in their individual assessments.

13.1.3 Classes of Companies

- ◆ **Indian Company [Section 2(26)]:** An Indian company means a company formed and registered under the Companies Act, 1956 and includes:
 - (a) a company formed and registered under any law relating to companies formerly in force in any part of India (other than the State of Jammu and Kashmir) and the Union territories specified in (c) below;
 - (b) in the case of the State of Jammu and Kashmir a company formed and registered under any law for the time being in force in that State;
 - (c) in the case of any of the Union Territories of Dadra and Nagar Haveli, under any law for the time being in force in that Union Territory; and
 - (d) any corporation established by or under a Central, State or Provincial Act and having its registered or principal office in India, and also any institution, association or body which is declared by the Board to be a company under section 2(17) where the principal office of the institution, association or body is in India.

It is, however, essential that in all cases the registered, or as the case may be, the principal office of the company, corporation, institution, association or body must be in India.

- ◆ **Domestic and Foreign:** Companies can be classified into two groups, viz. (1) Domestic company (2) Foreign company. Domestic company is one which is an Indian company or any other company, which, in respect of its income liable to tax under the Income-tax Act, 1961 has made the prescribed arrangements for the declaration and payment within India of the dividends including dividends on preferential shares payable out of such income [Section 2(22A)]. A company that is not a domestic company is a foreign company [Section 2(23A)].
- ◆ **Closely-held and widely-held:** Domestic companies are again divided into broad groups, viz (1) companies in which public are substantially interested and (2) companies in which public are not substantially interested. The former type of companies are also referred to as 'widely-held companies' while the latter are also referred to as 'closely-held companies'.

To determine whether a company is one in which the public are substantially interested, one has to apply the tests laid down in section 2(18). Briefly, the following companies fall under this category:

- (1) companies owned by the Government or the Reserve Bank of India or in which not less than 40% of the shares are held by the Government or the Reserve Bank of India or a corporation owned by that bank,
- (2) companies registered under section 25 of the Companies Act², 1956 [i.e., a company having as its object the promotion of commerce, arts, science, religion, charity or any other useful object and which prohibits payment of dividends to its members],

² Section 8 of the Companies Act, 2013

- (3) companies having no share capital but declared by the Board to be companies in which the public are substantially interested,
- (4) mutual benefit finance company i.e., a company which carries on, as its principal business, the business of acceptance of deposits from its members and which is declared by the Central Government under section 620A of the Companies Act, 1956³ to be a Nidhi or Mutual Benefit Society,
- (5) public limited companies whose shares are quoted in the stock exchange and
- (6) public limited companies whose equity shares carrying not less than 50% (40% in the case of industrial companies) of the voting power have been allotted unconditionally to or acquired unconditionally by and were throughout the relevant previous year beneficially held by the Government or statutory corporation or other widely-held companies or their subsidiaries, whose entire share capital has been held by the parent company throughout the previous year.
- (7) Companies whose equity shares carrying not less than 51% of the voting power were throughout the relevant previous year held by one or more co-operative societies.

Thus, it should be noted that all public limited companies must automatically be treated as companies in which public are substantially interested, whereas all private limited companies will be treated as companies in which public are not substantially interested.

◆ **Relevance of the above classification:**

- (1) All domestic companies are taxed at 30% while a non-domestic company will be taxed at 50% or 40%, depending upon the composition of its total income. A surcharge of 5% of the tax payable is to be charged in the case of domestic companies and 2% of tax payable in the case of foreign companies, if the total income exceeds ₹ 1 crore *but does not exceed ₹ 10 crore. Surcharge@10% of the tax payable is to be charged in the case of domestic companies and 5% of tax payable in the case of foreign companies, if the total income exceeds ₹ 10 crore.*
- (2) The question as to whether a company is one in which public are substantially interested or not is relevant for determining the application of section 2(22)(e) and section 79 also.

- ◆ **Special Provisions:** There are certain special provisions which are applicable only to companies in which public are not substantially interested. These relate to the provisions governing deemed dividend under section 2(22)(e), carry forward of losses under section 79, liability of directors under section 179 and liability to wealth-tax in case of closely held companies.

13.1.4 Tax liability of a company: A company is chargeable to income-tax on its total income that had accrued or arisen in the previous year calculated under the different heads of income and in accordance with the basic principles explained in the initial chapters of the book. The determination of the total income of a company is dependent on whether or not the

³ Section 406 of the Companies Act, 2013

company was resident in India during the relevant previous year.

Chapter 2 discusses in detail as to how the residential status of a company is to be determined and it also explains how to determine the scope of total income of company under section 5. Students are also advised to study the provisions of section 9 explained in that chapter which has much relevance to company taxation.

Thus we may conclude that the liability of a company to tax depends on the following:

- (a) Whether it is an Indian company as defined in section 2(26)?
- (b) Whether the company has made the prescribed arrangements for the declaration and payment of dividends within India or not?
- (c) The pattern of its shareholding: Is it a company in which the public are substantially interested or a subsidiary of such a company?

13.1.5 Flat rates and no initial exemption: Companies are taxed at flat rates, as stated above, as distinguished from the progressive rates of taxes applicable to individuals and Hindu undivided families. The initial exemption from tax available to these entities does not apply to companies.

13.1.6 Tax on income from life insurance business: Section 115B provides for a concessional rate of tax for taxing the profits and gains derived from the business of life insurance. Under these provisions, in the case of an assessee whose total income includes any profits and gains derived from the business of life insurance computed in accordance with the First Schedule to the Income-tax Act, 1961, the income-tax payable shall be the aggregate of (i) the amount of income-tax calculated on the income from life insurance business included in total income at the rate of 12½% and (ii) the amount of income-tax with which the assessee would have been chargeable had the total income of the assessee been reduced by the amount of profits and gains from the life insurance business.

Income accruing or arising to a company from life insurance business referred to in section 115B would not be subject to MAT.

Taxation of investment income/loss of non-life insurance business: Rule 5 of the First Schedule to the Income-tax Act, 1961 provides that the profits and gains of non-life insurance business would be the profit before tax and appropriations as disclosed in the profit and loss account prepared in accordance with the provisions of the Insurance Act, 1938 or the IRDA Act, 1999, after adjustment for unexpired risk and disallowances under sections 30 to 43B. Any provision for diminution in the value of investment debited to profit and loss account has to be added back. Any gain or loss on realization of investments not credited or debited to profit and loss account, shall be added or deducted, as the case may be.

13.1.7 Taxation of non-resident companies: The rates at which tax would be payable by such a company on the different categories of its income are stated above. A non-resident company which operates through an Indian branch would also be liable to pay tax on the prescribed rate on its income derived from a branch of India. When a non-resident company declares dividends outside India, then non-resident shareholders of such company would not have to pay any tax in India on their individual income even though the dividends would have been declared out of profits made by the company in India.

Foreign companies deriving income from royalties, patents, licence fees and fees for technical services in India are liable to be taxed in India. In the case of fees for technical services rendered, only that portion of income which relates to the services rendered in India is liable to tax in India and that received for services rendered outside India is not so liable. In respect of the income arising to a foreign company in India by way of specified royalties or fees for technical services rendered, the rate of tax is 50% if the royalties or fees are received from Government or an Indian concern pursuant to an agreement approved by the Government of India between 1.4.1961 and 31.3.1976 (in case of royalties) and between 1.3.1964 and 31.3.1976 (in case of fees for technical services).

◆ **Special rates of tax for taxing dividends, fees for technical services and royalties in the case of foreign companies [Section 115A]**

1. Where the income of a non-resident non-corporate assessee or a foreign company consists of -

- (i) dividends (other than dividends referred to in section 115-O)
- (ii) interest received from Government or from an Indian concern on monies borrowed or debt incurred by the Government or the Indian concern in foreign currency; or
- (iii) income received in respect of units purchased in foreign currency of a mutual fund specified under section 10(23D) or of the Unit Trust of India,

the same will be taxed at 20%.

However, the following interest income would be subject to a concessional rate of 5% on gross interest -

- (i) Interest income received by a non-corporate non-resident or a foreign company from an infrastructural fund referred to in section 10(47).
 - (ii) Interest of the nature and to the extent referred to in section 194LC i.e., interest received by a foreign company or a non-corporate non-resident, in respect of borrowing made by an Indian company in foreign currency from sources outside India between 1.7.2012 and 30.6.2015.
 - (iii) *Interest of the nature and to the extent referred to in section 194LD i.e., interest payable during the period between 1.6.2013 and 31.5.2015 in respect of investment made by an Foreign Institutional Investor (FII) or Qualified Foreign Investor (QFI) in a rupee denominated bond of an Indian company or a Government security.*
2. No deduction in respect of any expenditure or allowance shall be allowed to the assessee under sections 28 to 44C in computing the aforesaid income. Further, where the gross total income of these assessee consists only of incomes mentioned above, no deduction shall be allowed to them under Chapter VIA of the Income-tax Act, 1961. Further, where the gross total income includes the aforesaid incomes, Chapter VIA deductions will be allowed as if the gross total income as so reduced were the gross total income of the assessee.

3. It shall not be necessary for the aforesaid assessee to furnish a return of their income under section 139 if the total income in respect of which they are assessable under the Act during the previous year consisted only of the income referred above, and the tax deductible at source has been deducted from such income.
4. Where the total income of a non-corporate non-resident or a foreign company includes royalty or fees for technical services, other than income referred to in section 44DA(1), received from Government or an Indian concern in pursuance of an agreement made by the foreign company after 31.3.1976, the same will be taxed @25%, subject to the following conditions:
 - (a) such agreement must be made with an Indian concern ;
 - (b) the agreement must be approved by the Central Government, or
 - (c) where it relates to a matter included in the industrial policy for the time being in force the Government of India, the agreement should be in accordance with that policy.

Illustration 1

X Ltd., an Indian company, entered into an agreement with Mr. M, a non-resident, on 1.7.2006 and pursuant to the agreement, fees for technical services (FTS) of ₹ 10 lakh, which is taxable under section 115A, is payable to Mr. M every year. Examine the tax consequence of the said transaction in the hands of Mr. M for the A.Y.2014-15, if –

- (i) Mr. M is a resident of a country with which India has no DTAA.
- (ii) Mr. M is a resident of a country, with which India has a DTAA, which provides for taxation of such FTS@15%.
- (iii) Mr. M is a resident of a country with which India has a DTAA, which provides for taxation of such FTS@28%.

Answer

- | |
|---|
| <ol style="list-style-type: none"> (i) The FTS would be taxable@25% as per section 115A, since India does not have a DTAA with the other country. (ii) The FTS would be taxable@15%, being the rate specified in the DTAA, even though section 115A provides for a higher rate of tax, since as per section 90, the provisions of the DTAA would apply if they are more beneficial. (iii) The FTS would be taxable@25% as per section 115A even though the DTAA provides for a higher rate of tax, since as per section 90, the provisions of the Income-tax Act, 1961 (i.e., section 115A, in this case) would apply if they are more beneficial. |
|---|

- ◆ Tax on income from units purchased in foreign currency or capital gains arising from the transfer [Section 115AB]
 1. Where the total income of an overseas financial organisation (Off-shore Fund) includes the following incomes namely:
 - (a) income received in respect of units purchased in foreign currency, or

(b) income by way of long term capital gains arising from the transfer of units purchased in foreign currency,

the same will be taxed at the rate of 10%.

2. Where the gross total income of the off-shore fund consists only of income from units or income by way of long-term capital gains arising from the transfer of units or both, no deduction will be allowed to the assessee under sections 28 to 44C or under section 57 or under Chapter VIA. The provisions of the second proviso to section 48 will not apply to any long-term capital gains arising from the transfer of units purchased in foreign currency.
 3. Where the gross total income consists of the aforesaid income as well as other income, the deductions under Chapter VIA shall be allowed only on that portion of the gross total income which does not include income from units purchased in foreign currency.
 4. For the purposes of this section, 'Overseas financial organisation' or 'off-shore fund' means any fund, institution, association or body, whether incorporated or not, established under the laws of a foreign country, which has entered into an agreement for investment in India with any public bank or public financial institution or a mutual fund specified under section 10(23D). Such arrangement must be approved by SEBI.
- ♦ Tax on income from bonds or shares purchased in foreign currency or capital gains arising from their transfer [Section 115AC]
1. Where the total income of a non-resident includes the following types of income namely,
 - (a) income by way of interest on bonds of an Indian company issued in accordance with such scheme as may be notified by the Government or on bonds of a public sector company, sold by the Government, and purchased by him in foreign currency; or
 - (b) income by way of dividends (other than dividends referred to in section 115-O) on Global Depository Receipts
 - (i) issued in accordance with such scheme as the Central Government may specify against the initial issue of shares of an Indian company and purchased by him in foreign currency through an approved intermediary; or
 - (ii) issued against the shares of a public sector company sold by the Government and purchased by him in foreign currency through an approved intermediary; or
 - (iii) issued or re-issued against the existing shares of an Indian company purchased by him in foreign currency through an approved intermediary in accordance with a specified scheme; or
 - (c) income by way of long-term capital gains arising from the above bonds or shares.

The income-tax will be at the rate of 10% on the above income.

2. Where the gross total income includes interest or dividends in respect of bonds or shares referred to in this section, no deduction shall be allowed to him under sections 28 to 44C or under section 57 or under Chapter VI-A.
 3. Where the gross total income includes interest or dividend (other than dividends referred to in section 115-O) or income by way of long-term capital gains, such gross total income shall be reduced by the amount of such income and Chapter VI-A deduction will be allowed on such balance.
 4. The indexation provisions contained in the first and second proviso to section 48 shall not apply for the computation of long-term capital gain arising out of the transfer of bonds or shares.
 5. Where the total income of the non-resident consists only of interest or dividends on bonds and GDRs and tax has been deducted at source from such income, he need not file a return under section 139(1).
 6. Where the assessee acquired Global Depository Receipts or bonds in an amalgamated or resulting company by virtue of its holding Global Depository Receipts or bonds in the amalgamating or demerged company (as the case may be) these provisions shall apply to such Global Depository Receipts or bonds.
- ◆ **Tax on income from GDRs purchased in foreign currency [Section 115ACA]:** This section applies to resident individuals who are employees of an Indian company engaged in specified knowledge based industry or service, or its subsidiary engaged in specified knowledge based industry or service.

Sub-section (1) of the section provides that the income-tax payable shall be the aggregate of (i) ten per cent of the income by way of dividends (other than dividends referred to in section 115-O) in respect of Global Depository Receipts of an Indian company purchased in foreign currency in accordance with such employees' stock option scheme as the Central Government may, by notification in the Official Gazette, specify in this behalf, if any, (ii) ten per cent in case of long-term capital gains arising from the transfer of the aforesaid Global Depository Receipts, if any, and (iii) the amount of income-tax on the total income as reduced by the aforesaid income from the said Global Depository Receipts.

Sub-section (2) of the section provides that in the case of the aforesaid resident employee, no deduction shall be allowed under any provisions of this Act where the gross total income consists only of income from Global Depository Receipts. However, where the total income includes income from Global Depository Receipts, the deduction under any provisions of the Act shall be allowed as if the gross total income does not include the income from the Global Depository Receipts.

Sub-section (3) of the section provides that the first and second provisos to section 48 relating to the computation of capital gains shall not apply in case of transfer of Global Depository Receipts of an Indian company purchased by the resident employee in foreign currency. In other words, no indexation will be available even if the assets are long term capital assets.

The *Explanation* to the section defines the related expressions as follows:

13.10 Income Tax

- (a) "Global Depository Receipts" means any instrument in the form of a depository receipt or certificate (by whatever name called) created by the Overseas Depository Bank outside India and issued to non-resident investors against the issue of ordinary shares or foreign currency convertible bonds of issuing company;
 - (b) "Specified knowledge based industry or service" means -
 - (i) information technology software;
 - (ii) information technology service;
 - (iii) entertainment service;
 - (iv) pharmaceutical industry;
 - (v) bio-technology industry; and
 - (vi) any other industry or service, as may be notified by the Central Government.
 - (c) "Subsidiary" includes subsidiary incorporated outside India.
 - (d) "Information technology service" means any service which results from the use of any information technology software over a system of information technology products for realising value addition;
 - (e) "Information technology software" means any representation of instructions, data, sound or image, including source code and object code, recorded in a machine readable form and capable of being manipulated or providing inter-activity to a user, by means of automatic data processing machine falling under heading information technology products but does not include non-information technology products;
 - (f) "Overseas Depository Bank" means a bank authorised by the issuing company to re-issue Global Depository Receipts against issue of Foreign Currency Convertible Bonds or ordinary shares of the issuing company.
- ◆ Tax on income of Foreign Institutional Investors from securities or capital gains arising from their transfer [Section 115AD]: This section relates to tax on income of Foreign Institutional Investors from securities or capital gains arising from their transfer.
- In the case of a Foreign Institutional Investor, income-tax payable shall be the aggregate of the following:
- (1) 20% of the income (other than income by way of dividends referred to in section 115-O) received in respect of securities (other than those units referred to in section 115AB).
However, in case of interest referred to in section 194LD, income-tax is payable@5% of gross income.
 - (2) 30% of the short-term capital gains arising from the transfer of the said securities. However, the amount of income-tax payable on their income by way of short-term capital gains referred to in section 111A is to be calculated at 15%.
 - (3) 10% of long term capital gains arising from the transfer of the said securities.
 - (4) The amount of income-tax on the total income as reduced by the aforesaid items of income.

Where the gross total income consists only of income from the aforesaid securities no deduction will be allowed under sections 28 to 44C or under section 57. However, where the gross total income includes income from securities or capital gains arising from the transfer of such securities, the deduction under Chapter VIA will be allowed as if the gross total income does not include the aforesaid items of income.

The first and second provisos of section 48 relating to computation of capital gains will not apply in the case of transfer of aforesaid securities by the Foreign Institutional Investors.

◆ **Concessional rate of tax on dividends received by Indian companies from specified foreign companies [Section 115BBD]**

- (i) Dividends received by Indian companies from specified foreign companies to be subject to a concessional rate of 15% (as against the general rate of 30% applicable to Indian companies) for A.Y.2012-13, A.Y.2013-14 *and* A.Y.2014-15.
- (ii) This rate of 15% would be applied on gross dividend, in the sense, that no expenditure would be allowable in respect of such dividend.
- (iii) However, this concessional rate would not be applicable in respect of dividend received from a foreign company in which the holding of the Indian company is less than 26% of the nominal value of the equity share capital.
- (iv) Therefore, if the total income of an Indian company, includes income by way of dividend declared, distributed or paid by a specified foreign company, the income tax payable would be the aggregate of –
 - (a) Income-tax @15% on gross dividend from such specified foreign company; and
 - (b) Income-tax with which the assessee would have been chargeable had its total income been reduced by such dividend.
- (v) Specified foreign company means a foreign company in which the Indian company holds 26% or more in nominal value of the equity share capital of the company.

- ◆ **Other special provisions:** Section 44D and 44DA incorporates special provisions for computing income by way of royalties and fees for technical services chargeable to tax in the case of foreign companies and these provisions would apply notwithstanding any thing to the contrary contained in section 28 to 44C. These provisions have been explained under the head "Profits and Gains of Business or Profession". The special provisions in respect of deduction of head office expenditure, applicable to all non-residents contained in section 44C have also been explained. All these special provisions should be borne in mind while determining the liability of foreign companies to income-tax in India.

13.1.8 Capital Gains of companies

Special Provisions:

- (1) Where the assets of a company are distributed to its shareholders in species on its liquidation such a distribution is not deemed to be a transfer made by company for purposes of capital gains tax. In the absence of this specific provision, the company would be deemed to have made capital gain on the assets transferred and would

consequently be liable to tax in respect of such distribution [Section 46(1)].

Where a shareholder receives any money or assets from a company on its liquidation, he is chargeable to tax under the head 'capital gains' in respect of the money or the market value of the assets on the date of distribution, reduced by the amount of notional dividends, if any, assessed under section 2(22)(c) and the sum so arrived at shall be the full value of consideration for computation of capital gains under section 48 [Section 46(2)].

(2) Section 47 provides that the following transfers of capital assets will not be considered for the purposes of levying tax on capital gains under section 45:

- (i) By a holding company to its Indian subsidiary company provided the latter holds all the share capital of the former.
- (ii) By a subsidiary company to its Indian holding company provided the latter holds all the share capital of the former.
- (iii) In a scheme of amalgamation, by the amalgamating company to its amalgamated Indian company.
- (iv) In a scheme of amalgamation, by the amalgamating foreign company to the amalgamated foreign company subject to prescribed conditions.
- (v) In a demerger, by the demerged company to the resulting company, if the resulting company is an Indian company.
- (vi) Any transfer in a demerger of shares held in an Indian company by the demerged foreign company to the resulting foreign company subject to prescribed conditions.
- (vii) Any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company if the transfer or issue is in consideration of the demerger.

- ◆ **Exceptions:** However, the proviso to clause (v) of section 47 provides to the effect that the exemptions at (i) and (ii) above will not apply to the transfer of capital asset made after 29.2.1988 as stock in trade. This seeks to plug the loophole which facilitated the transferee holding/subsidiary companies to circumvent the operation of section 47A by resorting to the device of converting capital asset as stock in trade at the time of transfer itself. Now, the proviso secures that any profits derived by a holding company in a transfer of a capital asset after 29th February, 1988 to its wholly owned subsidiary company or vice versa will be subject to tax under the head 'capital gains' in case where the capital asset is taken over as stock-in-trade by the transferee company at the time of transfer itself.

Inter-corporate transfer of capital assets [Section 47A]: Section 47A provides for the withdrawal of the exemption in respect of capital gains in certain cases covered by (i) and (ii) above. Under the provisions of Section 47(iv) the transfer of a capital asset by a company to its wholly owned subsidiary company is exempt from capital gains tax levy. Similarly section 47(v) exempts transfer from subsidiary company to holding company. The only condition for such an exemption is that the transferee company must be an Indian company.

Section 47A provides that where the "transfer" of a capital asset between a parent company and its hundred per cent subsidiary company has been exempted from any

charge to capital gains tax by virtue of provisions of clause (iv) or (v) of section 47 such exemption will be revoked in either of the two under noted cases by an order of rectification under section 155(7A) of the Income-tax Act, 1961.

- (i) Within a period of eight years from the date of the transfer the capital asset in question is converted by the transferee company into or as, stock-in-trade of its business; or
- (ii) within a period of eight years from the date of the transfer the parent company or its nominee or as the case may be, the holding company ceases to hold the whole of the share capital of the subsidiary company.

Section 43C: Section 43C(1) provides that where an asset which has become the property of an amalgamated company under a scheme of amalgamation, is sold after the 29.2.1988 as stock-in-trade, then in computing the profits and gains received from such transfer, the cost of acquisition of the asset to the amalgamating company shall be the cost of acquisition of the asset to the amalgamated company, as increased by the cost of any improvement made thereto and the expenditure incurred wholly and exclusively in connection with such transfer. This provision is intended to curb the device earlier adopted by the tax payers, under which the stock-in-trade taken over by an amalgamated company was revalued at the time of amalgamation. Prior to the insertion of this provision, the amalgamating company was not liable to tax on the difference arising on account of revaluation of the stock-in-trade at a value and the amalgamated company also reduced its tax liability on the profit accruing to it in the subsequent sale of the stock-in-trade.

Capital gains arising on the conversion of a partnership firm into a company or succession of a sole proprietary concern by a company are exempt subject to certain conditions specified. For a detailed discussion, students may refer to the chapter dealing with capital gains.

13.1.9 Special provisions in regard to taxation of companies:

- (1) **Amalgamation :** The definition of the term amalgamation is contained in section 2(1A) and the other provisions in respect of amalgamation are contained in sections 32, 35, 35ABB, 35D, 35DD, 35E, 47, 49, 55, and 72A.
- (2) **Demerger :** The definition of 'demerger' is contained in section 2(19AA) and the related provisions are contained in sections 32, 35ABB, 35D, 35E, 47, 49, 55, and 72A.

Students may refer to chapter 6 (Profits and Gains of Business or Profession), chapter 7 (Capital Gains) and chapter 10 (Set off and Carry Forward of Losses) for detailed discussions.

13.1.10 Liability for deduction of tax at source: The principal officer of an Indian company or a company which has made the prescribed arrangements for the declaration and payment of dividends (including dividends on preference shares) within India, before making any payment in cash or before making distribution or payment to a shareholder falling within the definition of dividend in section 2(22) shall deduct from the amount of all such dividends, income tax at the rate or rates prescribed by the relevant Finance Act relating to the year in which the dividend was declared. The rates for deduction of tax at source have been specified in Part II of the First Schedule to the Finance Act.

13.14 Income Tax

Further, the liability of the company extends as well to the deduction of tax at source from salaries, interest on securities, interest other than interest on securities, payments to contractors or sub-contractors and other sums payable to non-residents in accordance with the provisions of the sections 192 to 206B.

Deductions available for certain expenses

1. Expenditure on scientific research (Section 35)
2. Expenditure for obtaining licence to operate telecommunication services (Section 35ABB)
3. Expenditure on eligible projects or schemes (Section 35AC)
4. Amortisation of certain preliminary expenses (Section 35D)
5. Amortisation of expenditure in case of amalgamation or demerger (Section 35DD)
6. Expenditure on prospecting, etc. for minerals (Section 35E)
7. Expenditure for promoting family planning among employees [Section 36(1)(ix)]

Tax incentives on certain incomes:

1. Profits and gains from industrial undertakings, etc. engaged in infrastructure development (Section 80-IA)
2. Profits and gains from industrial undertaking other than infrastructure development undertakings (Section 80-IB)
3. Profits and gains in respect of certain undertakings or enterprises in certain special category States (Section 80-IC)
4. Profits from business of collecting and processing of bio-degradable waste (Section 80JJA)
5. Deduction in respect of employment of new workmen (Section 80JJAA)

13.1.11 Restrictions on the deductibility of certain expenditure/payments of special significance to companies

1. Head Office expenditure in the case of non-residents (Section 44C)
2. Computation of income by way of royalties etc., in the case of foreign companies (Section 44DA)
3. Set-off of losses in the case of a company in which public are not substantially interested (Section 79).

13.1.12 Tax liability of a company in liquidation [Section 178]: This has been discussed later in this chapter under the heading 'Liability in Special Cases'. The tax implications of liquidation in the context of taxation of capital gains and in the matter of dividends have been explained in the respective chapters.

- ◆ **Liability of directors of private companies in liquidation:** Section 179 provides that when any private company is wound up and any tax is assessed on the company whether before or during the course of or after its liquidation in respect of its income of any previous year and it cannot be recovered from the company, then every person who was a director of the company at any time during the relevant previous year shall be jointly and severally liable

for the payment of such tax, penalty, interest or any other sum of money assessed on the company and remaining unpaid unless he proves to the satisfaction of the Assessing Officer, that the non-recovery of the amounts cannot be attributed to any gross neglect or misfeasance of duty on his part in relation to the affairs of the company.

Section 179 provides for the collection and recovery of tax in the case of all private companies. According to section 179, the directors of a private company would be personally liable to pay the taxes due from the company not only at the time when the company is wound up but even in case where the company is not in liquidation. Thus, the directors of private company are jointly and severally liable for the payment of any tax due from a private company in respect of its income liable to tax in any accounting year or from any other company in respect of any income of any previous year during which time, such other company was a private company. *“Tax due” includes penalty, interest or any other sum payable under the Income-tax Act, 1961.*

In cases where a private company is converted into a public company and the taxes assessed in respect of any income of any year during which such company was a private company could not be recovered from the company, then any tax due in respect of the income of private company could be recovered from any of the persons who were directors of the private company before it became a public company. The directors would be in a position to get away from this personal liability to pay the taxes of the company, only if it could be proved that the non-recovery of the taxes due from the private company is not attributable to any gross negligence, misfeasance or breach of duty on their part in relation to the affairs of the private company. Thus the personal liability of the directors has extended to cases of private companies which are not in liquidation and those which might have subsequently become public companies.

13.1.13 Carry forward and set off of losses incurred by closely-held companies:

Section 79 applies only in cases where a change in share holding has taken place in the case of company in which the public are not substantially interested. Such companies will be entitled to the benefit of carry forward and set off of any earlier year's losses in the following previous year only if on the last day of the previous year shares carrying not less than 51% of the total voting power are beneficially held by persons who beneficially held those shares on the last day of the previous year in which such loss was incurred.

The object of the section is to counter avoidance of tax by persons taking advantage of the corporate personality of the company. The section does not, however, affect the right of the company to set off its current losses against other current income nor does it affect the carry forward of unabsorbed depreciation allowance, development rebate, or investment allowance, expenditure on scientific research, patents or copyright, and expenses on the prospecting or the extraction of any mineral or group of associated minerals subject, however, to the other provisions of the Act for the carry forward and set-off of these items.

The proviso to section 79, however provides for an exception in this regard. Accordingly, carry forward and set off of past years' losses shall not be denied to a closely held company where a change in the shareholding resulting in a change in voting power to the extent of 51% or more has taken place consequent upon the death of a shareholder or gift of shares made by a shareholder to any of his relatives.

13.1.14 Prescribed arrangements for the declaration and payment of dividends within India: The arrangements (specified in Rule 27 of the Income-tax Rules, 1962) are the following:

- (i) The share register of the company concerned for all its shareholders shall be maintained regularly at its principal place of business within India in respect of any assessment year from a date not later than 1st April of each assessment year.
- (ii) The general meeting of the shareholders for passing the accounts of the previous year relevant to the assessment year and for declaring any dividends in respect thereof shall be held only at a place within India.
- (iii) the dividends declared, if any, shall be made payable only within India to all the shareholders.

It is obligatory for Indian companies to make the prescribed arrangements stated above; non-Indian companies will be treated as domestic companies only if they make the prescribed arrangements for the declaration and payment of dividends in India.

13.1.15 Minimum Alternate Tax on companies [Section 115JB]: As per section 115JB(1), in case of company (domestic or foreign), if the income-tax payable on the total income computed under the Income-tax Act, 1961 is *less* than 18.5% of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable by the assessee on such total income shall be the amount of income-tax at the rate of 18.5% (add surcharge, if applicable, i.e., 5% for domestic companies and 2% for foreign companies, where the total income exceeds ₹ 1 crore *but does not exceed ₹ 10 crore, and 10% for domestic companies and 5% for foreign companies where the total income exceeds ₹ 10 crore*). Further, education cess @2% and secondary and higher education cess@1% shall be added on the aggregate of income-tax and surcharge

As per section 115JB(2), prior to amendment by the Finance Act, 2012, every company was required to prepare its profit and loss account for the relevant previous year in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956. However, as per the proviso to section 211(2) of the Companies Act, 1956⁴, certain companies like insurance companies, banking companies, companies engaged in generation or supply of electricity etc., are allowed to prepare their profit and loss account in accordance with the form specified in or under the Act governing such class of company.

In order to align section 115JB(2) with the proviso to section 211(2) of the Companies Act, 1956, sub-section (2) of section 115JB has been substituted w.e.f. A.Y.2013-14 to require such companies to prepare their profit and loss account for the relevant previous year in accordance with the provisions of the Act governing such company. Companies, other than companies referred to in the proviso to section 211(2) of the Companies Act, 1956, shall continue to prepare their profit and loss account for the relevant previous year in accordance with the provisions of Part II of Schedule VI to the Companies Act, 1956⁵.

⁴ Second Proviso to section 129(1) of the Companies Act, 2013

⁵ Schedule III to the Companies Act, 2013

For computing the book profit, the net profit shall be increased by the following amounts if debited to the profit and loss account:

- (a) income-tax paid or payable, and the provision therefor; or
[It may be noted that income-tax includes –
 - (1) dividend distribution tax / tax on distributed income;
 - (2) interest;
 - (3) surcharge;
 - (4) education cess; and
 - (5) secondary and higher education cess]
- (b) amount carried to any reserves, by whatever name called, other than any amount transferred to Special Reserve under section 33AC; or
- (c) amounts set aside to provision for meeting liabilities other than ascertained liabilities; or
- (d) amount of provision for losses of subsidiary companies; or
- (e) amount of dividends paid or proposed; or
- (f) amount of expenditure relatable to any income to which section 10 [other than section 10(38)] or 11 or 12 apply; or
- (g) the amount of depreciation; or
- (h) the amount of deferred tax and provision therefor; or
- (i) the amount set aside as provision for diminution in the value of any asset.

Further, the net profit shall also be increased by the amount standing in revaluation reserve relating to the revalued asset on the retirement or disposal of such asset, in case the same is not credited to the profit and loss account.

The net profit shall be reduced by the following amounts:

- (i) amount withdrawn from any reserve or provision, if any, such amount is credited to the profit and loss account.
However, the amount withdrawn from reserves/provisions shall not be reduced from the book profit unless the book profit of that year has been increased by those reserves/ provisions;
- (ii) amount of income to which section 10 [other than section 10(38)] or 11 or 12 apply, if such amount is credited to the profit and loss amount;
- (iii) the amount of depreciation debited to the profit and loss account (excluding the claim of depreciation on account of revaluation of assets);
- (iv) the amount withdrawn from the revaluation reserve and credited to the profit and loss account, to the extent it does not exceed the amount of depreciation on revaluation of assets;
- (v) amount of brought forward loss or unabsorbed depreciation, whichever is less as per books of account. The loss shall not include depreciation; If either the figure of brought forward loss or unabsorbed depreciation is "NIL", no deduction will be allowed from the book profit of the relevant year;

(vi) amount of profits of a sick industrial company (BIFR company) commencing from the previous year in which the company became sick and ending with the assessment year during which the entire net worth becomes positive. For this purpose, "net worth" shall have the same meaning as assigned under section 3(1)(ga) of the Sick Industrial Companies (Special Provisions) Act, 1985.

(vii) the amount of deferred tax, if any such amount is credited to the profit and loss account.

The section also specifies that the profit and loss account for the relevant previous year has to be computed in accordance with Parts II of Schedule VI to the Companies Act, 1956. Further, while preparing the annual accounts,-

- (i) the accounting policies,
- (ii) the accounting standards followed for preparing such accounts,
- (iii) the method and rates for calculating depreciation

shall be the same as have been adopted for the purpose of preparing such accounts and laid before the company at its annual general meeting.

Where the financial year adopted by the company under the Companies Act, 1956⁶ is different from the previous year under the Income-tax Act, 1961, the accounting policies, etc. adopted shall correspond to the accounting policies followed for preparing such accounts for the financial year.

The section also provides that every company to which this section applies shall furnish, along with the return of income filed under section 139(1) or in response to a notice under section 142(1)(i), a report from a chartered accountant certifying that the book profit has been computed in accordance with the provisions of this section.

It is also provided that in respect of the relevant previous year, the amounts determined under the provisions of section 32(2) or section 72(1)(ii) or section 73 or section 74 or section 74A(3), shall be allowed to be carried forward.

Also, it has been provided that any income accruing or arising to a company from life insurance business referred to in section 115B would not be subject to MAT. [Sub-section (5A) of section 115JB]

Set-off of credit of tax paid under section 115JB [Section 115JAA]

- (1) This section provides that where tax is paid in any assessment year in relation to the deemed income under section 115JB(1), the excess of tax so paid over and above the tax payable under the other provisions of the Income-tax Act, 1961, will be allowed as tax credit in the subsequent years.
- (2) The tax credit is, therefore, the difference between the tax paid under section 115JB(1) and the tax payable on the total income computed in accordance with the other provisions of the Act.

⁶ As per section 2(41) of the Companies Act, 2013, the financial year of a company shall be the period ending 31st March of every year. If a company is incorporated on or after 1st January of a year, then the financial year shall be the period ending 31st March of the following year.

- (3) The tax credit shall be allowed to be set off in a year in which tax becomes payable on the total income computed in accordance with provisions of the Act other than section 115JB.
- (4) This tax credit is allowed to be carried forward for 10 assessment years succeeding the assessment year in which the credit became allowable.
- (5) Such credit is allowed to be set off against the tax payable on the total income in an assessment year in which the tax is computed in accordance with the provisions of the Act, other than 115JB, to the extent of excess of such tax payable over the tax payable on book profits in that year.
- (6) In case of conversion of a private company or unlisted public company into an LLP, the tax credit under section 115JAA for MAT paid by the company under section 115JB would not be allowed to the successor LLP.

Illustration 2

A.Y.	Normal tax liability	Tax liability u/s. 115JB	Tax payable by the assessee [Higher of (2) and (3)]	Additional tax liability (4) - (2)	Credit u/s. 115JAA utilised	Credit available for carry forward
(1)	(2)	(3)	(4)	(5)	(6)	(7)
2007-08	100	300	300	200	-	200
2008-09	120	90	120	NIL	30 [#]	170
2009-10	150	110	150	NIL	40	130
2010-11	180	200	200	20	-	150
2011-12	200	190	200	NIL	10	140
2012-13	300	280	300	NIL	20	120
2013-14	250	230	250	NIL	20	100
2014-15	225	175	225	NIL	50	50
2015-16	250	240	250	NIL	10	40
2016-17	275	270	275	NIL	5	35
2017-18	300	295	300	NIL	5	30*

Even though credit of 200 is available, only 30 can be utilised so that the tax payable by the assessee does not go below the amount computed under section 115JB.

* out of the credit of 30, 10 relates to A.Y. 2007-08 and 20 relates to A.Y. 2010-11. In view of provisions of sub-section (3A) of section 115JAA, the credit of 10 will not be allowable after A.Y. 2017-18 and would accordingly lapse. However, credit of 20 pertaining to A.Y. 2010-11 would be allowed to be carried forward till A.Y. 2020-21.

13.1.16 Tax on distributed profit of domestic companies: Chapter XII D [Section 115-O]:
The amounts declared, distributed or paid on or after 1.4.2003 by a domestic company by way of dividends are charged to additional income-tax at the flat rate of 15%, in addition to normal income-

tax chargeable on the income of the company. Dividend received from domestic companies on or after 1.4.03 are exempt in the hands of shareholders [Sub-section (1)]

Section 115-O(1A) seeks to provide relief from double taxation of dividends by removing the cascading effect of dividend distribution tax in a multi-tier corporate structure. A holding company receiving dividend from its subsidiary company can reduce the same from dividends declared, distributed or paid by it. For this purpose, a holding company is one which holds more than 50% of the nominal value of equity shares of the subsidiary. However, there are certain conditions to be fulfilled to avail this benefit. They are -

- *where such subsidiary is a domestic company, the subsidiary should have paid the dividend distribution tax, as payable on such dividend; and*
- *where such subsidiary is a foreign company, the tax is payable by the domestic company under section 115BBD on such dividend.*

Illustration 3

A Ltd., an Indian company, receives the following dividend income during the P.Y. 2013-14 -

- (1) from shares held in XYZ Inc., a foreign company, in which it holds 25% of nominal value of equity share capital – ₹ 80,000;
- (2) from shares held in PQR Inc., a foreign company, in which it holds 30% of nominal value of equity share capital – ₹ 1,85,000.
- (3) from shares held in LMN Inc., a foreign company, in which it holds 55% of the nominal value of equity share capital - ₹ 2,15,000
- (4) from shares held in Indian subsidiaries, on which dividend distribution tax has been paid by such subsidiaries – ₹ 90,000.

A Ltd. has paid remuneration of ₹ 18,000 for realising dividend, the break up of which is as follows

₹ 4,000 (XYZ Inc.)

₹ 9,000 (PQR Inc.)

₹ 5,000 (Indian subsidiaries)

The business income of A Ltd. computed under the provisions of the Act is ₹ 40 lakh. Compute the total income and tax liability of A Ltd., ignoring MAT. Assuming that A Ltd. has distributed dividend of ₹ 4,20,000 in February, 2014, compute the additional income-tax payable by it under section 115-O.

Solution

Computation of total income of A Ltd. for A.Y. 2014-15

Particulars	₹
Profits and gains of business or profession	40,00,000
Income from other sources (See Note below)	4,76,000
Total income	44,76,000

Note – Dividend income taxable under “Income from other sources”

Particulars	₹
From XYZ Inc. – net dividend (i.e., ₹ 80,000 – ₹ 4,000) is taxable at normal rates	76,000
From PQR Inc. – gross dividend is taxable@15% under section 115BBD [no deduction is allowable in respect of any expenditure as per section 115BBD(2)]	1,85,000
From LMN Inc – gross dividend is taxable@15% under section 115BBD [no deduction is allowable in respect of any expenditure as per section 115BBD(2)]	2,15,000
From shares in Indian subsidiaries ₹ 90,000 – exempt under section 10(34) since dividend distribution tax has been paid under section 115-O [As per section 14A, no deduction is allowable in respect of expenditure incurred to earn exempt income]	Nil
	4,76,000

Computation of tax liability of A Ltd. for the A.Y.2014-15

Particulars	₹
Tax@15% under section 115BBD on ₹ 4,00,000 (gross dividend)	60,000
Tax@30% on balance income of ₹ 40,76,000	12,22,800
	12,82,800
Add: Education cess@2% and Secondary and higher education cess@1%	38,484
Tax liability	13,21,284

Computation of additional income-tax payable by A Ltd. under section 115-O

Particulars	₹
Amount distributed by way of dividend	4,20,000
Less: Dividend received from Indian subsidiaries, on which DDT payable under section 115-O has been paid	90,000
Dividend received from foreign subsidiary, on which tax is payable under section 115BBD	2,15,000
	3,05,000
	1,15,000
Dividend Distribution tax@15%	17,250
Add: Surcharge@10%	1,725
	18,975
Add: Education cess@2% and secondary and higher education cess@1%	569
Additional income-tax payable under section 115-O	19,544

The NPS Trust is exempted from the applicability of dividend distribution tax in respect of dividend paid to any person for, or on behalf of, the NPS Trust. Hence, the dividend paid to any person for, or on behalf of, the NPS Trust would not be subject to dividend distribution tax. Therefore, for the purpose of calculating dividend distribution tax, a company can reduce such dividend from the dividends declared, distributed or paid by it. Even if no income tax is payable by a domestic company on its total income computed in accordance with the provisions of Income-tax Act, 1961, the tax on distributed profits shall be payable by such company [Sub-section (2)].

This tax must be paid to the credit of the Central Government within fourteen days from the date of (a) declaration of any dividend or (b) distribution of any dividend or (c) payment of any dividend, whichever is earliest [Sub-section (3)].

Section 115P provides that non-payment of dividend distribution tax within the time allowed under section 115-O(3) attracts simple interest @1% for every month or part thereof on the amount of such tax for the period beginning from the date following the date on which the tax was payable and ending with the date on which the tax is actually paid. The Principal officer of a domestic company and the company is liable to pay interest on such non-payment or delayed payment. Section 115Q provides that the principal officer and the company would be deemed to be an assessee-in-default if they fail to pay the tax in accordance with the provisions of section 115-O.

The tax on distributed profits so paid by the company shall be treated as the final payment of tax in respect of the amount declared, distributed or paid as dividends and no further credit therefore shall be claimed by the company or by any other person in respect of the amount of tax so paid [Sub-section (4)].

No deduction under any of the provisions of the Income-tax Act, 1961 shall be allowed to the shareholder in respect of the dividend income [Sub-section (5)].

13.1.17 Levy of additional income-tax on distributed income of a domestic company on account of buy-back of unlisted shares [New Chapter XII-DA]

- (i) Under section 115-O, dividend distribution tax (DDT) is levied on a company at the time when it distributes, declares or pays any dividend to its shareholders. Consequently, the amount of dividend received by the shareholders is not included in the total income of the shareholder, by virtue of exemption provided under section 10(34).*
- (ii) So far, the consideration received by a shareholder on buy-back of shares by a company is not treated as dividend but is taxable as capital gains under section 46A.*
- (iii) While payment of dividend is one option available to a company to distribute its reserves to its shareholders, another option available is to buy-back its own shares at a consideration determined by it. If the company exercises the former option, the payment of dividend would be subject to DDT under section 115-O and income in the hands of shareholders would be exempt as per section 10(34). However, if the company prefers the second option, the income would be taxed in the hands of shareholder under section 46A as capital gains.*

(iv) In order to discourage the practice of domestic companies resorting to buy back of unlisted shares instead of payment of dividends in order to avoid payment of tax by way of DDT, especially if the capital gains arising to the shareholders are either not chargeable to tax or are taxable at a lower rate, a new Chapter XII-DA, comprising of sections 115QA, 115QB and 115QC, has been inserted with effect from 1st June, 2013 to levy additional income-tax on buy back of such shares by domestic companies. The income arising to the shareholders in respect of such buy back of unlisted shares by the domestic company would be exempt under section 10(34A) w.e.f. A.Y.2014-15, where the company is liable to pay the additional income-tax on the buy-back of shares. For this purpose, buyback means purchase by a company of its own shares in accordance with the provisions of section 77A of the Companies Act, 1956.

(a) Levy of additional income-tax@20% on buyback of unlisted shares [Section 115QA]

(1) Section 115QA provides that the distributed income (i.e., consideration paid by the company for buyback of its own unlisted shares which is in excess of the sum received by the company at the time of issue of such shares) would be subject to additional income-tax@20% (plus surcharge@10% and education cess@2% and secondary and higher education cess@1%) in the hands of the domestic company.

(2) The company is liable to pay such additional income-tax even though no income-tax may be payable by it in respect of its total income computed under the provisions of the Act.

(3) Such tax should be paid to the credit of the Central Government within 14 days from the date of payment of any consideration for such buyback to the shareholder.

(4) The additional income-tax payable by the company shall be the final payment of tax on such income. No credit or deduction shall be claimed by the company or any other person in respect of such tax paid.

(5) Further, no deduction under any provision of the Income-tax Act, 1961 shall be allowed to the company or the shareholder in respect of income, which has been subject to additional income-tax, or tax thereon.

(b) Interest payable for non-payment of additional income-tax by the company [Section 115QB]

The principal officer of the domestic company and the company will be liable to pay simple interest on the amount of additional income-tax not paid within the specified time. Such interest is leviable at the rate of 1% for every month or part of the month on the amount of such tax not paid or short paid for the period beginning on the date immediately after the last date on which such tax was payable and ending with the date on which the tax is actually paid.

(c) The principal officer of the domestic company and the company will be deemed to be an assessee-in-default in respect of amount of tax payable by him or it, in case the additional income-tax is not paid to the credit of Central Government within the specified time. In such a case, all the provisions of the Act for the collection and recovery of income-tax would apply [Section 115QC].

Illustration 4

XYZ Ltd., a domestic company, purchases its own unlisted shares on 4th July, 2013. The consideration for buyback amounted to ₹ 21 lakh, which was paid on the same day. The amount received by the company two years back for issue of such shares was ₹ 13 lakh. Compute the additional income-tax payable by XYZ Ltd. Compute the interest, if any, payable if such tax is paid to the credit of the Central Government on 29th September, 2013.

Solution

XYZ Ltd is liable to pay ₹ 1,81,280 as additional income-tax, which is the amount calculated @22.66% (20% plus surcharge@10% plus cess@3%) on ₹ 8 lakh, being its distributed income (i.e., ₹ 21 lakh – ₹ 13 lakh).

The additional income-tax was payable on or before 18th July, 2013. However, the same was paid only on 29th September 2013.

Period for which interest@1% per month or part of a month is leviable -

Period	No. of months / part of month
19 th July – 18 th August, 2013 (whole of first month)	1
19 th August – 18 th September, 2013 (whole of second month)	1
19 th September – 29 th September, 2013 (part of third month)	1
Total number of months	3

Interest under section 115QB is payable @1% per month for 3 months on the amount of additional tax payable i.e., ₹ 1,81,280. Therefore, interest payable under section 115QB is ₹ 5,438.

13.1.18 Tax on distributed income of mutual funds [Chapter XII-E]: Chapter XII-E comprises of sections 115R, 115S and 115T.

(a) **Section 115R:** Any amount of income distributed by the specified company as defined in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 or a Mutual Fund to its unit holders on or after 1.4.03 shall be chargeable to tax and the specified company or the Mutual Fund shall be liable to pay additional income-tax at the rate specified in the table below –

Type of Fund	Person to whom income is distributed	Upto 31.5.2013	On or after 1.6.2013
<i>Equity-oriented fund</i>	<i>Any person</i>	<i>Nil</i>	<i>Nil</i>
<i>Other Funds</i>			
<i>Money market mutual fund or liquid fund</i>	<i>Individual or HUF</i>	<i>25%</i>	<i>25%</i>
	<i>Any other person</i>	<i>30%</i>	<i>30%</i>
<i>Fund other than MMMF or liquid fund</i>	<i>Individual or HUF</i>	<i>12.5%</i>	<i>25%</i>
	<i>Any other person</i>	<i>30%</i>	<i>30%</i>

<i>Infrastructure Debt Fund set up as a Mutual Fund</i>	<i>Non-corporate non-resident or a foreign company</i>	<i>25%, 30% or 12.5%, as the case may be.</i>	<i>5%</i>

Money market mutual fund means a means a money market mutual fund as defined in sub-clause 2(p) of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 i.e. it means a scheme of a mutual fund which has been set up with the objective of investing exclusively in money market instruments.

Liquid fund means a scheme or plan of a mutual fund which is classified by the Securities and Exchange Board of India as a liquid fund in accordance with the guidelines issued by it in this behalf under the Securities and Exchange Board of India Act, 1992 or regulations made thereunder.

However, this does not apply in respect of any income distributed (i) by the Administrator of the specified undertaking to the unit holders (ii) to a unit holder of equity oriented funds in respect of any distribution made from such funds.

The income from units received by a unit holder on or after 1.4.03 is exempt from income-tax.

The person responsible for making the payment of income distributed by the UTI or a Mutual Fund and the UTI or the Mutual Fund itself, as the case may be, shall be liable to pay the tax under this provision to the credit of the Central Government within fourteen days from the date of distribution or payment of such income, whichever is earlier.

The person responsible for making payment of the income distributed by the Unit Trust of India or a Mutual Fund and the Unit Trust of India or the Mutual Fund, as the case may be, liable to file a statement before 15th September each year to the manner, giving the details of the amount of income distributed to unit holders during the previous year, the tax paid and other relevant details.

(b) **Section 115-S:** This section provides that if the person responsible for making payment of the income distributed by the specified company or a Mutual Fund and the specified company or the Mutual Fund, as the case may be, fails to pay the income-tax to the credit of the Central Government within the time allowed under section 115-R, he or it shall be liable to pay simple interest at the rate of 1% for every month or part thereof on such amount of tax which has not been paid or was not paid in time.

(c) **Section 115-T:** This section provides that if the person responsible for making payment of the income distributed by the specified company or a Mutual Fund and the specified company or the Mutual Fund, as the case may be, fails to pay the income-tax to the credit of the Central Government, he or it shall be deemed to be an assessee in default in respect of the amount of tax payable and all the provisions of this Act for the collection and recovery of income-tax shall apply.

Specified company, for the purpose of section 115-S and 115-T, means specified company as referred to in section 2(h) of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002.

The expression "Mutual Fund", "open-ended equity oriented fund" and "Unit Trust of India" have been defined for the purposes of the newly inserted Chapter XII-E of the Income-tax Act in the Explanation as follows:

- (a) "Mutual Fund" means a Mutual Fund specified under clause (23D) of section 10;
- (b) "Equity oriented fund" means -
- the Unit Scheme, 1964 made by the Unit Trust of India; and
 - such fund where the investible funds are invested by way of equity shares in domestic companies to the extent of more than 65% of the total proceeds of such funds, provided that the percentage of equity share holding of the fund shall be computed with reference to the annual average of the monthly averages of the opening and closing figures;
 - "Unit Trust of India" means the Unit Trust of India established under the Unit Trust of India Act, 1963.

13.1.19 Levy of additional income-tax on income distributed by securitization trusts
[Insertion of Chapter XII-EA]

Related amendment in:

Section 10(23DA)	<i>Exemption of any income of a securitization trust from the activity of securitization</i>
Section 10(35A)	<i>Exemption of the distributed income referred to in section 115TA received from a securitization trust in the hands of the recipient-investor</i>

(i) *Securitization trusts are special purpose entities set up in the form of trust to undertake securitization activities.*

(ii) *For the purpose of the exemption and taxability provisions under the Income-tax Act, 1961, a "securitization trust" means a trust which is a special purpose distinct entity or special purpose vehicle, the details of which are tabulated hereunder, which fulfills the prescribed conditions –*

	<i>Form of trust</i>	<i>Regulation/Guidelines</i>	<i>Definition under the respective Regulation/Guidelines</i>
(1)	<i>Special purpose distinct entity</i>	<i>SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008.</i>	<i>Special purpose distinct entity means a trust which acquires debt or receivables out of funds mobilized by it by issuance of securitised debt instruments through one or more schemes, and includes any trust set up by the National Housing Bank or by the NABARD.</i> <i>For this purpose, "securitised debt instrument" means any certificate or instrument, by whatever name called, issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable including mortgage debt, as the case may be;</i>

(2)	Special purpose vehicle (SPV)	The guidelines on securitization of standard assets issued by RBI.	SPV means any company, trust, or other entity constituted or established for a specific purpose – (a) activities of which are limited to those for accomplishing the purpose of the company, trust or other entity as the case may be; and (b) which is structured in a manner intended to isolate the corporation, trust or entity as the case may be, from the credit risk of an originator to make it bankruptcy remote.

(iii) Due to the absence of specific provisions governing the taxation of such trusts under the Income-tax Act, 1961, these special purpose entities set up in the form of trusts to undertake securitisation activities experienced genuine hardship. The taxation at the maximum marginal rate under section 161 applicable in the case of a trust having income under the head "Profits and gains of business or profession" was viewed to be restrictive specifically where the investors in the trust are persons which are exempt from taxation under the provisions of the Income-tax Act, 1961 (for example, mutual funds).

(iv) Therefore, in order to overcome this restrictive factor and facilitate the securitisation process, a special taxation regime has been introduced in respect of taxation of income of securitisation entities, set up as a trust, from the activity of securitisation.

The significant provisions of the special regime are :-

(1) In case of securitisation vehicles which are set up as a trust and the activities of which are regulated by either SEBI or RBI, the income from the activity of securitisation of such trusts will be exempt from taxation. New clause (23DA) has been inserted in section 10 to exempt any income of a securitization trust from the activity of securitization with effect from A.Y.2014-15.

(2) New Chapter XII-EA, comprising of sections 115TA, 115TB and 115TC, has been inserted in the Income-tax Act, 1961, with effect from 1st June, 2013 to levy additional income-tax on securitization trusts in respect of income distributed to its investors.

(a) The securitisation trust will be liable to pay additional income-tax on income distributed to its investors [Section 115TA].

(i) The rates of additional income-tax and the effective rate of tax (i.e., including surcharge@10% and cess@3%) in respect of each category are shown hereunder –

	Category of investors to whom income is distributed	Rate	Effective rate of tax
(1)	Persons, in whose case, income, irrespective of its nature and source, is exempt from tax under the Income-tax Act, 1961 [for example, mutual funds exempt under section 10(23D)]	Nil	Nil

(2)	Individuals and HUFs	25%	28.325%
(3)	Other Investors [i.e., investors other than mentioned in (1) and (2) above]	30%	33.99%

(ii) Such tax has to be paid within 14 days from the date of distribution or payment of such income, whichever is earlier.

(iii) The person responsible for making payment of the income distributed by the securitization trust is required to furnish to the prescribed income-tax authority, on or before 15th September in each year, a statement in the prescribed form and verified in the prescribed manner, giving the following details –

- (1) Amount of income distributed to investors during the previous year;
- (2) The tax paid thereon; and
- (3) Other relevant details which are prescribed.

For example, the details of income distributed by the securitization trust during the P.Y.2013-14 has to be furnished in the prescribed form to the prescribed income-tax authority on or before 15th September, 2014.

(iv) The securitization trust will not be allowed any deduction under any other provision of the Act, in respect of income which has been subject to distribution tax under section 115TA.

(b) The securitisation trust will be liable to pay simple interest on the amount of additional income-tax not paid within the specified time i.e., within 14 days from the date of distribution or payment of such income, whichever is earlier. Such interest is leviable at the rate of 1% for every month or part of the month on the amount of such tax not paid or short paid, as the case may be, for the period beginning on the date immediately after the last date on which such tax was payable and ending with the date on which the tax is actually paid [Section 115TB].

(c) The person responsible for payment of income distributed by the securitization trust and the securitization trust will be deemed to be an assessee-in-default in respect of amount of tax payable by him or it, in case the additional income-tax is not paid to the credit of Central Government. In such a case, all the provisions of the Act for the collection and recovery of income-tax would apply [Section 115TC].

(3) Consequent to the levy of distribution tax, the distributed income referred to in section 115TA received from a securitization trust will be exempt from tax in the hands of the recipient-investor with effect from A.Y.2014-15 [Section 10(35A)].

Illustration 5

A securitization trust distributes income of ₹ 10 lakh on 6th September, 2013 to its investors comprising of -

	Category of investor	Income distributed (₹)
(i)	Mutual funds exempt under section 10(23D)	3,00,000
(ii)	Individuals and HUFs	1,50,000
(iii)	Persons other than mentioned in (i) & (ii) above	5,50,000

Compute the additional income-tax payable by the trust under section 115TA. Assuming that the additional income-tax payable as per section 115TA is paid to the credit of the Central Government on 25th November, 2013, compute the interest, if any payable, under section 115TB.

Solution

Computation of additional income-tax payable under section 115TA

	Category of investor	Income distributed (₹)	Rate of tax	Amount of tax (₹)
(i)	Mutual funds exempt under section 10(23D)	3,00,000	Nil	Nil
(ii)	Individuals and HUFs	1,50,000	28.325%	42,488
(iii)	Persons other than mentioned in (i) & (ii) above	5,50,000	33.99%	1,86,945
				2,29,433

The additional income-tax is payable on or before 20th September, 2013. However, the same was paid only on 25th November 2013.

Consequently, interest@1% per month or part of month is leviable under section 115TB, as follows –

Period	No. of months/ part of a month
21 st September – 20 th October, 2013 (whole of first month)	1
21 st October – 20 th November, 2013 (whole of second month)	1
21 st November – 25 th November, 2013 (part of third month)	1
No. of months for which interest is leviable u/s 115TB	3

Interest under section 115TB is payable @1% per month for 3 months on the amount of additional tax payable i.e., ₹ 2,29,433. Therefore, interest payable under section 115TB is ₹ 6,883.

13.1.20 Tax on Income received from venture capital companies/funds [Chapter XII-F (Section 115U)] : Chapter XII-F relates to special provisions with regard to the tax on the income distributed by venture capital companies and venture capital funds. The Chapter contains section 115U.

Sub-section (1) provides that notwithstanding anything contained in any other provisions of the Act, any income accruing or arising to or received by a person out of investments made in a

venture capital company or venture capital fund shall be chargeable to income-tax in the same manner as if such income were accruing or arising or received from investments made directly in the venture capital undertaking.

Sub-section (2) provides that the person responsible for crediting or making payment of the income on behalf of the venture capital undertaking or fund shall furnish within the prescribed time, to the person who is liable to tax in respect of such income and to the prescribed income-tax authority, a statement in the prescribed form and verified in the prescribed manner, giving details of the nature of the income paid or credited during the previous year and other relevant details.

Sub-section (3) provides that the income paid or credited by the venture capital company and the venture capital fund shall be deemed to be of the same nature and in the same proportion in the hands of the person referred to in sub-section (1) as it had been received by or accrued or arisen to the venture capital company or fund during the previous year.

Sub-section (4) provides that the provisions of Chapter XII-D (dealing with tax on distributed profits of domestic companies - Section 115-O to 115Q), Chapter XII-E (dealing with tax on distributed income of mutual funds - Section 115R to 115T) and Chapter XVII B (dealing with deduction of tax at source) shall not apply to the income paid by a venture capital company or venture capital fund under this Chapter.

The income accruing or arising to or received by the VCC or VCF during a previous year, from investments made in VCU, if not paid or credited to the investor, shall be deemed to have been credited to the account of the investor on the last day of the previous year in the same proportion in which such person would have been entitled to receive the income had it been paid in the previous year [Sub-section (5)]

However, where income has been so included on accrual basis in the total income of the investor in the previous year, then it shall not be included again at the time such income is actually paid to him by the VCC/VCF.

This expressions “venture capital company”, “venture capital fund” and “venture capital undertaking” for the purposes of Chapter XII-F of the Income-tax Act shall have the same meanings as assigned to them under section 10(23FB) [Please refer to Chapter 3].

13.1.21 Special provisions relating to income of shipping companies: To make the Indian shipping industry more competitive, a tonnage tax scheme for taxation of shipping profits has been introduced. Tonnage tax will induce more ships to fly the Indian Flag.

Chapter XII-G, containing sections 115V to 115VZC, provides for special provisions relating to taxation of the income of shipping companies. With the introduction of tonnage tax scheme, the companies have to exercise the option to be assessed under this scheme or under the normal provisions of the Income-tax Act. The salient features of the scheme are as follows:

- A company owning at least one qualifying ship may join.
- A qualifying ship is one with a minimum tonnage of 15 tons and having a valid certificate.
- If a company is incorporated after the initial period or a company which is incorporated before the initial period but becomes a qualifying company for the first time after the initial period,

this application is required to be made within three months of the date of incorporation or the date on which it becomes a qualifying company, as the case may be.

(1) Computation of Tonnage Income from Business of Operating Qualifying Ships

Computation of profits and gains from the business of operating qualifying ships [Section 115VA]

- (1) A company has the option to compute the income from the business of operating qualifying ships in accordance with the provisions of this Chapter.
- (2) Such income is deemed to be the income chargeable to tax under the head "Profits and gains of business or profession" in respect of such business.

Operating ships [Section 115VB]

- (1) A company shall be regarded as operating a ship if it operates any ship whether owned or chartered by it.
- (2) Even if only a part of the ship has been chartered in by it in an arrangement such as slot charter, space charter or joint charter, the company would be regarded as operating a ship.
- (3) However, a company will not be regarded as the operator of a ship which has been chartered out on bareboat charter-cum-demise terms or on bareboat charter terms for a period exceeding three years.
- (4) "Bareboat charter" means hiring of a ship for a stipulated period on terms which give the charterer possession and control of the ship, including the right to appoint the master and crew;
- (5) "Bareboat charter-cum-demise" means a bareboat charter where the ownership of the ship is intended to be transferred after a specified period to the company to whom it has been chartered;

Meaning of "Qualifying company" [Section 115VC]

- (1) A company will be a qualifying company if -
 - (a) it is an Indian company;
 - (b) the place of effective management of the company is in India;
 - (c) it owns at least one qualifying ship; and
 - (d) the main object of the company is to carry on the business of operating ships.
- (2) The expression "place of effective management of the company" has been defined in the Explanation to the section to mean -
 - (a) the place where the board of directors of the company or its executive directors make their decisions; or
 - (b) in a case where the board of directors routinely approve the commercial and strategic decisions made by the executive directors or officers of the company, the place where such executive directors or officers of the company perform their functions.

Meaning of “Qualifying ship” [Section 115VD]

- (1) A ship is a qualifying ship if
 - (i) it is a seagoing ship or vessel of 15 net tonnage or more;
 - (ii) it is registered –
 - (a) under the Merchant Shipping Act, 1958; or
 - (b) outside India in respect of which a licence has been issued by the Director-General of Shipping under section 406 or 407 of the Merchant Shipping Act, 1958
 - (iii) there is a valid certificate in force indicating the net tonnage of such a ship;
- (2) However, the following ships are not “qualifying ships” –
 - (i) a seagoing ship or vessel if the main purpose for which it is used is for the provision of goods or services of a kind normally provided on land (“seagoing ship” means a ship which is certified as seagoing by the competent authority of any country);
 - (ii) fishing vessels;
 - (iii) factory ships (which includes a vessel providing processing services in respect of processing of the fishing produce);
 - (iv) pleasure craft (i.e. a ship, whose primary use is for the purposes of sport or recreation);
 - (v) harbour and river ferries;
 - (vi) offshore installations;
 - (vii) a qualifying ship which is used as a fishing vessel for a period of more than thirty days during a previous year.

Manner of computation of income under tonnage tax scheme [Section 115VE]

- (1) A tonnage tax company engaged in the business of operating qualifying ships should compute the profits from such business under the tonnage tax scheme;
- (2) “Tonnage tax company” means a qualifying company in relation to which tonnage tax option is in force;
- (3) “Tonnage tax scheme” means a scheme for computation of profits and gains of business of operating qualifying ships under the provisions of this Chapter.
- (4) The business of operating qualifying ships giving rise to “relevant shipping income” (i.e. income referred to in section 115V-I(1)) has to be considered as a separate business, distinct from all other activities or business carried on by the company.
- (5) Such profits should be computed separately from the profits and gains from any other business.
- (6) The tonnage tax scheme will apply only if an option to that effect is made (in accordance with the provisions of section 115VP).

- (7) The profits and gains from the business of operating qualifying ships of a company engaged in such business and –
- not covered under the tonnage tax scheme or,
 - which has not made an option to that effect,
- have to be computed in accordance with the other provisions of this Act.

Tonnage income [Section 115VF]

- "Tonnage income" means the income of a tonnage tax company computed in accordance with the provisions of this Chapter. The tonnage income has to be computed in accordance with the provisions of section 115VG given below.
- The income so computed is deemed to be the profits chargeable under the head "Profits and gains of business or profession".
- Where income is so computed under section 115VG, the relevant shipping income (referred to in section 115V-I(1)) will not be chargeable to tax.

Computation of tonnage income [Section 115VG]

- The tonnage income for a previous year is the aggregate of the tonnage income of each qualifying ship.
- The tonnage income of a qualifying ship is to be calculated on the basis of the daily tonnage income of such ship multiplied by the number of days in the previous year.
- In case the ship is operated by the company as a qualifying ship for only part of the previous year, the tonnage income of the ship will be calculated on the basis of daily tonnage of such ship multiplied by the number of days in part of the previous year.
- The daily tonnage income of a qualifying ship has to be computed as under –

Qualifying ship having net tonnage	Amount of daily tonnage income
Up to 1000	₹ 70 for each 100 tons
Exceeding 1,000 but not more than 10,000	₹ 700 plus ₹ 53 for each 100 tons exceeding 1,000 tons
Exceeding 10,000 but not more than 25,000	₹ 5,470 plus ₹ 42 for each 100 tons exceeding 10,000 tons
Exceeding 25,000	₹ 11,770 plus ₹ 29 for each 100 tons exceeding 25,000 tons

- "Tonnage" means the tonnage of a ship indicated in the "valid certificate" (i.e. referred to in section 115VX) and includes deemed tonnage computed in the prescribed manner.
- "Deemed tonnage" means the tonnage in respect of an arrangement of purchase of slots, slot charter and an arrangement of sharing of break-bulk vessel.
- The tonnage is to be rounded off to the nearest multiple of hundred tons.
- No deduction or set-off is allowed in computing the tonnage income under this Chapter.

Calculation of tonnage income in case of joint operation [Section 115VH]

- (1) Where a qualifying ship is operated by two or more companies –
 - (a) by way of joint interest in the ship or by way of an agreement for the use of the ship and
 - (b) their respective shares are definite and ascertainable,
 - (c) the tonnage income of each such company shall be an amount equal to a share of income proportionate to its share of interest.
- (2) Where two or more companies are operators of a qualifying ship, the tonnage income of each company shall be computed as if each had been the only operator, if the conditions specified in (a) and (b) of (1) above are not satisfied.

Meaning of “Relevant shipping income”[Section 115V-I]

- (1) The “relevant shipping income” of a tonnage tax company means its profits from core activities and its profits from incidental activities
- (2) Where the aggregate of income from incidental activities exceeds one-fourth per cent of the turnover from core activities, such excess will not form part of relevant shipping income for the purposes of this Chapter and shall be taxable under the other provisions of this Act.
- (3) The core activities of a tonnage tax company are –
 - (i) its activities from operating qualifying ships; and
 - (ii) Other ship-related activities, being,
 - (a) shipping contracts in respect of –
 - (1) earnings from pooling arrangements i.e.
 - (i) agreement between two or more persons for providing services through a pool or
 - (ii) operating one or more ships and sharing earnings or operating profits on the basis of mutually agreed terms;
 - (2) contracts of affreightment i.e. a service contract under which a tonnage tax company agrees to transport a specified quantity of specified products at a specified rate, between designated loading and discharging ports over a specified period.
 - (b) Specific shipping trades, being, -
 - (1) on-board or on-shore activities of passenger ships comprising of fares and food and beverages consumed on board;
 - (2) slot charters, space charters, joint charters, feeder services, container box leasing of container shipping.
- (4) The incidental activities of the tonnage tax company are the activities which are incidental to the core activities and which may be prescribed for the purpose.

- (5) The Central Government can, by notification, exclude any activity under “other ship-related activities” mentioned in (3) above or prescribe the limit up to which such activities can be included in the core activities.
- (6) Every notification issued under this Chapter has to be laid before each House of Parliament to make the same effective.
- (7) If both Houses agree in making any modification therein, the notification will have effect in such modified form.
- (8) Similarly, if both Houses agree that the notification should not be issued, then such notification will be of no effect.
- (9) However, such modification or annulment will not affect anything previously done under that notification.
- (10) Where a tonnage tax company operates a non-qualifying ship, then the income attributable to operation of the non-qualifying ship should be computed in accordance with the other provisions of this Act.
- (11) In the following cases, the relevant shipping income is to be computed as if the transfer had been at market value of the goods and services as on the date of transfer—
 - (i) Where any goods or services held for the purposes of tonnage tax business are transferred to any other business carried on by a tonnage tax company, or
 - (ii) where any goods or services held for the purposes of any other business carried on by such tonnage tax company are transferred to the tonnage tax business, and
 - (iii) In both the above cases, the consideration, if any, for such transfer as recorded in the accounts of the tonnage tax business does not correspond to the market value of such goods or services as on the date of the transfer,
- (12) Where the computation of the relevant shipping income in the manner specified above presents exceptional difficulties, the Assessing Officer may compute such income on such reasonable basis as he may deem fit.
- (13) If the Assessing Officer is of the opinion that the affairs of the business transacted between the tonnage tax company and any other person are arranged in such a manner that the company gets more than the ordinary profits which might be expected to arise in the tonnage tax business, then he may take into account the amount of income which may be reasonably deemed to have been derived therefrom for computing the relevant shipping income.
- (14) The affairs of the business can be so arranged to yield more than ordinary profits owing to the close connection between the tonnage tax company and such other person or for any other reason.
- (15) In case the relevant shipping income of a tonnage tax company is a loss, then, such loss is to be ignored for the purposes of computing tonnage income.

Treatment of common costs [Section 115VJ]

- (1) Where a tonnage tax company also carries on any business or activity other than the tonnage tax business, the common costs attributable to the tonnage tax business should be determined on a reasonable basis.

- (2) Where any asset, other than qualifying ship, is not exclusively used for the tonnage tax business by the tonnage tax company, depreciation on such asset has to be allocated between its tonnage tax business and other business.
- (3) Such allocation of depreciation has to be done on a fair proportion to be determined by the Assessing Officer, having regard to the use of such asset for the purpose of the tonnage tax business and for the other business.

Depreciation [Section 115VK]

- (1) The depreciation for the first previous year of the tonnage tax scheme has to be computed on the written down value of the qualifying ships.
- (2) The written down value of the block of assets, being ships, as on the first day of the previous year, has to be divided in the ratio of the book written down value of the qualifying ships (qualifying assets) and the book written down value of the non-qualifying ships (other assets).
- (3) The block of qualifying assets would constitute a separate block of assets.
- (4) The manner of computing the book written down value of the block of qualifying assets and the block of other assets is as follows –
 - (a) the book written down value of each qualifying asset and each other asset as on the first day of the previous year is to be determined by taking the book written down value of each asset appearing in the books of account as on the last day of the preceding previous year;
 - (b) Any change in the value of assets consequent to their revaluation after 10.9.04 is to be ignored;
 - (c) The book written down value of all the qualifying assets and other assets are to be aggregated;
 - (d) The ratio of the aggregate book written down value of the qualifying assets to the aggregate book written down value of the other assets has to be determined.
- (5) In case an asset forming part of the block of qualifying assets begins to be used for purposes other than the tonnage tax business, an appropriate portion of the written down value allocable to such asset has to be reduced from the written down value of that block and added to the block of other assets.
- (6) In case an asset forming part of the block of other assets begins to be used for tonnage tax business, an appropriate portion of the written down value allocable to such asset has to be reduced from the written down value of the block of other assets and has to be added to the block of qualifying asset.
- (7) Depreciation on the block of qualifying assets and block of other assets so created shall be allowed as if the written down value as on the first previous year has been brought forward from the preceding previous year.
- (8) The expression “book written down value” means the written down value as appearing in the books of account.

Deemed deduction and set-off and carry forward of losses etc. [Section 115VL]

- (1) Any loss/allowance or deduction under sections 30 to 43B relating to or allowable for any of the relevant previous years, would be deemed to have been given full effect to in that previous year itself;
- (2) No set-off or carry forward of losses referred to in –
 - (i) sections 70(1) and 70(3); or
 - (ii) sections 71(1) and 71(2); or
 - (iii) section 72(1) or
 - (iv) section 72A(1),relating to the business of operating qualifying ships of the company is permissible where such loss relates to any of the previous years when the company is under the tonnage tax scheme;
- (3) No deduction under Chapter VI-A is allowable in relation to the profits and gains from the business of operating qualifying ships;
- (4) In computing the depreciation allowance under section 32, the written down value of any asset used for the purposes of the tonnage tax business has to be computed as if the company has claimed and has been actually allowed the deduction in respect of depreciation for the relevant previous year.

Set-off and carry forward of losses of tonnage tax business [Section 115VM]

- (1) Any losses attributable to its tonnage tax business that have accrued to a company before its entry in tonnage tax scheme can be set off only against the relevant shipping income when the company is under the tonnage tax scheme.
- (2) Such losses will not be available for set off against any income other than relevant shipping income in any previous year beginning on or after the date when the company exercises its option under section 115VP.
- (3) Any apportionment necessary to determine such losses should be made on a reasonable basis.

Capital gains from transfer of tonnage tax assets [Section 115VN]

- (1) Profits or gains arising from the transfer of a capital asset being an asset forming part of the block of qualifying assets is chargeable to income-tax in accordance with the provisions of section 45, read with section 50.
- (2) The capital gains so arising has to be computed in accordance with the provisions of sections 45 to 51.

Book profit or loss to be excluded for the purpose of section 115JB [Section 115VO]

This section seeks to exclude the book profits or loss derived from the activities of a tonnage tax company (referred to in section 115V-I(1)) for the purposes of section 115JB.

(2) Procedure for Option of Tonnage Tax Scheme

Method and time of opting for tonnage tax scheme [Section 115VP]

- (1) A qualifying company may opt for the tonnage tax scheme by making an application to the Joint-Commissioner having jurisdiction over the company in the prescribed form and manner.
- (2) An existing qualifying company should make an application at any time after 30th September, 2004 but before 1st January, 2005, which is the initial period.
- (3) In case of a company incorporated after the initial period or a company incorporated before the initial period but which becomes a qualifying company for the first time after the initial period, an application can be made within three months of the date of its incorporation or the date on which it became a qualifying company, as the case may be.
- (4) The Joint Commissioner, on receipt of an application for option for tonnage tax scheme, may call for such information or documents from the company as he thinks necessary in order to satisfy himself about the eligibility of the company.
- (5) After satisfying himself about the eligibility of the company to make such option for tonnage tax scheme, he can either pass an order in writing approving the option for tonnage tax scheme or, if he is not so satisfied, pass an order in writing refusing to approve the option for tonnage tax scheme.
- (6) A copy of such order should be sent to the applicant.
- (7) An order refusing to approve the option for tonnage tax scheme can be passed only after giving the applicant a reasonable opportunity of being heard.
- (8) Every order granting or refusing the approval of the option for tonnage tax scheme should be passed before the expiry of one month from the end of the month in which the application was received.
- (9) Where an order granting approval for tonnage tax scheme is passed, the provisions of this Chapter will apply from the assessment year relevant to the previous year in which the option for tonnage tax scheme is exercised.

Period for which the tonnage tax option will remain in force [Section 115VQ]

- (1) An option for tonnage tax scheme (after it has been approved under section 115VP(3)) would remain in force for a period of ten years from the date on which such option has been exercised.
- (2) For this purpose, the option would be taken into account from the assessment year relevant to the previous year in which such option is exercised.
- (3) An option for tonnage tax scheme would cease to have effect from the assessment year relevant to the previous year in which –
 - (i) the qualifying company ceases to be so or
 - (ii) a default is made in complying with the provisions contained in section 115VT or section 115VU or section 115VV.

- (4) The tonnage tax option will also cease to have effect in case –
 - (i) a company is excluded from the tonnage tax scheme under section 115VZC or
 - (ii) the qualifying company furnishes to the Assessing Officer, a declaration in writing to the effect that the provisions of this Chapter may not be made applicable to it.
- (5) In such a case, the profits of the company from the business of operating qualifying ships shall be computed in accordance with the other provisions of the Income-tax Act.

Renewal of tonnage tax scheme [Section 115VR]

- (1) An option for tonnage tax scheme approved under section 115VP may be renewed within one year from the end of the previous year in which the option ceases to have effect.
- (2) The provisions of sections 115VP and 115VQ discussed above would apply in relation to a renewal of the option for tonnage tax scheme in the same manner as they apply in relation to the approval of option for tonnage tax scheme.

Bar from opting for tonnage tax scheme in certain cases [Section 115VS]

- (1) A qualifying company is not eligible to opt for the tonnage tax scheme if –
 - (i) the company, on its own, opts out of the tonnage tax scheme or
 - (ii) it makes a default in complying with the provisions of section 115VT or section 115VU or section 115VV or
 - (iii) its option has been excluded from tonnage tax scheme in pursuance of an order made under section 115VZC(1).
- (2) In such cases, the qualifying company will not be eligible to opt for tonnage tax scheme for a period of ten years from the date of such opting out or default or order, as the case may be.
- (3) **Conditions for Applicability of Tonnage Tax Scheme**

Transfer of profits to Tonnage Tax Reserve Account [Section 115VT]

- (1) A tonnage tax company is required to credit to a reserve account (called Tonnage Tax Reserve Account) an amount not less than twenty per cent of the book profits derived from its core and incidental activities (referred to in section 115V-I(1)) in each previous year to be utilised in the manner laid down below –
 - (i) The amount credited should be utilized for acquiring a new ship before the expiry of 8 years for the purposes of the business of the company; and
 - (ii) Until the acquisition of a new ship, the amount can be utilized for the purposes of the business of operating qualifying ships other than for distribution by way of dividends or profits or for remittance outside India as profits or for the creation of any asset outside India. [Sub-section (3)]
- (2) A tonnage tax company may transfer a sum in excess of twenty per cent of the book profits. Such excess sum transferred should also be utilised in above manner.
- (3) “Book profit” will have the same meaning as in the Explanation to section 115JB(2) so far as it relates to income derived from the core and incidental activities.

- (4) Where the company has book profit from the business of operating qualifying ships and book loss from any other source, and consequently, the company is not in a position to create the full or any part of the reserves as required, then –
- the company should create the reserves to the extent possible in that previous year.
 - The shortfall, if any, will be added to the amount of the reserves required to be created for the following previous year.
 - Such shortfall will be deemed to be part of the reserve requirement of that following previous year.

(5) Consequences of misutilisation / non-utilisation [Sub-section (4)]

- Where any amount credited to the Tonnage Tax Reserve Account has –
 - been utilized for any purpose other than that referred to in (1) above; or
 - not been utilized for the purpose of acquiring a new ship for the purpose of the business of the company within 8 years; or
 - has been utilized for acquiring a new ship within 8 years but such ship is sold or transferred, otherwise than in any scheme of demerger, within 3 years from the end of the previous year in which it was acquired

then, an amount which bears the same proportion to the total relevant shipping income of the year in which such reserve was created, as the amount out of such reserve so utilized or not utilized bears to the total reserve created during that year shall be taxable under the other provisions of the Act i.e.

$$\text{Taxable amount} = \text{Relevant shipping income} \times \frac{\text{Extent of reserves unutilized or misutilised}}{\text{Total reserve created during the year}}$$

- Such amount as calculated above would be taxable -
 - in case (a) of (i) above, in the year in which the amount was so utilized; or
 - in case (b) of (i) above, in the year immediately following the period of 8 years;
 - in case (c) of (i) above, in the year in which the sale or transfer took place.
- However, the income so taxable under the other provisions of the Act will be reduced by the proportionate tonnage income charged to tax in the year of creation of such reserves.

(6) Shortfall in credit to Tonnage Tax Reserve Account [Sub-section (5)]

If there is any shortfall in the amount credited to the Tonnage Tax Reserve Account, then the amount which bears the same proportion to the total relevant shipping income as the shortfall in credit to the reserves bears to the minimum reserve required to be credited, will be taxable under the other provisions of the Act i.e.

$$\text{Taxable amount} = \text{Relevant shipping income} \times \frac{\text{Shortfall in credit to reserves}}{\text{Minimum reserve to be credited}}$$

- (7) Consequences of failure to create reserve for two consecutive previous years [Sub-section (6)] - If the reserve required to be created is not created for any two consecutive previous years, the option of the company for tonnage tax scheme will cease to have effect from the beginning of the previous year following the second consecutive previous year in which the failure to create the reserve had occurred.
- (8) Meaning of “new ship”: A new ship includes a ‘qualifying ship’, which before the date of its acquisition by the qualifying company was used by any other person. However, it should not have been owned by any person resident in India before the date of such acquisition.

Minimum training requirement for a tonnage tax company [Section 115VU]

- (1) A tonnage tax company, after its option has been approved under section 115VP(3) is required to comply with the minimum training requirement in respect of trainee officers in accordance with the guidelines framed by the Director-General of Shipping and notified in the Official Gazette by the Central Government. [Sub-section (1)]
- (2) A copy of the certificate issued by the Director-General of Shipping to the effect that such company has complied with the minimum training requirement in accordance with the guidelines referred to in sub-section (1) for the previous year is required to be furnished along with the return of income.
- (3) If the minimum training requirement is not complied with for any five consecutive previous years, the option of the company for tonnage tax scheme shall cease to have effect from the start of the previous year following the fifth consecutive year in which the failure to comply with the minimum training requirement occurred.

Limit for charter in of tonnage [Section 115VV]

- (1) Every company which has opted for tonnage tax scheme should charter in not more than forty nine per cent of the net tonnage of the qualifying ships operated by it during any previous year. The term “chartered in” does not include a ship chartered in by the company on bareboat charter-cum-demise terms.
- (2) Such proportion of net tonnage in respect of a previous year is to be calculated based on the average of net tonnage during that previous year.
- (3) The average of net tonnage is to be computed in such manner as may be prescribed in consultation with the Director-General of Shipping.
- (4) Where the net tonnage of ships chartered in exceeds the limit of 49% during any previous year, the total income of such company in relation to that previous year is to be computed as if the option for tonnage tax scheme does not have effect for that previous year.
- (5) Where the said limit of 49% is exceeded in any two consecutive previous years, the option for tonnage tax scheme shall cease to have effect from the beginning of the previous year following the second consecutive previous year in which the limit had exceeded.

Maintenance and audit of accounts [Section 115VW]: An option for tonnage tax scheme by a tonnage tax company will not have effect in relation to a previous year unless such company –

- (i) maintains separate books of account in respect of the business of operating qualifying ships and
- (ii) furnishes, along with the return of income for that previous year, the report of an accountant, in the prescribed form duly signed and verified by such accountant.

Determination of tonnage [Section 115VX]

- (1) The tonnage of the ship shall be determined in accordance with the valid certificate indicating its net tonnage.
- (2) "Valid certificate" means –
 - (i) in case of ships registered in India—
 - (a) having a length of less than twenty-four metres, a certificate issued under the Merchant Shipping (Tonnage Measurement of Ship) Rules, 1987 made under the Merchant Shipping Act, 1958;
 - (b) having a length of twenty-four metres or more, an international tonnage certificate issued under the provisions of the Convention on Tonnage Measurement of Ships, 1969 as specified in the Merchant Shipping (Tonnage Measurement of Ship) Rules, 1987 made under the Merchant Shipping Act, 1958;
 - (ii) in case of ships registered outside India,
 - (a) a licence issued by the Director-General of Shipping under section 406 or section 407 of the Merchant Shipping Act, 1958 specifying the net tonnage on the basis of Tonnage Certificate issued by the Flag State Administration where the ship is registered or
 - (b) any other evidence acceptable to the Director-General of Shipping produced by the ship owner while seeking permission for chartering in the ship.

(4) Amalgamation and Demerger of Shipping Companies

Amalgamation [Section 115VY]

- (1) In case of amalgamation, the provisions relating to the tonnage tax scheme would apply to the amalgamated company if it is a qualifying company.
- (2) However, where the amalgamated company is not a tonnage tax company, it should exercise an option for tonnage tax scheme under section 115VP(1) within three months from the date of the approval of the scheme of amalgamation.
- (3) Where the amalgamating companies are tonnage tax companies, the provisions of this Chapter would apply to the amalgamated company for such period as the option for tonnage tax scheme which has the longest unexpired period continues to be in force.

For example, if two tonnage tax companies X Ltd. and Y Ltd. are amalgamated to form a new company Z Ltd., and the option for tonnage tax scheme of X Ltd. has an unexpired period of 8 years and Y Ltd. has an unexpired period of 6 years, then the provisions of this Chapter would apply to the new company Z Ltd. for a period of 8 years.

- (4) Where one of the amalgamating companies is a qualifying company on 1st October, 2004

and has not exercised option for tonnage tax scheme within the initial period, then –

- (i) the provisions of this Chapter will not apply to the amalgamated company and
- (ii) the income of the amalgamated company from the business of operating qualifying ships has to be computed in accordance with the other provisions of the Act.

Demerger [Section 115VZ]

- (1) Where in a scheme of demerger, the demerged company transfers its business to the resulting company before the expiry of the option for tonnage tax scheme, then the scheme would apply to the resulting company for the unexpired period if it is a qualifying company.
- (2) The option for tonnage tax scheme in respect of the demerged company would remain in force for the unexpired period of the tonnage tax scheme if it continues to be a qualifying company.

(5) Other Provisions

Effect of temporarily ceasing to operate qualifying ships [Section 115VZA]

- (1) A temporary cessation (as against permanent cessation) of operating any qualifying ship by a company would not be considered as a cessation of operating of such qualifying ship. The company would still be deemed to be operating such qualifying ship for the purposes of this Chapter.
- (2) Where a qualifying company continues to operate a ship, which temporarily ceases to be a qualifying ship, then such ship will not be considered as a qualifying ship for the purposes of this Chapter.

(6) Cases Where Provisions of this Chapter Does Not Apply

Avoidance of tax [Section 115VZB]

- (1) The tonnage tax scheme will not apply where a tonnage tax company is a party to any transaction or arrangement which amounts to an abuse of the tonnage tax scheme.
- (2) A transaction or arrangement will be considered as an abuse if the entering into or the application of such transaction or arrangement results, or would, but for this section have resulted, in a tax advantage being obtained by –
 - (a) a person other than a tonnage tax company; or
 - (b) a tonnage tax company in respect of its non-tonnage tax activities.
- (3) “Tax advantage” includes,—
 - (i) (a) the determination of the allowance for any expense or interest, or
 - (b) the determination of any cost or expense allocated or apportioned,which has the effect of reducing the income or increasing the loss, as the case may be, from activities other than tonnage tax activities chargeable to tax.
Such computation should be on the basis of entries made in the books of account in respect of the previous year in which the transaction was entered into; or

- (ii) a transaction or arrangement which produces to the tonnage tax company more than ordinary profits which might be expected to arise from tonnage tax activities.

Exclusion from tonnage tax scheme [Section 115VZC]

- (1) Where a tonnage tax company is a party to any transaction or arrangement which amounts to an abuse of the tonnage tax scheme, the Assessing Officer has the power to exclude such company from the tonnage tax scheme, by an order in writing, after giving an opportunity of being heard to such company.
- (2) However, no order to this effect can be passed without the previous approval of the Chief Commissioner.
- (3) This section does not apply where the company shows to the satisfaction of the Assessing Officer that the transaction or arrangement was a bona fide commercial transaction and has not been entered into for the purpose of obtaining tax advantage under this Chapter.

Where an order has been passed by the assessing officer excluding the tonnage tax company from the tonnage tax scheme, then, the option for tonnage tax scheme shall cease to be in force from the first day of the previous year in which the transaction or arrangement was entered into.

13.1.22 Conversion of an Indian branch of foreign company into an Indian subsidiary company [Chapter XII-BB] [Section 115JG]

- (i) The provisions of this section apply to a foreign company engaged in banking business in India through its branch situated in India, which is converted into an Indian subsidiary company in accordance with the scheme framed by RBI.
- (ii) If the conditions notified by the Central Government in this behalf are satisfied, then capital gains arising from such conversion would not be chargeable to tax in the assessment year relevant to the previous year in which such conversion takes place.
- (iii) Also, the provisions of the Act relating to computation of income of foreign company and Indian subsidiary company would apply with such exceptions, modifications and adaptations as specified in the notification.
- (iv) Further, the benefit of set-off of unabsorbed depreciation, set-off and carry forward of losses, tax credit in respect of tax paid on deemed income relating to certain companies available under the Act shall apply with such exceptions, modifications and adaptations as specified in the notification.
- (v) If the conditions specified in the scheme of RBI or notification issued by the Central Government are not complied with, then, all the provisions of the Act would apply to the foreign company and Indian subsidiary company without any benefit, exemption or relief under this section.
- (vi) If the benefit, exemption or relief has been granted to the foreign company or Indian subsidiary company in any previous year and thereafter, there is a failure to comply with any of the conditions specified in the scheme or notification, then, such benefit, exemption or relief shall be deemed to have been wrongly allowed.

(vii) In such a case, the Assessing Officer is empowered to re-compute the total income of the assessee for the said previous year and make the necessary amendment. This power is notwithstanding anything contained in the Income-tax Act, 1961.

(viii) The provisions of rectification under section 154, would, accordingly, apply and the four year period within which such rectification should be made has to be reckoned from the end of the previous year in which the failure to comply with such conditions has taken place.

(ix) Every notification under issued under this section shall be laid before each House of Parliament.

13.2 Assessment of Other Entities

13.2.1 Levy of Alternate Minimum Tax (AMT) on all persons claiming profit-linked deductions, other than companies [Chapter XII-BA–Sections 115JC to 115JF]

(i) The Finance Act, 2011 had introduced the concept of AMT in relation to LLPs and accordingly the LLPs were subject to AMT @ 18.5% of adjusted total income.

(ii) Though the concept of Alternate Minimum Tax (AMT) was similar to MAT in case of corporates, however, the tax base in the case of LLPs was the adjusted total income computed as per the Income-tax Act, 1961 and not the book profit computed after making the specified adjustments to the profit as per the profit and loss account prepared in accordance with Schedule VI to the Companies Act, 1956.

(iii) The Finance Act, 2012 extended the levy of AMT to certain persons other than companies, in order to widen the tax base vis-à-vis profit-linked deductions. Accordingly, any person other than a company, who has claimed deduction under any section (other than section 80P) included in Chapter VI-A under the heading “C – Deductions in respect of certain incomes” or under section 10AA would be subject to AMT with effect from A.Y.2013-14. [Section 115JEE]

The provisions of AMT would, however, not be applicable to an individual, HUF, AOP, BOI, whether incorporated or not, or artificial juridical person, if the adjusted total income of such person does not exceed ₹ 20 lakh. [Section 115JEE]

(iv) Accordingly, where the regular income-tax payable by a person, other than a company, for a previous year computed as per the provisions of the Income-tax Act, 1961 (other than Chapter XII-BA) is less than the AMT payable for such previous year, the adjusted total income shall be deemed to be the total income of the person. Such person shall be liable to pay income-tax on the adjusted total income @ 18.5% [Section 115JC].

(v) “Adjusted total income” would mean the total income before giving effect to Chapter XII-BA as increased by the deductions claimed, if any, under –

- (1) any section (other than section 80P) included in Chapter VI-A under the heading “C – Deductions in respect of certain incomes”; and
- (2) section 10AA.

(vi) Such persons to whom this section applies should obtain a report in the prescribed form from a Chartered Accountant certifying that the adjusted total income and the AMT have

been computed in accordance with the provisions of this Chapter. The report has to be furnished on or before the due date of filing of return under section 139(1).

- (vii) Section 115JE specifically provides that “save as otherwise provided in this Chapter, all other provisions of this Act shall apply to a person referred to in this Chapter”. Hence, all other provisions relating to self-assessment under section 140A, advance tax, interest under sections 234A, 234B and 234C, penalty etc. would also apply to a person who is subject to AMT.

Tax credit for AMT [Section 115JD]

- (viii) AMT paid in excess of the regular income-tax payable under the provisions of the Income-tax Act, 1961 for the year would be eligible for credit to be carried forward and set-off against income-tax payable in the later year to the extent of excess of regular income-tax payable under the provisions of the Act over the AMT payable in that year. The balance tax credit, if any, shall be carried forward to the next year for set-off in that year in a similar manner.
- (ix) AMT credit can be carried forward for set-off upto a maximum period of 10 assessment years succeeding the assessment year in which the credit becomes allowable.
- (x) No interest shall, however, be payable on such tax credit.
- (xi) If the amount of regular income-tax or AMT is reduced or increased as a result of any order passed under the Income-tax Act, 1961, the amount of tax credit allowed under section 115JD would also vary accordingly.
- (xii) Section 140A has been correspondingly amended to provide that for determination of self-assessment tax payable, interest payable under section 234A and assessed tax, tax credit claimed to be set-off in accordance with section 115JD has also to be reduced.
- (xiii) Such tax credit allowed to be set-off in accordance with the provisions of section 115JD has to be reduced from the amount of tax on total income determined under section 143(1) or on regular assessment on which interest under section 234A is leviable for default in furnishing return of income.

Similar amendment has been made in section 234B levying interest for default in payment of advance tax, to enable reduction of tax credit under section 115JD while computing “assessed tax”.

Likewise, in section 234C levying interest for deferment of advance tax, such tax credit under section 115JD has to be reduced for computing “tax due on the returned income”.

Illustration 6

Mr. Rajesh has income of ₹ 45 lakhs under the head “Profits and gains of business or profession”. One of his businesses is eligible for deduction@100% of profits under section 80-IB for A.Y.2014-15. The profit from such business included in the business income is ₹ 20 lakhs. Compute the tax payable by Mr. Rajesh, assuming that he has no other income during the P.Y.2013-14.

Solution

Computation of regular income-tax payable under the provisions of the Act

Particulars	₹
Profits and gains of business or profession	45,00,000
Less: Deduction under section 80-IB	20,00,000
Total Income	25,00,000
Tax payable	
Up to ₹ 2,00,000	Nil
10% on next ₹ 3,00,000	30,000
20% on next ₹ 5,00,000	1,00,000
30% on balance ₹ 15,00,000	4,50,000
	5,80,000

Computation of Alternate Minimum Tax (AMT)

Particulars	₹
Total Income as per the Income-tax Act, 1961	25,00,000
Add: Deduction under section 80-IB	20,00,000
Adjusted Total Income	45,00,000
AMT = $18.5\% \times 45,00,000 =$	8,32,500

Since the regular income-tax payable as per the provisions of the Act is less than the AMT, the adjusted total income of ₹ 45 lakhs would be deemed to be the total income of Mr. Rajesh and he would be liable to pay tax@18.5% thereof. The tax payable by Mr. Rajesh for the A.Y.2014-15 would, therefore, be ₹ 8,32,500 plus education cess@2% and secondary and higher education cess@1%, totaling ₹ 8,57,475.

Mr. Rajesh would be eligible for credit to the extent of ₹ 2,60,075 [₹ 8,57,475 – ₹ 5,97,400 (i.e., ₹ 5,80,000 + 3% cess)] to be set-off the year in which tax on total income computed under the regular provisions of the Act exceeds the AMT. Such credit can be carried forward for succeeding 10 assessment years.

13.2.2 Assessment of Individuals

The term "individual" as such has nowhere been defined in the Income-tax Act, 1961. Section 2(31), however, states that "person" *inter alia*, includes an individual. In the commonly understood sense of the term, an individual means a human being or a single person. The person may be major, minor, married or unmarried, possessing sound or unsound mind. All the same, he is assessable as an 'individual' and is liable to pay tax, if the total income earned by him during any previous year exceeds the prescribed limit exempted from tax. If an

individual who is liable to pay tax for any year dies before he is assessed to tax, his executor, administrator or legal representative is treated as the individual assessee for purposes of assessment of the income of the deceased person. In the case of an individual who is a minor or a lunatic, the assessment of his income will be made on his guardian or the trustee. However, if the incapacitated person has no trustee or guardian or trustee or guardian is a non-resident and cannot be traced, the assessment can be made directly on the minor or lunatic. The rights and duties of all representative assesseees are the same as those of the persons they are representing.

1. Total income of an individual: The total income of an individual for any previous year, which is liable to tax, is to be computed under the various heads discussed earlier. Further, sections 60 to 65 of the Income-tax Act, 1961 provide for clubbing of income arising to minor children, spouse, daughter-in-law etc. with the income of the individual under certain circumstances. These provisions must be strictly construed inasmuch as they create an artificial liability to tax. (Students may refer to the discussion of this topic contained in Chapter 9 for a detailed study of these provisions).

A married woman, being an individual, is liable to income tax in respect of the total income of any previous year arising to her in her own right, including the income from assets inherited by her or gifted to her by a person other than her husband or her father-in-law or mother-in-law.

2. Assessment of a non-resident individual : The tax structure explained above is also applicable to an individual who is a non-resident during the previous year. The scope of deemed income taxable in the hands of a non-resident as laid down in section 5 has already been explained in section 9(1) which extends the liability to tax of a non-resident individual in respect of income which although not actually accruing or arising in India is deemed to be so accruing or arising, assumes significance in the assessment of non-resident individual. For a detailed consideration of the provisions of section 9, students are advised to refer to Chapter 2.

3. Flat rate of tax on winnings from lotteries, crossword puzzles etc. [Section 115BB] : Under section 115BB, gross winnings from lotteries, crossword puzzles, races including horse races (other than income from the activity of owning and maintaining race horses), card games and other games of any sort or from gambling or betting of any nature whatsoever shall be chargeable to income-tax at a flat rate of 30% on the gross winnings.

4. Tax on non-resident sportsmen or sports associations [Section 115BBA] : This section is applicable where the total income of an assessee,

- (a) being a sportsman (including an athlete), who is not a citizen of India and is a non-resident, includes any income received or receivable by way of participation in any game or sport or advertisement or contribution of articles in relation to any game or sport in India in newspapers, magazines, journals.
- (b) being a non-resident sports association or institution, includes any amount guaranteed to be paid or payable to such association or institution in relation to any game or sport played in India.
- (c) being an entertainer, who is not a citizen of India and is a non-resident, includes any income received or receivable from his performance in India.

The income-tax payable shall be the aggregate of -

- (i) the amount of income-tax calculated on the income referred to in clause (a) or clause (b) or clause (c) at the rate of 20%; and
- (ii) the amount of income-tax with which the assessee would have been chargeable had the total income of the assessee been reduced by the amount of income in clause (a), (b) and (c).

No deduction in respect of any expenditure or allowance shall be allowed under any provision of this Act in computing the income referred to in clause (a) or clause (b) or clause (c).

Further, such an assessee is not required to file a return of income under section 139(1), if his total income consists only of (a), (b) and (c) above and tax deductible at source has been fully deducted.

5. Special provisions relating to certain incomes of non-residents - Chapter XII A:

This Chapter seeks to lay down a concessional method of taxation of certain specified income of non-residents. For this purpose, a non-resident Indian means a non-resident individual who may either be an Indian citizen or a person of Indian origin. A person shall be deemed to be Indian origin if he or either of his parents or any of his grand-parents was born in undivided India.

'Foreign exchange asset' means any 'specified asset' which the assessee has acquired, purchased with or subscribed to in convertible foreign exchange. Such 'specified assets' are as follows:

- (a) shares in an Indian company.
- (b) debentures issued by an Indian company which is not a private company as defined in the Companies Act, 1956.
- (c) deposits with a non-private Indian company.
- (d) any specified securities of Central Government.
- (e) units of the Unit Trust of India.
- (f) such other assets as may be notified by the Central Government.

The income derived from such a foreign exchange asset is called investment income.

"Investment income" means any income derived (other than dividends referred to in section 115-O) from a foreign exchange asset.

"Long-term capital gains" means income chargeable under the head "Capital Gains" relating to a capital asset, being a foreign exchange asset which is not a short-term capital asset.

(i) Flat rate for investment income and long-term capital gains [Section 115E]: Where the total income of a non-resident Indian consists only of investment income and capital gains arising out of the transfer of long-term foreign exchange assets, tax payable by him shall be the aggregate of :

- (a) income-tax on investment income at the rate of 20%;
- (b) income-tax on long-term capital gains at the rate of 10%; and
- (c) income-tax on his other total income.

(ii) **Exemption of capital gains arising from transfer of long-term foreign exchange asset [Section 115F]** : Where the non-resident Indian transfers the original foreign exchange asset and within a period of six months of such a transfer deposits or invests the whole or part of the net consideration in:

- (a) any specified asset or
- (b) any notified savings certificates referred to in section 10(4B)

then, the capital gains arising on such a transfer will be dealt with as follows :

If the cost of the new asset, referred to in (a) or (b) above, is not less than the net consideration in respect of the original asset the whole of such capital gain shall be exempt. If such cost is less than the net consideration, the exemption will be limited to:

$$\text{Total capital gain} \times \frac{\text{Cost of new asset}}{\text{Net Consideration}}$$

Note:

1. When the new asset consists of deposits, the cost means the amount of such deposits.
2. Net consideration means the full value of the consideration received or accruing as a result of the transfer as reduced by any expenditure incurred wholly and exclusively in connection with such transfer.
3. Where the new asset is transferred or converted (otherwise than by transfer) into money, within a period of three years from the date of its acquisition, the capital gain, exempted as above, shall be chargeable as long term capital gain of the previous year in which the new asset is transferred or converted.

(iii) **Return need not be filed [Section 115G]** : Where the total assessable income of the non-resident during the previous year consisted only of investment income and long-term capital gains relating to foreign exchange assets and tax on such income has been deducted at source then he need not file a return of income under section 139(1).

(iv) **Benefits available even after the assessee becomes a resident [Section 115H]**: Where a person, who is a non-resident Indian in any previous year, becomes assessable as resident in India in respect of the total income in any subsequent year, he may furnish a declaration along with such a return to the effect that the provisions of this chapter shall continue to apply to him in relation to the investment income derived from any foreign exchange asset being debentures, deposits, securities of Central Government and such other notified assets. If he does so, then these provisions will continue to apply to him till such assets are transferred or otherwise converted into money.

(v) **Option to the assessee [Section 115-I]**: A non-resident Indian may elect not to be governed by these provisions. For this purpose he has to declare in the return regarding his option not to be governed by these provisions. In such a case the total income and tax payable there on will be computed in accordance with the other provisions of this Act and consequently, the provisions of this chapter will not apply to such non-resident assesseees.

6. Special concessions in the case of individuals not being citizens of India :

Although basically the law of income-tax is applicable alike to both citizens and non-citizens of India, and there is no difference in the general principles for computing the total income under the Income-tax Act, 1961, however, on a consideration of the peculiar circumstances in which a foreigner might come to or live in India, certain concessions and reliefs are granted to them. These have been discussed in detail in Chapter 3 under the head 'Incomes not includible in the total income' [Section 10(6)].

7. Exemptions and reliefs available to individuals : The tax exemptions and reliefs available under the Act to individuals in respect of income chargeable to tax fall under the following categories:

1. Income altogether excluded from the total income, and on which in consequence, no income-tax is payable [Section 10].
2. Deductions from gross total income both in respect of income, a part of which is not chargeable to income-tax and payments made by the assessee, a part or the whole of which is deductible from the gross total income.
3. Relief in tax when salary is paid in arrears [Section 89].

8. Rebate of tax and relief in certain cases

- ◆ **Income from association of persons or bodies of individuals:** If the assessee is a member of an association of persons or a body of individuals (other than a HUF, a company or a firm) income-tax shall not be payable by him in respect of any portion of the amount receivable by him from the association or body on which tax has already been paid by the association or body [Section 86]. For the purposes of this provision in the case of an association of persons which is assessable under section 67A, the members of the AOP whose shares in the income are indeterminate or unknown, will be entitled to receive equal shares in the income of the AOP and the individual share of such member will be determined accordingly.
- ◆ **Relief when salary etc. is paid in arrears or in advance [Section 89]:** It has already been explained in the Chapter relating to salaries that arrears or advances of salaries are assessable in the hands of the recipients in the year in which these are received. Consequently, in a financial year, an employee may become chargeable to tax in respect of salary for more than 12 months. Likewise, any payment in the nature of profit in lieu of salary (within the meaning of section 17(3)) is also chargeable in the year of receipt in addition to the normal salary received by the employee. In consequence, the aggregate salary income may become liable to tax at a rate higher than that at which it would otherwise have been assessed. To obviate such a hardship, the Assessing Officer has been empowered to grant relief in appropriate cases, on the employee making an application, in accordance with Rule 21A of the Income-tax Rules, 1962.

In appropriate cases coming under section 192(2A), where the employer is the Government or a public sector undertaking, co-operative society, local authority, university, institution or body, such employer himself is entitled to take into account the relief under section 89(1).

13.2.3 Assessment of Hindu Undivided Families

1. **Concept of HUF :** Under the Income-tax Act, 1961, a Hindu undivided family (HUF) is treated as a separate entity for the purpose of assessment. It is included in the definition of the term "person" under section 2(31). The levy of income-tax is on "every person". Therefore, income-tax is payable by a HUF. "Hindu undivided family" has not been defined under the Income-tax Act, 1961. The expression is, however, defined under the Hindu Law as a family, which consists of all males lineally descended from a common ancestor and includes their wives and unmarried daughters.

The relation of a HUF does not arise from a contract but arises from status. A Hindu is born into a HUF. A male member continues to remain a member of the family until there is a partition of the family. After the partition, he ceases to be a member of one family. However, he becomes a member of another smaller family. A female member ceases to be a member of the HUF in which she was born, when she gets married. Thereafter, she becomes a member of the HUF of her husband.

Some members of the HUF are called co-parceners. They are related to each other and to the head of the family. A HUF may contain many members, but members within four degrees including the head of the family (karta) are called co-parceners. A Hindu co-parcenary includes those persons who acquire by birth an interest in the joint coparcenary property. Only the coparceners have a right to partition.

2. **Schools of Hindu Law:** There are two schools of Hindu law. They are –

- (1) Mithakshara school of Hindu law
- (2) Dayabhaga school of Hindu law

Mithakshara law is followed by entire India except West Bengal and Assam. There is a basic difference between the two schools of thought with regard to succession. Under the Mithakshara law, the inheritance is by birth. One acquires the right to the family property by his birth and not by succession irrespective of the fact that his elders are living. Thus, every child born in the family acquires a right/share in the family property.

Dayabhaga law prevails in West Bengal and Assam. In Dayabhaga law, nobody acquires the right, share in the property by birth as long as the head of family is living, that is, the children do not acquire any right, share in the family property, as long as his father is alive and only on death of the father, the children will acquire right/share in the property. Thus, the father and his brothers would be the coparceners of the HUF.

3. **Assessment of Hindu Undivided family:** The income of a HUF is to be assessed in the hands of the HUF and not in the hands of any of its members. This is because HUF is a separate and a distinct tax entity.

Partition of HUF – There are two types of partition. They are –

- (1) **Total partition** – is a partition by which the entire family property is divided amongst the coparceners. After the total partition, the HUF ceases to exist as such.
- (2) **Partial partition** – is a partition which is partial as regards either the persons constituting the joint family or as regards the properties belonging to the joint family or both. In case

of a partial partition as regards persons constituting the joint family, some coparceners may separate from the joint family while the others might continue to remain as part of the joint family. In case of a partial partition as regards the property, there may be a division or severance of interest in respect of some part of the estate of the joint family, while the rest of the estate may continue to remain as property of the joint family.

Effect of partial partitions made after 31st December, 1978: However, partial partitions after 31st December, 1978 are not recognized for tax purposes. If any partial partition has been effected after 31.12.1978, then no claim of such partial partition shall be recorded by the Assessing Officer. Such family will continue to be assessed as if no such partial partition has been effected. Every member of the HUF, immediately before such partial partition, and the HUF shall be jointly and severally liable for any sum payable under the Act. The several liability of a member would be proportionate to the share of joint family property allotted to him on such partial partition.

Assessment after total partition: When a claim of total partition of HUF has been made by any member of the HUF on behalf of the HUF, the Assessing Officer shall inquire into such claim. For this purpose, he shall give notice to all the members of the HUF. Thereafter, the Assessing Officer shall, on completion of inquiry, record a finding as to whether total partition has taken place and if so, the date when such partition was effected. If partition has been effected in the previous year, the total income of the HUF for the previous year up to the date of partition shall be assessed as income of the HUF. Every member of the HUF is jointly and severally liable for payment of tax on such assessed income of the HUF. The several liability of a member would be proportionate to the share of joint family property allotted to him on such partition.

4. Computation of total income of HUF: The following points should be taken into consideration while determining the total income of HUF -

- (1) Income from the transfer of a self acquired property by an individual to his HUF for inadequate consideration or conversion of the self-acquired property into property of the HUF is not considered as the income of the HUF. It would be included in the income of the individual member who transferred the property to the HUF [section 64(2)]
- (2) Income from an impartible estate is included in the hands of the holder of the estate and not in the hands of the HUF. Even if the impartible estate is owned by the HUF, income from such estate is includible in the hands of the holder of the estate who is the eldest member of the HUF.
- (3) Section 10(2) exempts any receipt by an individual as a member of a HUF out of the family income.
- (4) If a member of the HUF receives any fee or remuneration as a director or a partner in a company or firm as a consequence of the investment made in such concern out of the funds of the HUF, such fee/remuneration shall constitute income of the HUF. However, any such fee or remuneration earned by a member of a HUF as a director or partner for services rendered purely in his personal capacity, will be included in the income of the individual member and not the HUF.

Income received in the capacity as a member: Section 10(2) gives total exemption in respect of any sum received by an individual as member of a Hindu Undivided Family either out of income of the family.

Conversion of separate property into property of HUF: However, to the above exemption there is an exception provided by section 64(2). Even though we have discussed this in the appropriate place it will be better to recapitulate.

Before this, let us understand the concept of conversion. Generally, income from self-acquired property of an individual, who is a member of a HUF will be assessed as his personal income and not as the income of the family. However, the individual can convert his separate properties into the property of the HUF. There are no legal formalities to be complied with. These principles have been upheld by various judicial rulings.

It naturally follows that once the assets belonging to the individual are impressed with the character of joint family property, the income arising therefrom, should be assessed as the income of the HUF. However, the deeming provisions of section 64(2) specifically provide that the entire income from the converted property is taxable as the income of the transferor. This provision applies not only to property converted in the above manner but also covers transfer of property by an individual, directly or indirectly, to the family otherwise than for adequate consideration, in other words, gifts. Accordingly, where an individual makes direct or indirect gift of his separate property to the Hindu Undivided family of which he is a member or if he transfers his separate property to his family for less than its fair market value, the provisions of section 64(2) will be attracted and the entire income from such separate property converted into HUF property will be included in the total income of the individual.

Example: A converts his self-acquired property into HUF property consisting of Mr.A, Mrs. A, B (A's major son) and C (A's minor son) on 1-4-2012. The annual income from such property is ₹ 12,00,000. On 1-4-2013, a partition took place among the members of the family and above converted property was divided amongst the members according to Hindu Law provisions. A has got income from other sources to the extent of ₹ 1,00,000. The HUF's income from other sources amounted to ₹ 80,000. Find out the taxable income of Mr.A and HUF for the assessment years 2013-14 and 2014-15.

Assessment of Mr. A

Assessment year 2013-14: As per the provisions of section 64(2)(b), the entire income derived from the converted property will be deemed to arise to A and not to family. Hence it will be included in A's individual assessment.

	₹
Income from converted property	12,00,000
Income from other sources	<u>1,00,000</u>
Total	<u>13,00,000</u>

Assessment year 2014-15 subsequent to partition: Section 64(2)(c) provides that on such partition, the income derived from such converted property as is received by the spouse or minor child on partition shall be deemed to arise to the spouse or minor child from assets transferred indirectly by the individual to the spouse or minor child. Hence, the income received by the spouse or minor child from such converted property shall be deemed to be the income of the transferor.

	₹	₹
Thus, out of ₹ 12,00,000, A's share is 1/4th		3,00,000
Mrs. A's share 1/4 th	3,00,000	
C (minor son's share 1/4th)	<u>3,00,000</u>	<u>6,00,000</u>
		9,00,000
Income from other sources		<u>1,00,000</u>
		<u>10,00,000</u>

Assessment of HUF:

Assessment year 2013-14: The proviso to section 64(2) says that once income from property has been included in the total income of the individual, it will be excluded from the total income of the family. Therefore, ₹ 12,00,000 having already been included in A's individual assessment will not be again assessed in the family's assessment.

	₹
Other income	<u>80,000</u>
	<u>80,000</u>

Assessment year 2014-15: As per the provisions of section 64(2)(c), the income derived by A, his spouse and his minor child have already been included in A's individual assessment. The share of B, A's major son, will be assessed in B's individual assessment. Hence, only other income is to be included in the family's assessment

	₹
Other income	<u>80,000</u>
	<u>80,000</u>

Can a female member throw personal property into joint family hotchpot? A connected question here is that whether a female member can impress upon her personal property the character of joint family property. The right to blend is limited to coparceners and a female member of the joint family cannot blend her separate property (even if she is an absolute owner thereof) with the joint family property. To blend is to share along with others and not to surrender one's interest in favour of others to the exclusion of oneself. A Hindu female cannot therefore "blend" because she, not being a coparcener, has no right to demand a share in the joint family property by asking for a partition. But she can always gift her absolute property to the family and then the property belongs to the family and the income arising out of the assets is to be taxed in the hands of the family. These principles emerge in the Supreme Court's decision in *Puspha Devi v. CIT* (1977) 109 ITR 730.

5. Business in the personal capacity of the Karta or member : Where the Karta or any member of a joint family carries on a business on his personal account, the income from any such business would constitute his personal income. It does not matter even if the business of the member and of the joint family are identical in nature and size. Suppose the capital for the individual's business is borrowed from the funds of the family what will be the position? Consider the following example.

Example 1: A HUF consists of the Karta, his wife, two sons and daughter. The HUF runs a departmental store. One of the two sons is qualified in business administration and the other one is an automobile engineer. Together they start a garage for repairing all types of motor cars. The technical aspects are looked after by the engineer while the general administration is taken care of by the son qualified in business administration. For starting the business the HUF has advanced an interest-free loan of ₹ 50,000. The business is yielding good profits. Now the question arises whether the income from the business should be assessed in the hands of the Hindu undivided family.

Answer: It is obvious that the family, in providing the interest-free loan to the business of the brothers has suffered a detriment. However, the Delhi High Court has laid down the following proposition in this connection in the case of *CIT vs. Charan Dass Khanna & Sons (1980) 123 ITR 194 (Delhi)*. If investment plays a minor role and it is primarily the personal efforts, specialised skill and enterprise of the individual coparceners which resulted in the new business being set up and the profits accruing, it may not essentially be said that the income belongs to the HUF. In the given example the good profits are more due to the specialised skills acquired by the two sons in their respective fields. Of course, the capital, got from the family as interest free loan, has its role to play but it is nevertheless a minor one. Therefore, we can say that the income from the business set up by the brothers is assessable in their hands as individuals according to the agreed rate of sharing and not as the income of the family.

The Supreme Court has also upheld this principle in *K.S. Subbiah Pillai vs. CIT (237 ITR 11)*. It was held that remuneration received on account of personal qualification and exercise of individual exertion was assessable as individual income and not as income of HUF. The following principles have been broadly applied by the Supreme Court for determining the character of the receipt by way of remuneration paid to a coparcener:

- (i) when the remuneration received by the coparcener though not in form but in substance was one of the modes of return made to the family because of investment of the family funds, it has to be assessed as the income of Joint Hindu Family.
- (ii) when the remuneration is not paid to the detriment of the family funds, it is assessable as the income of recipient Karta or coparcener as an individual.
- (iii) when it is a compensation for the services, skill or labour of the coparcener, it has to be assessed as the income of such a coparcener in his individual capacity.

Example 2: The Karta of a HUF receives salary in his capacity as a treasurer and secretary of a bank. The HUF has furnished ₹ 1,00,000 as security deposit. Decide whether the salary can be assessed as the income of the HUF.

Answer: The position of treasurer and secretary requires considerable personal skill and integrity on the part the incumbent. It is true that the security deposit might have been furnished by the HUF, however, since the salary is paid to the Karta primarily for the exercise of his personal skill and integrity, it is to be assessed as his individual income.

Hence, students should carefully understand the following:

- (a) Where the funds of a HUF are invested in a company or a partnership firm, the dividends or share of profits are generally taxable as the income of the family. In such a case the

fee, salary, commission or other remuneration received by the Karta, or any member of the family, in his capacity as director or partner would also be taxable as income of the family. The reasons for this treatment are as follows:

- (1) The income is earned by the detriment to the joint family funds.
 - (2) It is earned with the aid of joint family funds.
 - (3) There is real and sufficient connection between the investment of the joint family funds and the income by way of remuneration earned.
- (b) However, where the income is earned by the karta or any other member of the family by the exercise of the personal skill the income should be assessed in their individual hands even if some detriment is caused to the family funds, say, by way of loan, guarantee etc. whose role is only secondary.

6. Members of HUF and Partnership firms: A Hindu undivided family can become a partner in a firm. However, since it has no separate legal entity of its own, its Karta alone can be partner in the firm representing the family. The coparcenery has no place in the partnership.

When the Karta of joint Hindu family enters into a partnership with strangers, the member of the family do not, *ipso facto*, become partners in that firm. They have no right to take part in its management or to sue for its dissolution. The creditors of the firm are entitled to proceed against the joint family assets including the shares of the non-partner coparceners for their debts. This is because under Hindu Law, the Karta has the right when carrying on business to pledge the credit of the joint family to the extent of its assets. The liability on the part of other members of the HUF arises by reason of their status as coparceners and not by reason of any contract of partnership by them.

Partnership between Karta representing family and Coparcener: A Karta of a HUF representing the family on the one hand, and a member of that family in his individual capacity on the other, can enter into a valid partnership. An individual coparcener, while remaining joint, can possess, enjoy and utilise in any way he likes, property which is his individual property. Therefore, when he enters into partnership with the family he retains his share and interest in the property of the family while he simultaneously enjoys the benefit of his separate property and fruits of its investment.

7. Salary paid to Karta for managing the family's business: If remuneration is paid to the Karta of Hindu undivided family under a valid agreement which is *bona fide* and in the interest of and expedient for the business of the family and the payment is genuine and not excessive, such remuneration would be an expenditure laid out wholly and exclusively for the purpose of the business of the family and would be allowable as an expenditure.

8. Salary paid to member: A Hindu undivided family can be allowed to deduct salaries paid to member of the family if the payment is made as a matter of commercial or business expediency, but the service rendered must be to the family.

9. Gifts by HUF: A HUF as such is incapable of making a gift to any of its member. However, the Karta of a HUF has power to gift out of joint family property for certain approved purposes. The gift should be reasonable. For example, a father may make a gift of the

ancestral moveable properties of the joint family, of which he is the Karta, for the purpose of discharging duties prescribed by Hindu Law. The income of the joint family will stand reduced to the extent to the income arising out of the assets thus gifted out.

10. Gifts to HUF: Can an outsider make a gift to HUF? Under what circumstances will a gift made by an outsider be considered as a gift to the HUF? The answers to these questions are as follows:

- (a) If the HUF to which such a gift is made consists of only one coparcener, then the gifted property can be held by the members of the family only as tenants-in-common, i.e., the income arising out of such gifted property can be assessed as income in the hands of the Association of Persons (AOP).
- (b) If the HUF to which such a gift is made consists of minimum two coparceners, then the gifted property can be held by the members of the family as joint tenants and the income arising out of such gifted property can be assessed as income in the hands of the joint Hindu family.

Section 56(2)(vii) provides that any sum of money or value of property received by a HUF without consideration would be chargeable to income-tax under the head "Income from other sources", if the aggregate value exceeds ₹ 50,000 during a year. However, a sum received by a HUF from its relative, i.e., a member of the HUF, is exempt. For details refer Chapter 8 on "Income from other sources".

13.2.4 Assessment of Local Authority

1. General meaning: The expression "local authority" has been defined not by the Income-tax Act, 1961 but by section 2(31) of the General Clauses Act. A local authority is a person under section 2(31) of the Income-tax Act, 1961, and thus, constitutes a separate unit of assessment. It is chargeable to tax on its total income in respect of the previous year, computed in accordance with and under the basic provisions of the Act, which apply to other taxable entities and for all purposes of the Act, this entity is included in the term 'person'. All municipal corporations, or councils, committees, panchayat boards, port trusts, district boards and other authorities legally entitled to or entrusted by the Central or State Government with the control and/or management of a municipal or local fund are covered by the expression 'local authority'.

2. Exemptions: Under section 10(20), the income of a local authority which is chargeable to tax under the heads 'Income from house property,' 'Capital gains' and 'Income from other sources' accruing or arising to it anywhere in or outside India and income from a trade or business carried on by it which accrues or arises to it from the supply of a commodity or service with its own jurisdiction or from the supply of water or electricity within or outside its own jurisdictional area are totally exempt from tax. In other words, a local authority is taxable only in respect of the income arising to it from any business carried on by it provided that such income arises from the supply of any commodity or service, not being water or electricity outside its jurisdictional area, i.e., territorial limits.

A local authority is said to be resident at the place where the control and management of its affairs are situated and its residential status is governed by section 6(4). A local authority in

India is always resident in India, except where the control and management of its affairs is exercised wholly from outside India.

3. Tax rate: After total income, i.e., the income of a local authority chargeable to tax has been determined, the whole of it would attract tax at the rate applicable i.e., the one prescribed by the relevant Finance Act. There is no minimum amount exempt from tax in the case of a local authority: for income tax purposes, local authority is chargeable to tax on the whole of its income at 30%. *Surcharge@10% is applicable where total income exceeds Rs.1 crore.* Education cess@2% and Secondary and higher education cess@1% have to be added to the income-tax and surcharge.

13.2.5 Assessment of firms/LLPs and their partners

A firm is to be assessed as a unit and the share income from the firm in the hands of the partners is exempt. There is no need for registration.

1. General: Under section 2(23) of the Income-tax Act, 1961, the terms 'firm', 'partner' and 'partnership' have the same meanings respectively as have been assigned to them under the Indian Partnership Act, 1932, but the expression 'partner' also includes any other person who being a minor, has been admitted to the benefits of an existing partnership. A firm though not a legal person or juridical entity, is chargeable to tax as a separate entity distant from the partners and the partners are assessable as individuals and not as an association persons or body of individuals. The term 'firm' as used in the Act covers both registered and unregistered firms.

Consequent to the Limited Liability Partnership Act, 2008 coming into effect in 2009 and notification of the Limited Liability Partnership Rules w.e.f. 1st April, 2009, the Finance (No.2) Act, 2009 has incorporated the taxation scheme of LLPs in the Income-tax Act, 1961, on the same lines as applicable for general partnerships, i.e. tax liability would be attracted in the hands of the LLP and tax exemption would be available to the partners. Therefore, the same tax treatment would be applicable for both general partnerships and LLPs.

Consequently, the following definitions in section 2(23) have been amended -

- (1) The definition of 'partner' to include within its meaning, a partner of a limited liability partnership;
- (2) The definition of 'firm' to include within its meaning, a limited liability partnership; and
- (3) The definition of 'partnership' to include within its meaning, a limited liability partnership.

The definition of these terms under the Income-tax Act, 1961 would, in effect, also include the terms as they have been defined in the Limited Liability Partnership Act, 2008. Section 2(q) of the LLP Act, 2008 defines a 'partner' as any person who becomes a partner in the LLP in accordance with the LLP agreement. An LLP agreement has been defined under section 2(o) to mean any written agreement between the partners of the LLP or between the LLP and its partners which determines the mutual rights and duties of the partners and their rights and duties in relation to the LLP.

The residential status of a firm to be determined depending upon the fact whether or not the control and management of its affairs is exercised from within India. Even if the negligible part of the control and management is exercised from within India the firm would be resident in

India for all the purposes. For determining the residential status of a firm, it is immaterial to ascertain the residential status of partners thereof because a firm may be resident even in cases where all the partners are not resident in India and they control or manage the affairs from outside India. Every firm is liable to pay tax flat rate of 30% on its total income of the previous year computed in accordance with the provisions of the Act, *plus surcharge@10% if its total income exceeds Rs.1 crore*, plus education cess@2% plus secondary and higher education cess@ 1%.

The following are the salient features of assessment of partnership firms:

- (i) The firm will be taxed as a separate entity. There will be no distinction between registered and unregistered firm.
- (ii) The share of the partner in the income of the firm will not be included in the hands of the partner. It will be exempt under section 10(2A).
- (iii) Any salary, bonus commission or remuneration, by whatever name called, which is due to or received by a partner will be allowed as a deduction subject to certain restrictions.
- (iv) Where a firm pays interest to any partner the firm can claim deduction of such interest from its total income. However, the maximum rate at which interest can be allowed to a partner will be 12% per annum.
- (v) The income of the firm will be taxed at a flat rate of 30%. *Surcharge@10% is attracted if its total income exceeds Rs.1 crore*. Education cess @ 2% and secondary and higher education cess@1% will be levied on income-tax plus surcharge, if applicable.

For the purpose of our discussion we can divide the partnership firms assessable under this Act into two types.

- (a) Partnership firms assessed as such (PFAS)
- (b) Partnership firms assessed as association of persons (PFAOP)

2. Partnership Firm Assessed As Such (PFAS) [Section 184]

Conditions to be fulfilled: To get the status of PFAS the firm should be evidenced by an "instrument". The word "instrument" means a document of legal nature by which any right or liability is created, limited, extended, or extinguished.

Instrument does not necessarily mean a regular partnership deed, but it may constitute any other relevant document. If the terms of a partnership are contained in a number of documents or in the correspondence between the parties, the documents or letters would constitute "instrument" for the purposes of section 184(1)(i).

The next condition is that the individual shares of partners must be specified in the instrument. A firm cannot get the status of PFAS unless the instrument of partnership specifies the individual shares of partners in the profits of the partnership. Evidence regarding the shares of partners should be available within the framework of the instrument. It should not involve searching of a number of documents.

The next condition is that a certified copy of the instrument should accompany the first return of income of a firm. As already noted "instrument" in this sense refers not only to the partnership deed but also other documents from which the existence of partnership can be

proved. Accordingly, certified copies of all documents will have to be submitted. Section 184 requires that the copy of the instrument shall be certified in writing by all partners other than minors. If, however, the return is made after the dissolution of the firm, it should be certified by all partners other than minors who were partners in the firm immediately before dissolution and by the legal representative of any such partner who is deceased. The certified copy of the instrument of partnership shall accompany the return of income of the firm of the previous year relevant to the assessment year.

If there is any change in the constitution of the firm or profit-sharing ratio during any previous year, a certified copy of the revised instrument of partnership should be filed along with the return of income of the relevant assessment year. Even if there is a change in remuneration/payment of interest to partners but there is no change in profit sharing ratio, a copy of the revised instrument of partnership should be submitted along with return to comply with the provisions of section 40(b).

Section 184(5) provides that where the firm commits any default as mentioned in section 144 the firm shall be assessed as a firm and not as an AOP, which was the case earlier. However, no deduction for payment of interest, salary, bonus, commission or remuneration, by whatever name called, made by the firm to any partner shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession". However, the interest, salary, bonus, commission or remuneration so disallowed shall not be charged to tax in the hands of the partners under clause (v) of section 28.

Computation of income of partnership firm: While computing the income of a firm assessed as such, we have to keep in mind the following points:

- (1) Remuneration is to be allowed
- (2) Interest is to be allowed
- (3) Unabsorbed depreciation and other losses should be provided for.

Remuneration paid to partners: First let us discuss the question of deduction of remuneration to the partners. In this context we have to remember the conditions prescribed by section 37 as regards the allowability of residuary expenses. Accordingly, no capital expenditure or personal expenses will be allowed. Further the remuneration paid must be only and exclusively for the purposes of the business of the firm. Apart from the general conditions prescribed in section 37 there are certain specific conditions prescribed by section 40(b).

They are as follows: -

- (1) Such remuneration should be paid only to the working partner
 - (2) It should be authorised by the partnership deed
 - (3) It should not pertain to a period prior to partnership deed
 - (4) It should not exceed the permissible limit.
- (1) **Payment should be to a working partner:** *Explanation 4* to section 40(b) defines working partner as one who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner. This definition is very general. It seems

that a partner can be a working partner in more than one firm. If a partner is employed somewhere else too, he can still be a working partner in the firm. However, in all such situations the partner must in fact be a working partner in the firm. In other words, merely because a person is working somewhere else too, such a fact does not by itself debar him from being a working partner in a firm in which he is a partner. As stated before, to be a working partner, the partner has to be actively engaged in conducting the affairs of the business or profession of the firm. Now in order to be actively engaged in conducting the affairs of the business or profession does not require either expressly or by implication that the concerned partner should be so actively engaged in conducting the business affairs on a full time basis. A partner can be said to be actively engaged in conducting the affairs of the firm even if he devotes a part and not the whole of his working hours.

Further, in order to be actively engaged in the affairs, a partner is not expected to be engaged in the whole of the affairs of the business of the firm, nor is he expected to know everything about the affairs of the business of the firm. For example, in a firm with many partners one partner may be looking after purchases, another after sales and another after production and still another after administration, finance and accounts. It cannot be contended that just because they are not over all in charge, they cannot be considered as working partner. Another significant point to be noted here is that the definition of "working partner" in Explanation 4 contemplates an individual. Therefore a partner other than an individual (example a company) cannot be working partner. An interesting situation may be considered here. When a company is a partner in a firm, a director or shareholder of the company can very well be an employee of the firm in which the company is a partner. Any salary/remuneration paid by the firm to such an employee would be totally outside the ambit of disallowance under section 40(b). This would be so because the individual who is an employee of the firm is not a partner in the firm. It is the company in which he is the director which is the partner and, section 40(b) contemplates allowance of remuneration paid by a firm to its partners and not to other employees.

- (2) **It should be authorised by the Partnership Deed:** Any payment of salary, bonus, commission or remuneration by whatever name called to a working partner is not allowed as a deduction if the payment is not authorised by partnership deed or it is not in accordance with the terms of partnership deed. As a result, a mere general authority in the partnership deed that such and such working partners would be paid remuneration as may be agreed upon between the partners from time to time will not be sufficient. The partnership deed will have to contain clear direction as to the quantum of remuneration to be paid to the working partners. For example such remuneration may be specified by way of annual fixed payment or as a certain specified percentage of the firm's book profit at the year end. It may be noted that such remuneration need not be paid on a monthly basis. An item like commission can be paid even as a percentage of sales. Remuneration also can be an yearly payment.

Now, a question arises whether the names of individual working partners should be specified in the partnership deed or whether it is sufficient if the total remuneration payable to the working partners as a whole is indicated. One opinion is that it is not necessary that the

individual partners should be identified or designated. It will be sufficient to lay down an authorisation in the deed to the effect that remuneration will be payable to the class of working partners up to so and so percentage of the book profit. And further that, within such limits the working partners shall share such remuneration in any ratio as may be agreed upon. In other words this concept gives recognition to the working partners as a class and authorising remuneration for the class rather than identifying or designating individual working partners and authorising remuneration for each individual working partner. There is nothing in the section 40(b) which prohibits this type of interpretation. However in order to avoid litigation it is better that the deed identifies and designates the working partners as well as the remuneration payable to them.

As a result of this stipulation, every firm constituted on or after April 1, 1992 will have to provide for an appropriate clause in its partnership deed satisfying this requirement. However, so far as the existing firms are concerned, they will have to execute a supplementary deed or a deed of change in the constitution so as to incorporate a clause within the deed of partnership relating to payment of remuneration to its working partners.

- (3) **It should not pertain to period prior to partnership deed:** By virtue of a further restriction contained in 40(b)(iii), such remuneration paid to the working partners will be allowed as deduction to the firm from the date of such partnership deed and not from any period prior thereto. Consequently, if for instance a firm incorporates the clause relating to payment of remuneration to the working partners by executing an appropriate deed as on July 1st, but effective from April 1st, the firm would get deduction for the remuneration paid to its working partners from July 1st onwards but not for the period from April 1st to June 30th. In other words, it will not be possible to give retrospective effect to oral agreements entered into *vis-a-vis* such remuneration prior to putting the same in a written partnership deed.

Example: A and B entered into partnership agreement on April 1, 2013. As per the deed, each of them will be entitled to salary of ₹ 2,000 per month apart from profit. On August 1, 2013, they executed a supplementary deed by which they increased the remuneration to ₹ 3,000 each effective from 1st April 2013. Discuss the validity of the supplementary deed.

Remuneration will be payable effective from the date of the deed which provides for the payment of such remuneration. In the given case, the original deed provides for remuneration at the rate of ₹ 2,000 for each partner from April 1, 2013 onwards. The supplementary deed is executed on August 1, 2013 increasing the limit of remuneration. Such increase in the limit of remuneration will be allowable only from 1st August 2013, being the date of supplementary deed. Hence, for the period from 1st April 2013 to 31st July 2013, the partners will be allowed remuneration only at the rate of ₹ 2,000 per month.

- (4) **It should not exceed the permissible limit:** As we have seen earlier, salary, bonus, commission or other remuneration may be paid to any working partner in accordance with and as authorised by the terms of the partnership deed and in relation to any period falling after the partnership deed. However, the maximum amount of such payment to all the partners during the previous year should not exceed the limits given below:-

On the first ₹ 3 lakh of book profit or in case of loss, the limit would be the higher of ₹ 1,50,000 or 90% of book profit and on the balance of book profit, the limit would be 60%.

Book Profit: The permissible remuneration is to be computed as a percentage of book profit. For this purpose we have to draw up the profit and loss account and find the net profit. This profit and loss account is to be prepared in the manner laid down in Chapter IV-D. It may be noted that Chapter IV-D contains the provisions relating to computation of income under the head 'Profits and gains of business or profession'. Further, *Explanation 3* also lays down that if while arriving at the above net profit, the remuneration paid/payable by a firm to its partners is debited to such a profit and loss account, the aggregate of such remuneration paid/payable to the partners shall be added to the net profit in order to arrive at the book profit.

When the Act says that the profit and loss account should be prepared in the manner laid down in Chapter IV-D, it means that only those items which are chargeable under section 28 as income will be taken into account and only deductions permissible thereunder will be allowed. For example, rent from house property, dividend, interest on bank deposit or government securities are not chargeable as income from business or profession under section 28. Therefore, if the profit and loss account of a firm contains these above receipts, they have to be excluded while calculating the net profit. In the same way, items which are to be disallowed under the various provisions from sections 28 to 44D will have to be eliminated. It naturally follows, therefore, that brought forward business losses will not be deducted while calculating book profit.

The above table shows the upper limits up to which deduction is allowed to firm in respect of the remuneration paid to its working partners. It does not mean that a firm is prohibited from paying remuneration beyond these limits. A firm can pay remuneration to working partners beyond these limits but it will suffer disallowance in respect of such excess under section 40(b) and consequently pay tax on it at the maximum marginal rate as per section 167A. If a firm pays remuneration to non-working partners, the same will be the result. However the above limits apply to the remuneration paid to the group of all working partners in a firm taken together and not to each individual partner. Finally, it may be noted that section 40(b) does not compel a firm to pay remuneration to its working partners. It is purely at the discretion of the firm. However, once a firm pays remuneration to its working partners it will be subject to the restrictive provisions of section 40(b). It is also open to a firm to pay salary only to a few working partners and not all the working partners.

- ◆ **Interest payable to partners:** So far as allowability of interest paid by a firm to its partners under section 40(b) is concerned, the following conditions have been prescribed by section 40(b):
 - (1) The interest payable by a firm to its partners should be authorised by and in accordance with the partnership deed.
 - (2) The interest payable by a firm to its partners should not be for a period falling prior to the date of such partnership deed authorizing the payment of such interest.
 - (3) The rate of interest payable to the partners shall not exceed 12% simple interest per annum.

Apart from the above conditions the conditions prescribed by section 36(1)(iii) and section 40(a)(i) should also be satisfied. Section 36(1)(iii) provides that the amount of interest paid in respect of capital borrowed must be for the purposes of the business or profession. Section 40(a)(i) provides that any interest which is payable outside India will not be allowed as a deduction unless tax has been deducted therefrom.

An important question could be regarding the amount with reference to which this interest @12% will have to be calculated. For example, a partner may have contributed capital to the firm and in addition may also advance loan to the firm. The question would be whether the interest paid by the firm on capital would be allowable or that on the loan would be allowable. Moreover, some firms have an accounting system of maintaining current accounts of partners in addition to the capital accounts. When some balance is standing to the credit of a partner in such current account as well the question arises whether the interest paid on the balance in the current account will be allowable within the meaning of section 40(b).

In this regard, it may be noted that section 40(b) does not refer to nor does it make any distinction between the capital contributed by a partner to the firm, the loan advanced by a partner to the firm or the balance in the current account of a partner. Therefore, the interest paid by a firm to its partners on the credit balance standing in all the accounts/whether in capital account, loan account or current account, shall be allowed as deduction to the firm under section 40(b). The idea seems to be to allow interest on the funds employed in the firm by a partner.

As it happens, many a time, a partner may have debit balance in his current account and credit balance in his capital account or loan account. The question which would arise in such a situation could be whether the interest payable to such a partner at the rate of interest authorised by and in accordance with partnership deed will be reckoned with reference to the aggregate of the credit balance in the capital account and the loan account including the debit balance in the current account or whether it should be calculated on the net balance that is the aggregate of the credit balance in the capital account and in the loan account as reduced by the debit balance in the current account. It appears that in such a situation the equitable principle would be to allow interest reckoned with reference to the net balance. Alternatively, if interest is recovered from a partner on the debit balance in his account and interest is paid to the same partner on the credit balance in his account, the net amount paid to that partner would be subjected to the provisions of section 40. However, interest received from one partner cannot be set-off against interest paid to another partner under this proviso.

The next issue which is to be considered here is the point of time at which interest should be credited to the partners' accounts. For example, a firm may adopt a policy of crediting interest quarterly to the credit of the partners' accounts. In such a case, the firm would be paying in effect interest on interest at the year end. This would amount to compounding interest quarterly. This is not permitted under section 40(b) because what that section contemplates is simple interest and simple interest here would mean interest which is calculated yearly or annually. Paying the interest on interest credited periodically during a year would be contrary to the concept of simple interest per annum.

- ◆ **Partner in a representative capacity:** If an individual is a partner in a firm in a representative capacity (that is on behalf and for the benefit of another person) and not in his personal capacity then interest paid by the firm to such individual in his personal capacity and not as a representative partner will not be subject to the conditions and ceiling as prescribed for disallowance. But interest paid by the firm to such individual as representative partner or person represented shall be subject to the conditions and ceiling as prescribed (*Explanation 1*).

Example: X is a partner in a firm in a representative capacity for and on behalf of his HUF. Supposing the firm pays interest of ₹ 6,000 to X in his personal capacity and not in his capacity as the representative of HUF, it will be allowed as deduction and the prescribed ceiling will not apply. However, if such payment is made to X as a representative and partner or if the firm has paid the interest directly to the HUF, then the payment will be subject to the conditions and ceiling as prescribed.

- ◆ **Interest received by a non-representative partner:** If interest is paid to an individual partner who is not the representative partner and the interest received by him is on behalf of or for the benefit of another person, then such interest payment shall be allowed without applying the ceiling limits.

Example: X is a partner of a firm in his individual capacity and is not a representative partner. Interest is paid by the firm to him in respect of a deposit made by his wife. This will be allowed as a deduction because such interest is not received by him in any representative capacity but purely on behalf of another person.

- ◆ **Computation of income of partner of a firm (PFAS):** While computing the income of a partner including a minor partner of a firm, the following points have to be taken into consideration.

Share income exempt under section 10(2A): The partner's share in the total income of firm (PFAS) will be exempt in his hands and will not be included in his total income. His share in the total income of the firm will be calculated as follows:-

$$\text{Total income of firm} \times \frac{\text{Partner's share in profits of firm as per partnership deed}}{\text{Total profit of the firm}}$$

By virtue of this exemption a partner of PFAS will not be taxed in respect of his share in the firm's income since the firm itself will be taxed as a separate entity at the maximum marginal rate. There will be no allocation of income among the partners. On account of this exemption, he will not be entitled to set-off his share in the firm's loss against his other personal income.

- ◆ **Chargeability of remuneration and interest:** Remuneration and interest received by a partner of a PFAS in accordance with the conditions prescribed under section 40(b) will be taxable in his hands as income from profits and gains of business or profession.

If remuneration or interest paid to a partner is disallowed in the assessment of the firm due to the fact that they are not in accordance with the conditions prescribed under section 40(b) then the partner will not be taxed in respect of the amount because in such

a case the firm itself will be liable to pay tax on the amount which has been disallowed in its assessment. In other words, if the firm is given the benefit of deduction of remuneration and interest paid to a partner then the liability to tax in respect of such amount will be that of a partner. If the firm is not given the benefit of deduction because of the non-compliance with the provisions of section 40(b) then the firm itself will be liable in respect of the amount and the partner will not be taxed in respect of it in his personal assessment. It is obvious that such remuneration or interest which has been disallowed in the hands of the firm but actually received by a partner will be assumed to be his share in the income of such firm and exemption under section 10(2A) will operate.

Suppose a portion of the remuneration and interest in the assessment of the firm is disallowed since they exceed the overall ceiling limit prescribed under section 40(b), the question arises as to how to allocate such disallowance in the hands of the partner. One reasonable basis is to assume that the remuneration and interest paid to the partners concerned has been disallowed in proportion to the gross remuneration and interest paid to them and the exemption of the disallowed sum should be available to the partners in the same proportion.

- ◆ **Rates of tax:** A PFAS will be chargeable in respect of its total income at the maximum marginal rate of 30% *plus surcharge@10%, if its total income exceeds Rs.1 crore*, plus education cess@2% plus secondary and higher education cess@1% thereon.
- ◆ **Treatment of losses:** If PFAS incurs any loss the firm alone can set off and forward such losses to be set off against income of the subsequent years. The firm will not be allowed to apportion its unabsorbed losses among its partners.
- ◆ **Set off of carry forward loss in case of change in the constitution of the firm [Section 78]:** If there is a change in the constitution of the firm the loss of a retired/deceased partner can be carried forward by the firm only to the extent that it does not exceed such partner's share in the profits of the firm of the relevant previous year. It does not matter whether it is a PFAS firm or PFAOP firm. However, it is to be carefully noted that section 78 is applicable only in case there is a change in the constitution of the firm as result of retirement or death of a partner in the previous year. In other words, it does not apply when there is a change in the profit sharing ratio or change in the constitution because of induction of a new partner. Similarly, section 78 will not apply to set off and carry forward of unabsorbed depreciation etc.

Section 167A: In the case of a firm which is assessable as a firm, tax shall be charged at the rate as specified in the Finance Act of the relevant year.

Section 167C: This section provides for the liability of partners of LLP in liquidation. In case of liquidation of an LLP, where tax due from the LLP cannot be recovered, every person who was a partner of the LLP at any time during the relevant previous year will be jointly and severally liable for payment of tax unless he proves that non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the LLP. This provision would also apply where tax is due from any other person in respect of any income of any previous year during which such other person was a LLP. *“Tax due”, for the purpose of this section, includes penalty, interest or any other sum payable under the Income-tax Act, 1961.*

◆ Conversion of company into a LLP

(i) Consequent to the Limited Liability Partnership Act, 2008 coming into effect in 2009 and notification of the Limited Liability Partnership Rules w.e.f. 1st April, 2009, the Finance (No.2) Act, 2009 had incorporated the taxation scheme of LLPs in the Income-tax Act, 1961 on the same lines as applicable for general partnerships, i.e. tax liability would be attracted in the hands of the LLP and tax exemption would be available to the partners. Therefore, the same tax treatment would be applicable for both general partnerships and LLPs.

(ii) Under section 56 and section 57 of the Limited Liability Partnership Act, 2008, conversion of a private company or an unlisted public company into an LLP is permitted. However, under the Income-tax Act, no exemption is available on conversion of a company into an LLP. As a result, transfer of assets on conversion would attract capital gains tax. Further, there is no specific provision enabling the LLP to carry forward the unabsorbed losses and unabsorbed depreciation of the predecessor company.

(iii) Therefore, section 47(xiii b) provides that -

(1) any transfer of a capital asset or intangible asset by a private company or unlisted public company to a LLP; or

(2) any transfer of a share or shares held in a company by a shareholder

on conversion of a company into a LLP in accordance with section 56 and section 57 of the Limited Liability Partnership Act, 2008, shall not be regarded as a transfer for the purposes of levy of capital gains tax under section 45, subject to fulfillment of certain conditions. This clause has been introduced to facilitate conversion of small private and unlisted public companies into LLPs. These conditions are as follows:

(1) the total sales, turnover or gross receipts in business of the company should not exceed ₹ 60 lakh in any of the three preceding previous years;

(2) the shareholders of the company become partners of the LLP in the same proportion as their shareholding in the company;

(3) no consideration other than share in profit and capital contribution in the LLP arises to the shareholders;

(4) the erstwhile shareholders of the company continue to be entitled to receive at least 50% of the profits of the LLP for a period of 5 years from the date of conversion;

(5) all assets and liabilities of the company become the assets and liabilities of the LLP; and

(6) no amount is paid, either directly or indirectly, to any partner out of the accumulated profit of the company for a period of 3 years from the date of conversion.

(iv) However, if subsequent to the transfer, any of the above conditions are not complied with, the capital gains not charged under section 45 would be deemed to be chargeable to tax in the previous year in which the conditions are not complied with, in the hands of the LLP or the shareholder of the predecessor company, as the case may be [Section 47A(4)].

(v) Further, the successor LLP would be allowed to carry forward and set-off the business loss

and unabsorbed depreciation of the predecessor company [Section 72A(6A)].

(vi) However, if the entity fails to fulfill any of the conditions mentioned in (iii) above, the benefit of set-off of business loss/unabsorbed depreciation availed by the LLP would be deemed to be the profits and gains of the LLP chargeable to tax in the previous year in which the LLP fails to fulfill any of the conditions listed above.

(vii) The tax credit under section 115JAA for MAT paid by the company under section 115JB would not be allowed to the successor LLP [Sub-section (7) of section 115JAA].

(viii) The actual cost of the block of assets in the case of the successor LLP shall be the written down value of the block of assets as in the case of the predecessor company on the date of conversion [Explanation 2C to section 43(6)].

(ix) The aggregate depreciation allowable to the predecessor company and successor LLP shall not exceed, in any previous year, the depreciation calculated at the prescribed rates as if the conversion had not taken place. Such depreciation shall be apportioned between the predecessor company and the successor LLP in the ratio of the number of days for which the assets were used by them [Section 32(1)].

(x) The cost of acquisition of the capital asset for the successor LLP shall be deemed to be the cost for which the predecessor company acquired it. It would be further increased by the cost of improvement of the asset incurred by the predecessor company or the successor LLP [Section 49(1)].

(xi) If the capital asset became the property of the LLP as a result of conversion of a company into an LLP, and deduction has been allowed or is allowable in respect of such asset under section 35AD, the actual cost would be taken as Nil [Explanation 13 to section 43(1)].

(xii) If a company eligible for deduction under section 35DDA in respect of expenditure incurred under Voluntary Retirement Scheme (one-fifth of such expenditure allowable over a period of five years) is converted into a LLP and such conversion satisfies the conditions laid down in section 47(xiiib), then, the LLP would be eligible for such deduction from the year in which the transfer took place.

(xiii) If a shareholder of a company receives rights in a partnership firm as consideration for transfer of shares on conversion of a company into a LLP, then the cost of acquisition of the capital asset being rights of a partner referred to in section 42 of the LLP Act, 2008 shall be deemed to be the cost of acquisition to him of the shares in the predecessor company, immediately before its conversion [Section 49(2AAA)].

Illustration 7

A Pvt. Ltd. has converted into a LLP on 1.4.2013. The following are the particulars of A Pvt. Ltd. as on 31.3.2013 –

- (1) Unabsorbed depreciation ₹ 13.32 lakh
Business loss ₹ 27.05 lakh
- (2) Unadjusted MAT credit under section 115JAA ₹ 8 lakh

(3) WDV of assets

Plant & Machinery (15%) ₹ 60 lakh

Building (10%) ₹ 90 lakh

Furniture (10%) ₹ 10 lakh

(4) Cost of land (acquired in the year 2000) ₹ 50 lakh

(5) VRS expenditure incurred by the company during the previous year 2011-12 is ₹ 50 lakh. The company has been allowed deduction of ₹ 10 lakh each for the P.Y.2011-12 and P.Y.2012-13 under section 35DDA.

Assuming that the conversion fulfills all the conditions specified in section 47(xiiib), explain the tax treatment of the above in the hands of the LLP.

Solution

(1) As per section 72A(6A), the LLP would be able to carry forward and set-off the unabsorbed depreciation and business loss of A Pvt. Ltd. as on 31.3.2013. However, if in any subsequent year, say previous year 2014-15, the LLP fails to fulfill any of the conditions mentioned in section 47(xiiib), the set-off of loss or depreciation so made in the previous year 2013-14 would be deemed to be the income chargeable to tax of P.Y.2014-15.

(2) As per section 115JAA(7), the credit for MAT paid by A Pvt. Ltd. cannot be availed by the successor LLP.

(3) The aggregate depreciation for the P.Y.2013-14 would be –

Plant & Machinery ₹ 9 lakh (15% of ₹ 60 lakh)

Building ₹ 9 lakh (10% of ₹ 90 lakh)

Furniture ₹ 1 lakh (10% of ₹ 10 lakh)

In this case, since the conversion took place on 1.4.2013, the entire depreciation is allowable in the hands of the LLP. Had the conversion taken place on any other date, say 1.7.2013, the depreciation shall be apportioned between the company and the LLP in proportion to the number of days the assets were used by them. In such a case, the depreciation allowable in the hands of A Pvt. Ltd. and the LLP would be calculated as given below -

In the hands of A Ltd. (for 91 days)

Plant and machinery	$\frac{91}{365} \times 900000$	2,24,384
Building	$\frac{91}{365} \times 900000$	2,24,384
Furniture	$\frac{91}{365} \times 100000$	24,932

In the hands of the LLP (275 days)

Plant and machinery	$\frac{274}{365} \times 900000$	6,75,616
Building	$\frac{274}{365} \times 900000$	6,75,616
Furniture	$\frac{274}{365} \times 100000$	75,068

(4) The cost of acquisition of land in the hands of the LLP would be the cost for which A Pvt. Ltd. acquired it, i.e., ₹ 50 lakh.

(5) The LLP would be eligible for deduction of ₹ 10 lakh each for the P.Y.2013-14, P.Y.2014-15 and P.Y.2015-16 under section 35DDA.

3. Association of persons (AOP) including partnership firms assessed as AOP (PFAOP): Section 2(31) defines “person” as including “association of persons” or a body of individuals. The expression association of persons is to be understood in its ordinary sense meaning there by a group or congregation of persons. The expression association of persons is of a wider connotation and scope than that of a body of individuals. An association of persons may have as its members not only individuals (including minors) but also companies, firms, joint families and other associations. When there is a group of persons formed for the promotion of an enterprise or when co-adventures join together in a common action they are assessable as an association of persons provided they did not in law constitute a partnership. Ordinarily, there can be no association of persons in business unless the members of the group join together out of their own volition or will.

In order to constitute an association of persons the members thereof must join any common purpose or common action and the object of the association must be to produce income. Mere receipt of income by a group of members in common will not make it an association unless income is earned by its own effort in common. For this reason appointing of a common agent, manager or lessee will not make the owners assessable as an association of persons. Thus, where the income does not arise to the group of members from any joint venture or joint activities the group of persons cannot be assessed as an association of persons. The most important features of an association of persons are that -

- (i) the number of members is not restricted and
- (ii) the shares of each member or group of members is not definite and ascertainable.

The co-owners, co-legatees and joint receivers joining for a common purpose or action would be assessable as an association of persons. For example, if the funds of a number of beneficiaries are put together and one business is carried on with the combined resources by the trustee, guardian or administrator, the business must be regarded as a single business assessable in the hands of an association of persons. However, section 26 specifically provides an exception to the assessment of co-owners as an association of persons. According to that section, where the shares of the co-owners in respect of income from house property are defined and ascertainable

the co-owners must be assessed not as an association of persons but individually even if the property may be owned and managed and developed jointly by the co-owners. Thus, in all cases where the share of each member in group of members is definite and precisely ascertainable, the assessment cannot be made as an association of persons.

For the purpose of assessment, it is not necessary that the association should be legally constituted. In other words, it is not necessary that there must be mutual rights and obligations amongst the members enforceable in law. The illegality, invalidity or incorrectness in the constitution of an association does not in any way affect its liability to tax or its chargeability as a unit of assessment. A partnership which is illegal or otherwise void will have to be assessed as an association of persons. The question whether there is an association of persons or not depends upon the facts and circumstances of each case.

Section 185 provides that where a firm does not comply with the provisions of section 184 for any assessment year, the firm shall be assessed as a firm and not as an AOP, which was the case earlier. However, no deduction for payment of interest, salary, bonus, commission or remuneration, by whatever name called, made by the firm to any partner shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession. However, the interest, salary, bonus, commission or remuneration so disallowed shall not be charged to tax in the hands of the partners under section 28(v).

Computation of total income of AOP/BOI and PFAOP [Section 67A]

1. Computation of total income in the case of an association of persons or body of individuals will be done in the same manner as in the case of any other assessee.
2. In computing the total income, salary, bonus, commission, remuneration or interest paid to partners/members will not be allowed.

However in the case of payment of interest the following provisions will apply:

Explanation 1: If interest is paid by an AOP/BOI to any member who was also paid interest to the AOP/BOI then only that amount of interest paid by the AOP/BOI will be disallowed in its assessment which is in excess of the interest paid by the member to the AOP/BOI.

Explanation 2: If an individual is a member of an AOP/BOI in a representative capacity, on behalf of or for the benefit of another person, then interest paid by the AOP/BOI to such individual in his personal capacity will not be taken into account for the purpose of disallowance. But interest paid by the AOP/BOI to such individual or vice-versa or representative member or interest paid by the AOP/BOI directly to the beneficiary will be taken into account for the purpose of disallowance.

Explanation 3: If interest is paid to a member who is not a member in a representative capacity but such interest is received by him on behalf of or for the benefit of another person the interest payment will be allowed.

- ◆ **Computation of tax where shares of members in AOP/BOI are unknown [Section 167B]:** Tax on the total income would be computed as follows:
 - If individual share of any partner is not known, tax will be levied at the maximum marginal rate, or at a higher rate.

- If individual share of a partner is known but total income of any member/partner exceeds the basic exemption limit, then the firm will pay tax at the maximum marginal rate.
- If individual share of a partner is known and no member/partner has total income exceeding the basic exemption limit, the firm will pay tax at the rates applicable to an individual.
- ◆ **Computation of member's/partner's share in the total income of association of persons/AOP firm [Section 67A]** : A member's share in the income of an association of persons/AOP firm (wherein the shares of members are determinate/known) will be computed as follows:
 - (a) Any interest, salary, bonus, commission, remuneration, etc. paid to a member/partner during the previous year will be deducted from the total income of the association, and the balance will be apportioned among the members in proportion to their respective shares.
 - (b) If the amount apportioned to a member/partner as per (a) is a profit, any interest, salary, etc. paid to him by the association or AOP firm during the previous year will be added to that amount and the aggregate sum will be such member's/partner's share in the income of the AOP/AOP firm.
 - (c) If the amount apportioned to a member/partner as per (a) is a loss, any interest, salary, etc. paid to him by the association or AOP firm will be deducted from the amount of loss and the balance sum will be such member's/partner's share in the income of the AOP/AOP firm.

The share of a member in the income/loss of the AOP/AOP firm will, for the purposes of assessment, be apportioned under the various heads of income in the same manner in which income/loss of the association has been determined under each head.

Any interest paid by a member on capital borrowed by him for the purpose of investment in the AOP/AOP firm will be allowed as deduction from share while computing his income under "Profits and gains of business or profession."

- ◆ **Assessment of share in the hands of member/partner [Section 86]:**
 - A member's/partner's share in the total income of an association of persons/AOP firm will be treated as follows:
 - If an AOP/AOP firm has paid tax at the maximum marginal rate, or a higher rate, the partner's share in the total income of the firm will not be included in his total income and will be exempt.
 - If the AOP/AOP firm has paid tax at regular rates applicable to an individual, the member's/partner's share in the income of the association/AOP firm will be included in his total income for rate purposes only. In other words, the member/partner will be allowed rebate at the average rate in respect of such share.

If the AOP/AOP firm has not paid tax on its total income, the member's/partner's share in the total income of the association/AOP firm will be included in his total income and taxed at regular rates.

13.2.6 Assessment of Co-operative Societies

1. General provisions: The expression “co-operative society” means a society registered under the Cooperative Societies Act, 1912 or under any other law for the time being in force in any State for the registration of co-operative societies [Section 2(19)]. For purposes of taxation, it is treated as a separate assessable entity. The profits of any business of insurance carried on by a co-operative society are to be computed in accordance with the rules set out in the First Schedule to the Act. Apart from this, the computation of income in the case of a co-operative society should also be made in the same way under each head of income as in the case of any other assessee. Entrance fees received by a co-operative society from its members is taxable as its income from business irrespective of the nature of the business carried on by the society as was held in *Co-operative Central Bank vs. C.I.T.* (1965) 57 ITR 579.

A member of a co-operative society to whom a building or a part thereof is allotted or leased under a house building scheme of the society must be deemed to be the owner of that building or part thereof under section 27(iii). Accordingly, the co-operative society is not liable to pay tax in respect of the income from the house property even though it may be the real owner according to official records and the tenant may have taken the building on lease. But where the tenant is not a member of the society or where the house is allotted to him otherwise than under a house building scheme of the society, the society will be liable to tax in respect of the income of the house property.

2. Exemptions: 1. The income of a marketing society derived from the letting out of godown or warehouses for storage, processing or facilitating the marketing of commodities is totally exempt from tax under section 10(29).

2. Section 80P provides certain exemptions to co-operative societies. However, the exemption is not available to co-operative banks, other than primary agricultural credit societies and primary co-operative agricultural and rural development banks. Students may refer to the detailed discussion of this provision in Chapter 12 “Deductions from gross total income”.

It may also be noted that the provisions of section 194A which require deduction of income-tax at source from interest other than interest on securities, credited or paid, do not apply to such income credited or paid—

- (i) by a co-operative society to a member thereof or to any other co-operative society;
- (ii) in respect of deposits with a primary agricultural credit society or a primary credit society or a co-operative land mortgage bank or a co-operative land development bank;
- (iii) in respect of deposits with a co-operative society, other than a co-operative society or bank engaged in carrying on the business of banking.

13.2.7 Assessment of Mutual Concerns

1. General principles of mutuality: (1) The first principle of mutuality is that no person can trade with himself or make income out of himself. A mutual association arises where persons forming a group associate together with a common object and contribute monies for achieving that object and divide the surplus amongst themselves in the character. The cardinal

requirement in the case of mutual association is that all the contributors to the common fund must be entitled to participate in the surplus and all the participators to the surplus must be contributors to the common fund. In other words, there must be complete identity between the contributors and the participators.

(2) The participation in the surplus need not be immediate but it may assume the shape of a reduction in the future contribution or a division of the surplus on dissolution.

(3) It does not make any difference whether the persons joining together form an association or incorporate a company because the fact of incorporation does not destroy the identity of the contributors and participators.

(4) Where there is mutuality, the fact that some members alone take advantage of the mutual enterprise would not affect the mutual character of the association.

(5) There is nothing in law which prohibits a mutual association from carrying on a trade so long as it is confined to its own members.

(6) It is not necessary that the surplus should be returned to every member of the association pro rata. The identification between the contributors and the participators should be regarded as one whole and not in relation to each individual.

(7) It is not necessary that all the activities of such an association should be mutual in character. There may be activities of a non-mutual character but the exemption from tax will apply to the surplus arising out of the mutual enterprise.

From the above principles we can conclude that one cannot trade with one self and earn taxable profits thereby. Hence if there is a mutual concern, ordinarily there should be no tax on the profits arising out of mutual operations. But the Income-tax Act, 1961 provides for assessment of the income of a mutual concern in the following circumstances:

- (1) Where the mutual concern is a mutual insurance society and the income is derived from the carrying on of any business of insurance.
- (2) Where the mutual concern is a trade, professional or similar association and the income in question is derived from specific service performed for its members.

2. Insurance business: Under section 2(24)(vii) any surplus accruing to life as well as general mutual insurance concerns will fall within the definition of the word "income" and as such would be taxable as income from business. Section 44 expressly provides the profits and gains of any business of insurance including that carried on by a mutual insurance company or a cooperative society shall be computed not according to the provisions of the Act for computation of income under the various heads but according to the method prescribed in the Rules contained in the First Schedule to the Act.

3. Trade and professional associations: A trade, professional or similar association may be a mutual concern. Section 28(iii) enacts that "income derived by a trade, professional or similar association from specific services performed for its members" shall be taxable as business profits. Under section 2(24)(v) any sum chargeable under section 28(iii) is deemed to be income. The object of these provisions seems to be to tax as profit the surplus arising from specific services rendered to members by a mutual trade, professional or similar association which otherwise may

not be liable to tax in view of the general principles applicable to mutual concerns.

It may carefully be noted that a trade association is not the same thing as a trading association. A trade association means an association of tradesmen or businessmen for the protection or advancement of their common interests. Again clause (iii) of section 28 taxes the profit accruing only on specific services rendered by an association to its members. Any surplus arising to a mutual association in other way e.g. from entrance fees or members' periodic subscriptions would be outside the scope of this clause and would be non-taxable on the general principles stated above.

Since the surplus arising to trade, professional or similar association during the process of advancement of the common interest of the members is not includible in the taxable income it follows that the concerned expenditure will not also be allowed. Section 44A gives a benefit in this regard. It provides that in the case of such trade associations which did not distribute any parts of its income to its members, the amount of any deficit (deficiency) (excess of expenditure incurred for the advancement of the common interest of the members of the association over receipt from the members) would be deductible from the assessable income of the association to the maximum extent of 50% of such income.

This deficiency is to be deducted in the first instance from the assessable income under the head "Profits and gains of business or profession". If the deficiency exceeds such income the balance of deficiency can be set off against assessable income from any other head. The maximum limit of 50%, however, still operates. It can be carried forward to the next year and set-off against income of the relevant assessment year. It should be noted that any adjustment of the deficiency is permissible only after effect has been given as provided in the Act to all losses, allowances etc., for the year in question or brought forward from earlier years.

4. Clubs: The consensus of judicial opinion is that any surplus accruing to a members' club from the subscriptions and charges for various conveniences paid by members is not income or profit at all, nor can a social club be deemed to trade as far as its dealings with its own members are concerned. The position would be the same even though the club may be incorporated as a company or registered as a society. But a club is taxable on the profit derived from subscriptions and charges paid by non-members and on the income derived from its capital assets. Where a club is an incorporated company carrying on business it may be taxable on the money received from its members as well as non-members in the course of its business.

However, if the club is not a member's club but is a proprietary club i.e. if the club is owned by an outsider and not by the members themselves, the proprietor would be taxable on the profits earned by running the club. The position would not in any way be affected by the fact that the proprietor is a limited company and some of the shareholders are members of the club.

5. Co-operative societies: In the case of a co-operative society, the liability to tax depends upon whether (a) it is a mutual concern earning non-taxable surplus or (b) it is a non-mutual concern earning taxable profits. Exemption under section 80P is available to co-operative societies. However, this benefit is not available to co-operative banks, other than primary agricultural credit societies and primary co-operative agricultural and rural development banks. The definition of income has been enlarged to include within its scope,

the profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members. Therefore, the concept of mutuality no longer applies to a co-operative society carrying on any business of banking.

13.3 Liability in Special Cases

13.3.1 Legal representatives [Section 159]:

- ◆ **Meaning:** Section 2(19) states that the term “legal representative” in the Income-tax Act, 1961 has the meaning assigned to it in clause (11) of section 2 of the Code of Civil Procedure, 1908. Section 2(11) of the Code of Civil Procedure provides as follows:
 “Legal representative” means a person who in law represents the estate of a deceased person and includes any person who intermediates with the estate of the deceased and where a party sues or is sued in a representative character the person on whom the estate devolves on the death of the party so suing or sued. It is not necessary that the legal representative should be the beneficial owner of the estate. Nor need he be in possession of any property of the deceased. It is sufficient that the estate devolves on him. So far as HUF is concerned it continues to exist as an assessable unit despite change in its composition including the change of its Karta by death or otherwise and consequently there is no scope or necessity for involving this section when a Karta dies. A legal representative assessed under this section is different from a representative assessee to whom sections 160 to 167 apply. Legal representative does not fall within any of the categories of representative assessee enumerated in section 160. Where a person leaves a will appointing executors, the executors are the legal representative. The Act expressly declares that the legal representative is deemed to be an assessee for the purpose of this Act.
- ◆ **Liability of legal representative:** The Act imposes a liability on the legal representative not only in respect of tax but also any other sum (penalty, fine or interest) which the deceased would have been liable to pay if he had not died. This liability is limited to the extent to which the estate is capable of meeting the liability.
- ◆ **Assessment on legal representative:** This section applies irrespective of whether the assessment proceedings has not been started, or were pending, or were completed and the assessment made, before the death of the deceased. If at the date of death of the deceased a return of income had not been made under section 139(1) and a notice under section 139(2) or section 148, as the case may be, had not been served on him, the Assessing Officer should first issue the notice under appropriate section to the legal representative of the deceased and then proceed to assess the income of the deceased in the hands of the representative as if the representative were the assessee. If there are more legal representatives than one, the notice should be served on all of them; but it would be sufficient if the notice is served on one or more who effectively represent the estate or who are ascertained, after diligent and bonafide inquiry by the Assessing Officer to be the legal representatives. It is obligatory upon the representative to comply with the notices appropriately served. Assessment may be made on the representative under section 147 in respect of income of the deceased which had escaped assessment in the relevant years.

- ◆ **Income upto the date of death and the end of the accounting year:** Students should carefully note that section 159 applies in respect of the income of the deceased only upto the date of death and not upto the end of the accounting year in which the death occurs. The income of the estate for the period from the date of death upto the end of the accounting year in which the death occurs should be assessed under section 168 in the hands of the executor. Thus in respect of the year of death two separate and distinct assessments would have to be made, the prior one on the legal representative and the latter one on the 'executors' under section 168. This may even lower the incidence of tax for the year. The position will be the same even if the representative and the 'executor' are one and the same.
- ◆ **Apportionment:** As a consequence of two separate assessments as mentioned above apportionment of income between the two periods becomes necessary. Here it is to be noted that certain incomes like dividends or interest if they become payable after the death cannot be apportioned to the period upto the date of death because they do not accrue from day to day.
- ◆ **Penalty on legal representative:** Penalty proceedings for a default committed by the deceased can be started or continued against the legal representative. He, being an assessee, is also liable to a penalty for his own default.

Personal liability: We have noted that the liability of a legal representative is "limited to the extent to which the estate is capable of meeting the liability". However, he becomes personally liable to the extent of the value of any asset of the estate which he disposes off while the liability for tax remains undischarged. This personal liability is imposed by sub-section (4) only in respect of tax and not in respect of penalty, fine or interest.

- ◆ **Recovery from legal representative:** A legal representative must be regarded as an assessee for the purposes of recovery proceedings. A recovery certificate issued to the tax recovery officer during the life-time of the assessee may, after his death, be enforced against his legal representative without the name of the latter being substituted in the certificate. But such proceeding cannot be started against him unless he has been served with a notice of demand under section 156. Further he is not personally liable for the tax payable by the deceased unless some assets of the deceased have come into his hands and are not properly applied or accounted for.

13.3.2 Representative assessee [Section 160]

- ◆ **General :** Besides the legal representatives mentioned above, in certain cases, the income received by one person can be assessed in the hands of another. Persons who are liable to be assessed on behalf of other because of their association with the real recipient of the income are known as representative assessee. The expression 'representative assessee' means:
 - (i) the agent of a non-resident including a person who is treated as an agent under section 163 in respect of the income of the non-resident which is deemed to accrue or arise to him in India;
 - (ii) the guardian or a manager of a minor, a lunatic or an idiot in respect of the income of such latter person;

- (iii) the Court of Wards, Administrator-General, Official Trustee, Receiver or Manager appointed by or under any order of a Court in respect of the income which they received or are entitled to receive on behalf of or for the benefit of any person; and
- (iv) a trustee appointed under a trust deed by a duly executed instrument in writing, whether, testamentary or otherwise, in respect of any income which he is entitled to receive on behalf of or for the benefit of any person;
- (v) a trustee appointed under an oral trust in respect of the income which he receives or is entitled to receive on behalf of or for the benefit of any person.

The explanation added for the purpose of the last category makes it clear that a trust which is not declared by a duly executed instrument in writing (including a Wakf deed which is valid under the Mussalman Wakf Validating Act, 1913) will be deemed to be a trust declared by a duly executed instrument in writing if a statement in writing signed by the trustee or trustees and setting out the purpose or purposes of the trust, particulars of the trustee or trustees, the beneficiary or beneficiaries and the trust property, is prepared and forwarded to the Assessing Officer within the specified time limit. The specified time-limit will be three months from date of the declaration of the trust. For this purpose, the item 'oral trust' means a trust which is not declared by a duly executed instrument in writing including any Wakf deed and which is also not deemed under the new explanation I to be a trust declared by a duly executed instrument in writing.

- ◆ **Liability of a representative assessee [Section 161]:** Every representative assessee is deemed to be an assessee under the Income-tax Act. He therefore, has the same responsibilities, duties and liabilities as if the income were being received by him beneficially. He is liable to be assessed in his own name in respect of such income but the assessment is deemed to have been made upon him in his representative capacity. The tax is levied on and is recovered from such an assessee, in like manner and to the same extent as it would have been levied upon and recovered from the person represented by him.

Where any income in respect of which the trustee, appointed under a trust declared by a duly executed instrument in writing whether testamentary or otherwise, including any valid wakf deed, is liable as a representative assessee, consists or includes profits and gains of business, tax shall be charged on the whole of the income in respect of such a person at the "maximum marginal rate". However, this provision will not apply in cases where such profits and gains are receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance and such is the only trust so declared by him.

The department has the option to make an assessment on the representative assessee or a direct assessment on the person beneficially entitled to the income. Thus, the Assessing Officer may assess the agent or the non-resident; he may assess the guardian, manager, receiver or trustee or assess the beneficiary directly. Therefore, if an incapacitated person has no trustee or guardian or, if the trustee or guardian is not resident in India and cannot be found, the assessment may be made on the incapacitated person directly. But once the department has exercised this option and assessed the representative assessee or the beneficial recipient of the income, it cannot again assess

the same income to tax in the hands of the other. The department having assessed either of the two, has the option to recover the tax from the property held by him or by the other. This option conferred on the department in the interest of the revenue has to be exercised judiciously and with reasonable care.

The provisions of sections 160 and 161 contain only a machinery to levy and collect the tax but do not, in any way, affect the incidence of tax on a certain income and the scope of total income that must be subjected to tax.

- ◆ **Right of a representative assessee to recover tax paid [Section 162]:** Every representative assessee who is charged to tax as such is entitled to recover the tax paid from the person on whose behalf he had paid it or to adjust it against any moneys in his possession, but belonging to the other persons. The representative assessee has the right to retain out of the moneys in his representative capacity, an amount equal to any sum paid or payable by him under the Act in addition to the right to recover the same from the beneficial owner of the income. An agent who apprehends that he may be assessed as a representative assessee has the right to retain such sum irrespective of the fact that the non-resident may turn out to be not at all assessable to tax in India when the assessment is ultimately made upon him.
- ◆ **Statutory agent of non-residents:** An agent is considered a representative assessee but only if he is the agent of non-resident person. According to section 163, an agent, in relation to a non-resident person, includes any person in India:
 - (i) who is employed by or on behalf of the non-resident;
 - (ii) who is having any business connection with the non-resident;
 - (iii) from or through whom the non-resident is in receipt of any income, whether directly or indirectly;
 - (iv) who is trustee of the non-resident; and
 - (v) any other person who (whether resident or non-resident) has acquired a capital asset in India by means of a transfer from the non-resident.

In the first four cases stated above, the person sought to be assessed as the agent of a non-resident must necessarily be in India whereas it need not be so in the fifth case. Thus, a non-resident may be treated as the agent of another non-resident. The appointment of the agent may be made any time before or after the expiry of the relevant previous year. An agent of a non-resident may be appointed under this section even if at the date of such appointment the non-resident is not alive.

According to the proviso to this section, where transactions are carried on in the ordinary course of business through a broker in India and the broker does not deal directly with or on behalf of a non-resident principal but deals with or through a non-resident broker the broker in India cannot be treated as statutory agent in respect of the income arising to the non-resident from such transactions. Thus, where bona fide hedging transactions take place through a broker in India and a foreign broker acting for an undisclosed principal, the Indian broker cannot be deemed to be agent of the foreign principal. But generally a broker is not deemed to be the agent of a non-resident person so long as he functions exclusively in his capacity as a

broker.

For the purposes of section 163(1), the expression “business connection” shall have the meaning assigned to it in *Explanation 2* to clause (i) of section 9(1) of the Income-tax Act, 1961.

Before a person can be treated as an agent of a non-resident he must be given a reasonable opportunity of being heard by the Assessing Officer as to his liability to be so treated.

The agent is chargeable to tax in India as a representative assessee only in respect of the income which is deemed to accrue or arise in India to the non-resident under section 9(a)(i). He is chargeable to tax in the like manner and to the same extent as the non-resident and is assessable in respect of the income of the non-resident only. The agent for being assessed under this section need not be in receipt of the income on behalf of the non-resident in respect of which he is assessed. Thus, a person in India who has not received any income on behalf of a non-resident but has actually paid the non-resident the sums sought to be taxed (i.e., interest on a loan advanced by the non-resident or dividends) may be treated as an agent under this section. The agent's liability is personal and, therefore, cannot be negotiated; this liability is not also conditional to take effect upon his having funds of the non-resident. If the agent is not able to recover from the non-resident the amount of tax, he cannot claim it as a bad debt or a loss or an expense incidental to the business. There is no provision in the Act for recovering the tax from his personal assets, where the assessment is made directly on the non-resident's agent though the department is entitled to proceed against the non-resident's property in the possession of the agent.

13.3.3 Taxation of Discretionary Trusts [Section 164(1)]: Section 164 deals with taxation of trustees of discretionary trusts. This section applies in the case of a representative assessee referred to in clause (iii) or clause (iv) of sub-section (1) of section 160 in a case where any income or part thereof is not specifically receivable on behalf of or for the benefit of any one person or where the individual shares of the persons on whose behalf or for whose benefit such income or such part thereof is receivable are indeterminate or unknown.

The representative assessee referred to in clauses (iii) and (iv) of section 160(1) are the Court of Wards, the Administrator General, the Official Trustee or any receiver or manager including any person whatever his designation who in fact manages the property on behalf of another, appointed by or under any order of a Court and a trustee appointed under a trust declared by a duly executed instrument in writing whether testamentary or otherwise (including any Wakf Validating Act, 1913).

Such a discretionary trust will be liable to tax at the maximum marginal rate of income-tax on their entire income.

With a view to obviating hardship in genuine cases where the circumstances are such that tax evasion could not be considered to be main purpose of creating a trust, certain exceptions have been specified where the trust would not be taxed at the maximum marginal rate. The exceptions are as under:

- (1) Where none of the beneficiaries has any other income chargeable to tax or is a beneficiary under any other trust. In this context, the expression, “income chargeable to tax” would mean total income above the exemption limit for the relevant assessment year. Thus the income of a discretionary trust will be chargeable to tax at the maximum

marginal rate in cases where any of the beneficiaries has any other taxable income exceeding the exemption limit or if any of the beneficiaries is a beneficiary under any other trust.

- (2) Where the discretionary trust is created under a will and such trust is the only trust so created under the will.
- (3) In case of a discretionary trust created prior to 1.3.1970 by a non-testamentary instrument if the Assessing Officer is satisfied that the trust was so created bona fide exclusively for benefit of the dependent relatives of settlor or where the settlor is a H.U.F. for the benefit of the members of such families in circumstances where such relatives or members are mainly dependent on the settlor for their support and maintenance.
- (4) In cases where the income is receivable by the trustee on behalf of provident fund, superannuation fund, gratuity fund, pension fund or any other fund created bona fide by a person carrying on a business or profession exclusively for the benefit of persons employed in such business or professions.

In the above four cases the income of the trustees will be taxed not at the marginal rate but at the rate applicable to the income of an association of persons.

Where any income in respect of which a trustee appointed under a trust declared by a duly executed instrument in writing whether testamentary or otherwise, is liable as a representative assessee consists of or includes profits and gains of business, the above concessional treatment i.e. assessing the income at the rate applicable to an AOP will apply only if such profits and gains are receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance and such trust is the only trust so declared by him.

For the purposes of these provisions a trust under which a discretionary power is given to the trustees to decide the allocation of the income every year or a right is given to the beneficiary to exercise the option to receive the income or not each year will all be regarded as discretionary trusts and assessed accordingly. This is made clear in *Explanation 1* to section 164 which provides as under.

- (a) Any income in respect of which the Court of Wards, the Administrator General, the Official Trustee, receiver, manager, trustee or mutawalli appointed under a Wakf deed is liable as a representative assessee or any part thereof shall be regarded as not being specifically receivable on behalf or for the benefit of any person unless the person on whose behalf or for whose benefit such income or such part thereof is receivable during the previous year is expressly stated in the order of the Court or the instruments of trust or wakf deed, as the case may be, and is identifiable as such on the date of such order, instrument or deed. For this purpose, it is not necessary that the beneficiary in the relevant previous year should be actually named in the order of the Court or the instrument of trust or wakf deed, all that is necessary is that the beneficiary should be identifiable with reference to the order of the Court or the instrument of trust or wakf deed on the date of such order instrument or deed.
- (b) The individual shares of the person on whose behalf or for whose benefit such income or part thereof is receivable will be regarded as indeterminate or unknown unless the

individual shares of such persons are expressly stated in the order of the court or the instrument of trust or wakf deed, as the case may be, and are ascertainable as such on the date of such order, instrument or deed.

This explanation seeks to prevent trustees and beneficiaries from manipulating the arrangements in such a manner that a discretionary trust is converted into a specific trust whenever it suits them tax-wise.

- ◆ **Income from property held under wholly for charitable or religious purposes [Section 164(2)]:** In case the income, in respect of which the shares of the beneficiaries are indeterminate or unknown, is derived from property held under trust wholly for charitable or religious purpose or which is of the nature referred to in section 2(24)(ia) (voluntary contributions received by a trust) or which is of the nature referred to in sub-section (4A) of section 11 (business income received by a trust), the tax shall be charged on so much of the income as is not exempt under section 11 or 12 as if the income not so exempt were the income of an association of persons.

Where the whole or any part of the relevant income is not exempt under section 11 or section 12 because any income thereof is for the benefit of prohibited persons or the rules with regard to investments in specified channels have not been followed, tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate.

- ◆ **Income from property held under trust partly for religious purposes and partly for other purposes [Section 164(3)]:** If property held under trust partly for religious purposes and partly for other purposes and the individual share of the beneficiaries in the income applicable to purposes other than charitable purposes is not known, tax liability will be the aggregate of the following:
 - (a) the tax which would be chargeable on that part of the relevant income which is applicable to charitable or religious purposes (as reduced by the income, if any, which is exempt under section 11 as if such part (or such part so reduced) were the total income of the association of persons; and
 - (b) the tax on that part of income which is applicable to purposes other than charitable or religious and in respect of which shares of beneficiaries are indeterminate or unknown, at the maximum marginal rate.

However, in the following cases, income will be charged to tax as if it were income of an association of persons:

- (a) where none of the beneficiaries has any other income chargeable to tax i.e. income should not exceed the maximum amount not chargeable to income-tax and none of the beneficiaries is a beneficiary under any other private trust; or
- (b) where the trust is created by will and such trust is the only trust so declared by him; and
- (c) where the trust is a non-testamentary one created before March 1, 1970 for the exclusive benefit (to the extent it is not utilised for charitable or religious purposes) or relatives of the settler mainly dependent on the settler for their support or main-

tenance or where settler is a Hindu undivided family, for the exclusive benefit of its members so dependent upon it.

- (1) Where the relevant income consists of or includes profits and gains of business, the preceding concessional method of taxation shall apply only if the income is receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance and such trust is the only trust so declared by him.
- (2) Where the whole or any part of the relevant income is not exempt under section 11 or section 12 because any income thereof enures to the benefit of prohibited persons or the rules with regard to investment in specified channels have not been followed, tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate.

- ◆ **Taxation of Oral Trusts [Section 164A]:** Under this provision, any income which a trustee receives or is entitled to receive on behalf of or for the benefit of any person under an oral trust will be chargeable to income tax at the maximum marginal rate. For this purpose the expression "maximum marginal rate" is the rate of income-tax including surcharge of income-tax applicable in relation to the highest slab of income in the case of an association of persons as specified in the Finance Act of the relevant year. As a result of this provision an oral trust, the terms whereof are not subsequently recorded in writing and intimated to the Assessing Officer in the specified manner, will be chargeable to income-tax at the maximum marginal rate in all cases. However, if the terms of an oral trust are subsequently recorded in writing and intimated to the Assessing Officer in the specified manner the income will be chargeable to tax at the maximum marginal rate only in those cases where the shares of the beneficiaries are indeterminate and unknown. Where, however, such shares are determinate or known the tax will be levied and recovered from the trustees in the same manner and to the same extent as would be leviable or recoverable from the beneficiaries.
- ◆ **Case where part of trust income is chargeable:** Section 165 provides that in cases where only some portion of the trust income to which the beneficiary or beneficiaries is/are entitled is taxable and the other portion is not taxable, the taxable portion of the income received by him from the trust as a beneficiary shall be only such portion thereof as bears to the whole income of the trust. In other words, where a part only of the trust income is chargeable to tax under this Act, the beneficiaries' share of the income should be taken to be that derived proportionately from the chargeable and non-chargeable portions of the trust income and should be assessed accordingly in the hands of trustee/s.

It may be worthwhile to mention here that every representative assessee is regarded in law as an assessee for all the purposes of the Income-tax Act, 1961 and is subject to the same duties, responsibilities and liabilities, as if the income were received by or accruing to or in favour of him beneficially and is thus liable to assessment in his own name in respect of the income. It has also been specifically provided that a representative assessee shall not be assessed under any other provisions of the Act in respect of any income relating to which he is representative assessee except in his representative capacity as provided for in section 161 of the Act. A protection has been given to the

representative assessee with regard to the recovery of the tax paid by him, if any, on behalf of a beneficiary as regards the income in respect of which he is a representative assessee. Provision has also been made for the representative assessee to obtain a certificate from the Assessing Officer stating the amount which the representative assessee is entitled to retain for the final settlement of the liability.

13.3.4 Executors and Administrators [Sections 168 and 169]: Where executors and administrators or other persons have been appointed to administer the estate of a deceased, the income arising from such an estate shall be chargeable to tax in the hands of the executor or executors, as the case may be. If there is one executor, the assessment shall be made on him in the status of an individual. If on the other hand, there are more executors than one, then the assessment will be made on them in the status of an association of persons. Separate assessment shall be made on the executor or executors on the total income of each completed previous year or part thereof as is included in the period from the date of death of the deceased to the complete distribution to the beneficiaries of the estate according to their several interests. Any income of the estate of any previous year which is distributed or applied to the benefit of any specific (but not residuary) legatee of the estate during that previous year shall be excluded from the computation of the total income of that previous year assessed in the hands of the executors. The income so excluded shall, however, be included in the total income of the previous year of the 'specific legatee' himself.

Where the executors apply a portion of the income received by them from the estate in a particular way pursuant to the directions of the testator or other legal obligations, it is merely an application of income and would not entitle the executors to claim any deduction in respect of the income so applied. Thus, payment of the cost of the probate, death duties and other debts due to the State or periodic payments to the beneficiaries (other than the specific legatees) property of the testator or to a Court cannot be excluded in computing the executor's chargeable income from the estate.

Under the general law when an executor gives his assent to a specific legatee, the title of the legatee relates back to the date of death and consequently the income arising after the death and before the asset belong to the legatee is taxable in his hands but not as the income of the executor. However, it is only the income distributed to or applied for the benefit of any specific legatee during the previous year which should be excluded from the executors' total income. In other words if the income is not so distributed or applied in the previous year, it would be taxable as part of the income of the executor. If the executor is also the sole beneficiary it does not necessarily follow that he receives the income in the latter capacity.

If the legatee is a residuary legatee, the income from the residue is the income of the executor taxable in his hands so long as the estate has not been completely administered; it is only after the estate is fully administered and the net residue is ascertained that the residuary legatee gets a title and the income, therefore, can be said to accrue to him and can be taxed in his hands. This principle would apply irrespective of the fact whether the residue is settled in trust for a life tenant or is bequeathed absolutely and it would apply even if a part of the income of the estate had been actually paid on account to the residuary legatee pending the administration of the estate. However, the administration may be regarded as completed, the executor's assent to the residuary legacy as valid and the legatee's title as established,

although some liabilities due by the estate may remain undischarged.

According to section 169 the rights of the executors for relation and reimbursement or for the recovery of the tax paid by them are the same as those of representative assessee under section 162.

13.3.5 Liability of successor to business in respect of tax chargeable from the predecessor [Section 170]: Where a person carrying on any business, profession, or vocation is succeeded to by another person, both the successor and the person who is succeeded to (hereinafter called the predecessor) shall be assessed in respect of the actual share to which he is separately entitled in his income, profits and gains of the previous year. Thus, the predecessor in business would be assessable in respect of the income of the year of succession upto the date of succession while the successor would be assessable in respect of the income of that year after the date of succession. Accordingly, the income of the year in which the succession takes place is to be apportioned between the predecessor and the successor with the share of each. The income must be computed separately and each must be granted the deductions and allowance applicable to him. The assessment on each of these persons must be separate and distinct.

However, where the predecessor cannot be found the assessment of the profits of the year on which the succession took place up to the date of succession and also of the one year preceding the year of succession should be made on the predecessor. Again, if the assessment has already been made on the predecessor for either or both of the years aforesaid, but the tax due in pursuance of each assessment cannot be recovered from the predecessor or any person, it shall be entitled to recover the full amount of tax paid by him from the predecessor.

Under this section the Assessing Officer is required to record a finding that the tax in respect of the income of the year of succession or the preceding year cannot be recovered from the predecessor, before seeking to recover such tax from the successor. The successor's liability to tax arises also in respect of any gain (e.g., capital gains) accruing to the predecessor from the transfer of the business. The provisions of the section do not apply to cases of succession on the death of the person carrying on a business. The successor, however, is not entitled to claim to carry forward and set off the losses incurred by his predecessor. He has no right to carry forward even the unabsorbed depreciation allowance of the years prior to his succession to the business. The predecessor also cannot carry forward his loss because the right of carry forward can be exercised only if the business in which the loss was incurred is in existence and continues to be carried on by the same person.

13.3.6 Assessment after partition of a H.U.F.[Section 171]: The relevant provisions in this regard have been discussed earlier under the heading "Assessment of a Hindu undivided family".

13.3.7 Shipping business of non-residents [Section 172]: For the assessment of freight earned in India by ships belonging to or chartered by a non-resident, a special mode of assessment is prescribed under the Act. Under this section, no vessel owned by a non-resident can leave any port in India, unless the port authorities grant a tax clearance certificate. Such a certificate shall not be granted unless the master of the vessel produces a certificate from the Income-tax Authorities showing that the taxes payable have been paid or

satisfactory arrangements for their payment have been made. Where the non-resident owner has an agent in India from whom tax is recoverable on a regular assessment, the Assessing Officer in such cases, may grant a port clearance certificate, valid for one year on receipt of an application in his behalf. If the Assessing Officer is not satisfied that there is an agent in India who can be assessed on behalf of non-resident, he shall make a separate assessment in respect of the income of each vessel, before it leaves the port.

In such cases, 7½% of the amount paid or payable in or out of India on account of carriage of passengers or goods to the owner or charterer, is deemed to be his income accruing in India in respect of the carriage. The income of the non-residents from shipping business must be computed under section 44B.

It is the responsibility of the master of the ship to prepare and furnish to the Assessing Officer return of the full amounts paid or payable to the owner or the charterer, on account of the carriage of goods or passengers. On receipt of such a return the Assessing Officer assesses the income and determines the amount of tax payable thereon, at the rates applicable to a company which has not made prescribed arrangement for the declaration and payment of dividends within India. This sum is payable by the master of the ship.

The time limit for completing such assessments is 9 months from the end of the financial year in which the return under section 172(3) is furnished. However, in respect of returns filed on or before 1.4.2007, assessments are required to be completed on or before 31.12.2008.

After the close of the previous year, it is permissible for a non-resident person on whom tax has been charged on an adhoc basis in respect of the income of a vessel to apply along with a return of his income that he may be assessed on the basis of the business income that actually arose to him in the previous year. On completion of the regular assessment the tax paid towards the adhoc assessment shall be adjusted against the amount due from the assessee and the excess or deficiency if any, shall be refunded to or recovered from the non-resident.

13.3.8 Recovery of tax in respect of the income of a non-resident [Section 173]: The provisions for recovery of tax in respect of non-residents are contained in section 173. According to this section, the tax chargeable on the income, which is deemed to accrue or arise in India under section 9(1)(i), in the name of the non-resident or his agent who is liable as a representative assessee, may be recovered by deduction of tax at source under any of the provisions of Chapter XVII-B.

Any arrears of tax may be recovered also in accordance with the provisions of the Income-tax Act, 1961. However, the limitation contained in section 173 is that such recovery can be made only from any assets of the non-resident which are within India or which may at any time come within India.

However, in a case where the Central Government has entered into an agreement for recovery of tax with the Government of the country where the non-resident resides, the provisions of section 228A provide for an exception to the limitation contained in section 173.

Under section 90A(1), the Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India for, inter alia, recovery of income-tax under the Income-tax Act, 1961 and under the corresponding law in

force in that country or specified territory.

Section 228A provides for the procedure of recovery of tax in pursuance of an agreement entered into by the Central Government with the Government of any country outside India. Sub-section (2) thereof provides that where an assessee is in default or is deemed to be in default in making a payment of tax, the Tax Recovery Officer may, if the assessee has property in a country outside India, forward to the Board a certificate drawn up by him under section 222 and the Board may take such action thereon as it may deem appropriate having regard to the terms of the agreement with such country.

13.3.9 Income earned in a financial year assessed in the same financial year - Exceptions to the general rule [Sections 174 to 176]: Generally, the assessment year is always ahead of the previous year. In other words, income which is earned during one financial year is not charged to tax in that very same year but in the next following financial year. To this general rule, there are certain exceptions which are as under:

Persons leaving India [Section 174]: Where it appears to the Assessing Officer that any individual may leave India during the current financial year or shortly after its expiry and that there is no present intention of his returning to India, the Assessing Officer may proceed to assess his total income for the period comprised in the current financial year i.e. the total income of the period from the expiry of the last previous year and if a previous year has already been determined in his case upto the probable date of his departure.

The total income of each completed previous year or part thereof including such period shall be chargeable to tax at the rates in force in that assessment year and separate assessment must be made in respect of each such completed previous year or part thereof. The Assessing Officer is entitled to estimate the income of the individual leaving India for such period or part thereof in cases where his income cannot be readily determined in the manner provided in the Act for the computation of income under each head.

For the purposes of making this assessment the Assessing Officer may serve a notice upon the assessee requiring him to furnish within such time (not being less than seven days) as may be specified in the notice a return, under section 139(2) setting forth his total income for each completed previous year comprised in the period of assessment, and his estimated total income for any part of the period. For all practical purpose this notice issued by the Assessing Officer would not be deemed to be a notice under section 139(2). The tax chargeable on any, individual under the section shall be over and above the tax, if any, chargeable under any other provision of the Act. If an assessee does not furnish the return as required by the notice of the Assessing Officer a best judgment assessment must be made on him under section 144; non-compliance with the requirements of the notice may also attract liability to penalty under section 271.

Assessment under this section may be made even on the income of the period beyond the expiry of the assessment year if the probable date of the assessee's departure is after the expiry of the assessment year. In addition to the issue of notice for making an assessment under this section, the Assessing Officer may as well issue notice under sections 139(2) and 148(1) requiring him to furnish a return and other relevant information within such period being not less than seven days, as he may think fit. Thus, the Assessing Officer is empowered to make more assessment than one on a person leaving India before his departure from India.

AOP or BOI or Artificial Juridical Person formed for a particular event or purpose [Section 174A]: Section 174A provides for accelerated assessments in cases of certain AOP, BOI etc. If such AOP, BOI etc. is formed or established for a particular event or purpose and the Assessing Officer apprehends that the AOP/BOI is likely to be dissolved in the same year or in the next year, the Assessing Officer can make assessment of the income upto the date of dissolution as income of the relevant assessment year. The provision is on the same basis as contained in section 174 which deals with accelerated assessment of persons leaving India.

Persons trying to alienate their assets [Section 175]: If it appears to the Assessing Officer during any current assessment year that any person is likely to charge, sell, transfer, dispose of or otherwise part with any of his assets with a view to avoiding payment of the whole or any part of his liability under the Income-tax Act, the total income of such person, for the period from the expiry of the previous year for that assessment year to the date when the Assessing Officer commences proceedings under this section shall be chargeable to tax in that assessment year itself. All the provisions of the Act shall apply to such proceeding as they apply in the case of a person leaving India.

Discontinuance of business or profession [Section 176]: Where any business or profession is discontinued in any assessment year, an assessment may be made in that very year of the income from business for the period between the expiry of the previous year relevant to that assessment year and the date of discontinuance, in addition to the assessment, if any, made on the income, profits or gains of the earlier previous year or years. Thus, the Assessing Officer has an option to make a premature assessment of the profits earned up to the date of discontinuance in the year of discontinuance instead of the usual financial year.

The term 'discontinuance' used in this context, refers to complete cessation of the business instead of a mere change of ownership or change in the constitution of firm. A change of ownership may involve succession and, for purpose of this section, a business must be regarded as being continued despite successive changes in its ownership. Since succession and discontinuance are two mutually exclusive concepts there cannot be a discontinuance in cases where there is succession. If a part of the business of an assessee is dropped owing to its non-profitable nature, either permanently or temporarily, it would not imply that the business has been discontinued. In other words, inactivity in trade does not lead to the conclusion that the trade has been discontinued. There may be cases where the trade may be carried on even after the dissolution of the firm or the liquidation of the company. The amalgamation of two separate and independent business belonging to two distinct owners may result in the discontinuance of those business and the change of ownership. Where the business of a joint family or a firm is split up on partition of the family or the dissolution of the firm and the business is divided into branches or portions amongst the members, it would be a case of discontinuance of the old business even if some or all the members carry on their business in the same premises and take advantages of the old business connections. This is because of the fact that in such a case of the assessee i.e., the family or the firm, has ceased to carry on the business and there is no succession insofar as the integrity of the business is not preserved as was held in *Sait Nagjee Purshotam and Co. Vs. C.I.T. (1964) 51 I.T.R. 489 (S.C.)*.

In the case of a profession a firm may discontinue its profession though its patterns may remain in the profession and vice versa. Where a professional man joins a firm, he does not cease to carry on his profession and only when he retires from the firm and ceases to practice

once and for all he would be said to have discontinued his profession even though the firm in which he was a partner might continue to function after his retirement with or without new partners. In order to constitute proper discontinuance of the profession for purposes of this section it is not essential that there should be a complete cessation of the professional practice for the rest of man's life. For instance, an advocate would be said to have discontinued his professional practice when he takes up a full-time assignment as a judge or a legal adviser; but after retirement or resignation from the service he is entitled to return to his professional practice again.

The total income of each completed previous year or part thereof included in the period for which assessment is to be made shall be computed separately and shall be chargeable to tax at the rate or rates in force in respect of each of the relevant assessment years. Any person discontinuing his business or profession must necessarily give notice to the Assessing Officer of the fact of discontinuance within fifteen days from the date thereof. Failure to give this notice would entail the levy of penalty under section 272. Discontinuance and dissolution of business or profession by an association or a firm do not fall within the provisions of section 176 as they are dealt with under sections 177 and 189 respectively.

In the case of profession which has been discontinued, any sum received in any year on account of the cessation of the profession by, or on the retirement or death of the person carrying on profession, after the date of discontinuance is deemed to be the income of the recipient and charged to tax accordingly in his hands as if the amount would have been included in his total income if it had been received before the discontinuance. This specific provision for taxing the receipts after discontinuance of the profession thus constitutes an exception to the general rule that professional receipts would be taxable only if the profession is carried on in the year of account: section 176(4) applies only to a profession and not to a business discontinued.

According to sub-section (3A) of section 176, in cases where any business is discontinued in any year, any monies received after the discontinuance of the business must be deemed to be the income of the recipient and must be charged to tax accordingly as his income from business in the year of its receipt if such monies would have been included in the total income of the assessee who carried on the business had such monies been actually received prior to the discontinuance of the business.

The other procedural provisions in regard to service of notice, mode of assessment, collection of tax etc. are the same as those applicable to a person leaving India, as discussed earlier.

13.3.10 Liabilities arising when an association carrying on business is dissolved or business is discontinued [Section 177]: Where any business or profession carried on by an association of persons had been discontinued or where an association of persons is dissolved the assessment officer is bound to make an assessment of the total income of the association of persons as if no such discontinuance has taken place. Consequently, all the provisions of the Act, including those relating to the levy of penalty or any other sum chargeable under the Act, apply to such an assessment. If the Assessing Officer or the Commissioner (Appeals) in the course of any proceeding under the Act, in respect of any association of persons is satisfied that the association of persons is guilty of any of the acts attracting the provisions of sections 270 to 275, he may impose or direct the imposition of a

penalty in accordance with those sections.

Every person who was at the time of discontinuance or dissolution a member of the association of persons, and the legal representative of any such member who is deceased, shall be jointly and severally liable for the amount of tax penalty or other sum payable and all the provisions of the Act, so far as may be, shall apply to any such assessment, imposition of penalty etc. Where the dissolution or discontinuance had taken place after the commencement of any proceeding under the Act, the proceeding may be continued against the member of the association immediately prior to the discontinuance or dissolution and the legal representative of any deceased member from the stage at which they stood at the time of discontinuance or dissolution. The liability of the legal representative of any deceased member shall, however, be limited to the extent to which the estate is capable of meeting the liability. But if the legal representative, while his tax liability remains undischarged, creates a charge on or disposes off or parts with any of the assets of the estate of the deceased which are, or may, come into his possession, this personal liability shall, however, be limited to the value of the assets so charged, disposed of or parted with.

A society registered under the Societies Registration Act, 1860 is a legal entity separate and distinct from its members. Its members are not personally liable for the tax assessed and levied on the society, which is assessable as an association of persons so long as the society is not dissolved or its business is not discontinued [*Swami Sachitan and Vs. I.T.O. (1964) 53 I.T.R. 533*].

13.3.11 Companies under Liquidation [Section 178 and 179]:

1. In the case of all companies [Section 178]: Every person (i) who is the liquidator of any company which is being wound up, whether under the orders of a Court or otherwise, or (ii) who has been appointed as the receiver of any assets of a company is bound under a statutory obligation to give notice of his appointment as liquidator or receiver, as the case may be. This notice may be given within thirty days of his appointment to the Assessing Officer having jurisdiction to assess the income of the company. The Assessing Officer, in his turn is bound after making such enquiries or calling for such information as he may deem fit, to notify to the liquidator, within three months from the date of receipt of the notice of appointment, of the amount which in his opinion would be sufficient to provide for any tax which is then or likely thereafter to become payable by the company.

The liquidator is debarred from parting with the assets of company and its properties in his hands until he is notified by the Assessing Officer of the amount which will be sufficient to provide for any tax which is then, or is likely thereafter, to become payable by the company except with the prior approval of the Commissioner and for a specific purpose viz., payment of the tax payable by the company, payment to secured creditors whose debts are entitled under law to priority of payments over the debts due to the Government on the date of liquidation and meeting such costs and expenses of the winding up of the company as are, in the opinion of the Chief Commissioner or the Commissioner, reasonable immediately on receipt of the notice and before parting with any of the assets of the company, directly or indirectly.

If the liquidator fails to notify the Assessing Officer of his appointment within the time

specified or fails to set aside the amount intimated by the Assessing Officer as being sufficient to provide for the tax liability of the company or parts with any of the assets or property of the company in his hands in contravention of the above provisions, he shall be personally liable for payment of the tax which the company would be liable to pay or, as the case may be, the amount intimated to him by the Assessing Officer. Failure to comply with the above requirement would be an offence punishable under section 276A.

Where there are more liquidators than one, their obligations and liabilities under this section are joint and several. The provisions of this section have the effect of over-riding any thing to the contrary contained under the Companies Act or any other law for the time being in force and apply to all companies, public or private.

Leave of the winding up Court is not necessary for an Assessing Officer to commence or continue the assessment proceedings against the company in liquidation. An assessment cannot, however, be made on a company after it has ceased to exist and its name has been struck off the Register of Companies by the Registrar.

2. In the case of private companies [Section 179]: Where any private company is wound up and any tax assessed on the company, whether before or in the course of its liquidation in respect of any income of any previous year cannot be recovered, then, every person who was director of a private company at any time during the relevant previous year shall be jointly and severally liable for the payment of the tax unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company. The personal liability imposed by this section on the directors of a private company shall have the effect of over-riding any provision under the Companies Act, 1956 by which the liability of the directors is reduced or curtailed. Thus, personal liability can be imposed by the Assessing Officer on a direction even without any adjudication by a Court.

The directors of a private company would be personally liable to pay the taxes due from the company not only at the time when the company is wound up but even in cases where the company is not in liquidation. Thus, the directors of a private company are jointly and severally liable for the payment of any tax due from a private company in respect of its income liable to tax in any accounting year from any other company in respect of any income of any previous year during which time such other company was a private company. In cases where a private company is converted into a public company and the taxes assessed in respect of any income of any previous year during which such company was a private company could not be recovered from the company, then, any tax due in respect of the income of the private company could be recovered from any of the persons who were directors of the private company before a public company. A director would be free from this personal liability to pay the taxes of the company, if he could prove that the non-recovery of the taxes due from the private company is not attributed to any gross negligence, misfeasance or breach of duty on his part in relation to the affairs of the private company.

For the purposes of this section, "tax due" includes penalty, interest or any other sum payable under the Income-tax Act, 1961.

Tax Planning and Ethics in Taxation

14.1 Basic Concepts

Tax planning involves an intelligent application of the various provisions of the Direct Tax Laws to practical situations in such a manner as to reduce the tax impact on the assessee to the minimum. A thorough understanding of the principles, practices and procedures of tax laws and the ability to apply such knowledge to various practical situations is expected at the final level.

14.1.1 Method of study of tax planning: A thorough up-to-date knowledge of tax laws is a pre-requisite for a successful study of tax planning techniques. Not only an up-to-date knowledge of the statute law necessary, but one must also be aware of the contents of the various circulars issued by the CBDT and also of case laws in the form of various decisions of the Courts. One of the best methods to study tax planning in action is to analyse the case laws. In view of this position, students should realise the importance and usefulness of keeping track of the judgments of Supreme Court and of various High Courts as reported in Income-tax Reports and other such journals from time to time. Students should make it a point to go through the relevant cases and understand the issues involved and the rationale of the judgments. Of course, tax planning in a particular case would depend on the facts and circumstances of that particular case.

Apart from the above, students are advised to go through the articles on tax laws published in tax journals and financial papers. They should try to refer to the various papers on topics relating to tax planning that are presented at the various seminars organised by the Institute and its Regional Councils and the Branches from time to time. These papers often contain much food for thought.

With this brief introduction, let us go into the basic concepts of tax planning.

14.1.2 Concept of tax planning: Planning is the formulation of a system which in its implementation is designed to achieve a specific result. Economic planning is the privilege of the State; tax planning is that of the subject. Men, material and money are the resources available at the disposal of a nation and to conserve the same the State resorts to economic planning. Tax planning aims to reduce the outflow of cash resources made available to the government by way of taxes so that the same may be effectively utilised for the benefit of the individual or the business as the case may be. Just as sound economic planning is indispensable for a welfare State, a sound tax planning is equally indispensable for the welfare of the citizen.

Before entering into a transaction or before starting a business, one normally considers its

profitability and other aspects. Amongst other aspects, the tax implications of the transactions of the business have to be thought out before actually embarking on the deal. Otherwise one may be caught unwittingly in huge tax liability. Planning from the point of view of taxation helps in generating greater savings of investible surplus.

Tax planning may be defined as an arrangement of one's financial affairs in such a way that, without violating in any way the legal provisions, full advantage is taken of all tax exemptions, deductions, concessions, rebates, allowances and other reliefs or benefits permitted under the Act so that the burden of taxation on the assessee is reduced to the minimum.

It involves arranging one's financial affairs by intelligently anticipating the effects which the tax laws will have on the arrangements now being adopted. As such it is a very stimulating intellectual exercise.

Any tax planning scheme should be a natural one and should not give an appearance of an artificial arrangement on the face of it. The tax planner or the tax adviser should exercise great care and caution in designing any tax planning scheme as its failure will result in great difficulties and heavy burden of tax to the assessee for whom the scheme is evolved.

14.1.3 Tax planning and tax avoidance: Reduction of taxes by legitimate means may take two forms — tax planning and tax avoidance. 'Tax planning' is wider in range. At this stage, the distinction between 'tax avoidance' and 'tax evasion' may be noted. The dividing line between tax evasion and tax avoidance is very thin. The Direct Taxes Enquiry Committee (Wanchoo Committee) has tried to draw a distinction between the two items in the following words.

"The distinction between 'evasion' and 'avoidance', therefore, is largely dependent on the difference in methods of escape resorted to. Some are instances of merely availing, strictly in accordance with law, the tax exemptions or tax privileges offered by the government. Others are maneuvers involving an element of deceit, misrepresentation of facts, falsification of accounting calculations or downright fraud. The first represents what is truly tax planning, the latter tax evasion. However, between these two extremes, there lies a vast domain for selecting a variety of methods which, though technically satisfying the requirements of law, in fact circumvent it with a view to eliminate or reduce tax burden. It is these methods which constitute "tax avoidance".

14.1.4 Judicial thinking—A brief survey: However, it is to be noted that judicial attitude towards tax avoidance schemes has distinctly hardened as is evident from the judgment of the Supreme Court in *M/s. Mc Dowell and Co. Ltd. vs. Commercial Tax Officer 1985 Taxman 77(3)-(1985) 154 I.T.R. 148 (SC)*. Though this decision was rendered in the context of A.P. General Sales Tax Act, the principles emerging out of this decision will have relevance to direct taxes also.

Before discussing the relevant observations of the Supreme Court in relation to tax avoidance scheme it will be instructive to have an idea of the development in judicial thinking in England since our own judicial thinking on the subject has been largely derived from English thinking.

English Scene: In *Inland Revenue Commissioner vs. Duke of Westminster 1936 AC 1* it was

held "Every man is entitled if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax."

After the World War II and the consequent huge profiteering and racketeering the attitude of the courts towards the avoidance of tax perceptibly changed and hardened. Commenting on a tax avoidance scheme the court observed that it scarcely lies in the mouth of the taxpayer who plays with fire to complain of burnt fingers.

It was felt that there must be some limit to the devices which courts can put up with in order to defeat the fiscal intentions of the legislature. A very significant departure from the Westminster Principle was made in *Ramsay vs. Inland Revenue Commissioners (1982) AC 300*. It was felt in that case that even though the doctrine that courts could not go behind a given genuine document or transaction to some supposed underlying substance was a cardinal principle, it must not be overstated or over-extended. While obliging the courts to accept documents or transactions, found to be genuine, as such, the doctrine did not compel the court to look at the document or transaction in blinkers isolated from any context to which it properly belonged. If it could be seen that a document or transaction was intended to have effect as a part of a nexus or series of transactions or as an ingredient of a wider transaction intended as a whole, there was nothing in the doctrine to prevent it being so regarded. To do so was not to prefer form to substance or substance to form. It was the task of the court to ascertain the legal nature of any transaction to which it was sought to attach a tax consequence and if that emerged from a series or combination of transactions, intended, apart as such, as was that series or combination which might be regarded.

Thus, two things were established. The first was a significant change in the approach adopted by the court with regard to its judicial role towards tax avoidance scheme. The second was that it was crucial when considering any such scheme to take the analysis far enough to determine where the profit, gain or loss was really to be found. It was also stated that the fact that the court accepted that each step in a transaction was a genuine step producing its intended legal results did not confine the court to consider each step in isolation for the purpose assessing the fiscal results. Thus we can say that the true principle of the decision in *Ramsey* was that the fiscal consequence of a preordained series of transactions intended to operate as such, are generally to be ascertained by considering the result of the series as a whole and not by dissecting the scheme and considering each transaction separately.

In *I.R.C. vs. Burmah Shell Co. Ltd. (1982) STC 30 (Burmah)* and *Furniss (Inspector of Taxes) vs. Dawson (1984) 1 All E.R.530*, it was held that where tax avoidance was targeted through a series of transactions with no commercial or substantial value but with the only aim of avoiding tax, the Courts have to ignore the transactions and the tax liability has to be determined as if these transactions never took place.

Indian Scene: In *CIT vs. A. Raman & Co. 1 SCR 10* the Supreme Court followed the dictum of the Westminster's case. It observed that avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed is not prohibited. The tax payer may resort to a device to divert the income before it accrues or arises to him. Effectiveness of the device depends not

upon consideration of morality but on the operation of the Income-tax Act. Legislative injunction in taxing statutes may not, except on pain of penalty, be violated but it may lawfully be circumvented. The same view was expressed in *CIT vs. Kharwar* 72 ITR 603 as follows:

“The taxing authority is entitled and is indeed bound to determine the true legal relation resulting from a transaction, if the parties have chosen to conceal by a device the legal relation, it is open to the taxing authorities to unravel the device and to determine the true character of relationship. But the legal effect of a transaction cannot be displaced by probing into the substance of the transaction.”

However, the Supreme Court in *Mc Dowell's* case clearly departed from the above views and expressly disassociated itself with the earlier observations of the Supreme Court echoing the sentiments of Westminster principle. The court enumerated the evil consequences of tax avoidance as follows:

1. Substantial loss of much needed public revenue.
2. Serious disturbance caused to the economy of the country by the piling up of mountains of blackmoney, directly causing inflation.
3. Large hidden loss to the community by some of the best brains of the country involved in perpetual litigation.
4. Sense of injustice and inequality which tax avoidance arouses in the minds of those who are unwilling or unable to profit by it.
5. The unethical practice of transferring the burden of tax liability to the shoulders of the guileless, good citizens from those of the ‘artful dodgers’.

The court felt that there was as much moral sanction behind taxation laws as behind any other welfare legislation and it was a pretence to say that avoidance of taxation was not unethical and that it stood on no less a moral plane than honest payment of taxation.

In the view of the court the proper way to construe a taxing statute while considering a device to avoid tax was not to ask whether the provisions should be construed literally or liberally, nor whether the transaction was not unreal and not prohibited by the statute, but whether the transaction was as device to avoid tax and whether the transaction was such that the judicial process might record its approval to it.

The court felt that it was neither fair nor desirable to expect the legislature to intervene and take care of every device to avoid taxation. It was up to the court to take stock to determine the nature of the new and sophisticated legal devices to avoid tax and consider whether the situation created by the devices could be related to the existing legislation with the aid of emerging techniques of interpretation as was done in *Ramsey's* case to expose the devices for what they are really worth and to refuse to give judicial benediction.

The Supreme Court emphasised that tax planning may be legitimate provided it is within the framework of law and colourable devices cannot be part of tax planning. It is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods. The Supreme Court also recommended that it is the obligation of every citizen to pay the taxes honestly without resorting to subterfuge.

It is significant to note that in deciding *Mc Dowell's* case, the Supreme Court was not content in merely adjudicating the dispute as to whether sales tax was leviable on the Central Excise paid by the purchaser on behalf of the seller and not exhibited in the bill. It also stated in this case that it decided to break away from the long tradition of earlier cases holding that tax avoidance is both legitimate and legal.

Another significant case decided by the Supreme Court, though involving a dispute relating to payment of bonus, is worthy of reference at this stage as it also reflects the same thinking as in *Mc Dowell's* case. In *Associated Rubber Industries case (1986) 157 ITR 77*, a new wholly owned subsidiary company was created with no asset of its own except investments transferred by the holding company with no business income, except receiving dividend from the transferred investments. The Supreme Court held that on facts the purpose of such a transfer of investments was nothing but to reduce the gross profits of the holding company and thereby to reduce the payment of bonus. There was no direct evidence that the subsidiary was formed as a device to reduce the gross profits of the principal company for whatever purpose. But Justice Chinnappa Reddy in passing his judgment was following the principles earlier laid down by him in *Mc Dowell's* case and was of the opinion that the transfer of shares was nothing but a device like tax evasion to avoid a welfare legislation like the Payment of Bonus Act. It was observed that it is the duty of the Court in every case where ingenuity is expended to avoid liability to taxation and welfare legislation, to get behind the smoke screen and discover the true state of affairs.

The above decision seems to have introduced a new doctrine that it is upto the court to take stock, weigh out sophisticated legal devices and expose the devices for what they really are. The fact that this new doctrine has started gaining ground very fast is seen from a quick succession of decisions, after *Mc Dowell* in *Kartikeya vs. Sarabhai* and in *Associated Rubber's* case. The above change in the trend of judicial thinking clearly shows that the line of demarcation between Tax Planning and Tax avoidance.

In order to curb tax avoidance, provisions such as applicability of transfer pricing provisions in respect of specified domestic transactions, treating any transaction with the person located in the notified jurisdiction areas to be treated as international transaction, General Anti-avoidance Rules, provisions relating to furnishing of Tax Residency Certificate for claiming benefit of double tax avoidance agreements have been introduced.

The decision in *Mc Dowell's* case and the subsequent developments have evoked lot of debate in all legal and tax circles.

The Gujarat High Court in *CIT vs. Smt. Minal Rameshchandra (1987) 61 CTR (Guj) 80* had occasion to consider the impact of *Mc Dowell's* case. The following propositions appear to emerge from the same.

- (1) *Mc Dowell's* case and observations therein cannot be ignored and these are binding on all courts.
- (2) *Mc Dowell's* case and observation therein should be understood in the context of questioning the legitimacy of use of artificial and transparent device and sham practices to circumvent the law.

- (3) Where the arrangement cannot be dismissed as an artificial tax device (and not as a legitimate transaction), the subject can be taxed only having “regard to strict letter of the law and not merely to the spirit of the statute or the substance of the law” and had been consistently laid down earlier. In this sense there is no radical departure from law, prior to Mc Dowell case.

In *C.W.T. vs. Arvind Narottam 173 ITR 479 (SC)* judge Sabyasachi Mukerji made the following significant observations:

1. Where the language of the deed of settlement is plain and admits of no ambiguity there is no scope for considerations of tax avoidance.
2. One would wish as noted by Chinnappa Reddy in Mc Dowell’s case that one could get the enthusiasm of Justice Holmes that taxes are the price of civilization and one would like to pay that price to buy civilization. But the question which many ordinary tax payers very often in a country of shortages (with ostentatious consumption and deprivation for the large masses) ask is does he with taxes buy civilization or does he facilitate the waste and ostentation of the few. Unless waste and ostentation in government spending are avoided or eschewed no amount of moral sermons would change people’s attitude to tax avoidance.
3. Where the true effect on the construction of the deeds is clear, appeal to discourage tax avoidance is not a relevant consideration”.

In the light of the above development we have to ascribe a proper meaning to the concept of tax-planning. We can take a cue from the structure of our tax laws.

Our tax laws tend to serve a dual purpose of collecting revenue and of achieving certain social objectives. There are in-built tax incentives which promote savings and investments in new enterprises and facilitate development of backward areas. A lot of exemptions and incentives are provided in all the direct taxes. If an assessee takes maximum advantage of these incentives, exemptions etc. and enlarges the scope of his disposable resources, there can be no objection because the legislature wants the optimum utilisation of these incentives to promote economic activity in the country. The complexity of our tax-laws makes it impossible for even an intelligent assessee to comprehend them properly and avail all the reliefs which may be genuinely provided by such laws. Moreover, the interaction of other laws such as MRTP Act, FERA, Companies Act etc. make the exercise much more complicated. It requires, therefore, meticulous planning to bring down the tax commitments keeping in view not only the statutes but also the judge-made law. We may say that the above area properly belongs to tax-planning. In this sense there is nothing unethical about tax-planning.

Due to constant changes in the law and new court decisions, it is always necessary to have a continuous review in relation to all matters of tax planning so that appropriate changes are introduced without delay.

It may be noted that the scope of the three English cases of Ramsay, *Burmah Oil Company* and *Dawson* have been substantially narrowed by a more balanced view on tax planning in the case of ‘*Craven vs. White*’

14.1.5 Basic framework of Direct Tax Laws : An inter-relation between them: We have today an integrated and more or less self-checking system of taxation in the field of direct taxes. The different direct taxes are so integrated that the same transaction may give rise to liability under the different Acts in different manners. All these Acts contain deeming provisions which envisage some sort of clubbing of income/wealth belonging to others. Under the Income-tax Act, 1961 it is the total income of the assessee which is chargeable to tax. Under certain circumstances (Section 60 to 64 of the Income-tax Act, 1961) even income of other persons is to be included in the assessee's total income. Under the Wealth-tax Act, 1957 it is the net wealth of the assessee as on the valuation date relevant to the assessment year which attracts tax. In computing the net wealth of the assessee as on the valuation date, certain assets transferred by the assessee and held by specified categories of persons are also sought to be included under section 4 of the Wealth-tax Act, 1957.

Thus, the same transaction might give rise to tax liability under different Acts under different circumstances. For instance, a transfer might be complete under the general law. Still, if the transfer without consideration is made to, say, the spouse of the transferor, the income arising from the transferred assets will continue to be taxed in the hands of the transferor for income-tax and the wealth will be taxed in the hands of the transferor for wealth-tax purposes. Thus there exists an intimate inter-relationship between the various direct taxes Acts and that under certain circumstances the assessee will not stand to gain from the tax point of view even by transferring the property to others.

In view of this position, a tax planner should always take into account the implications of the proposed transactions not only under the Income-tax Act, 1961 but also under the other direct taxes Acts. The relevant Finance Acts should be taken into account. The relative implications should be studied and the impact of the relevant legal provisions should be taken into account.

14.1.6 Doctrine of form and substance: One of the reasons which prompts a tax payer to resort to tax planning is the existence of the doctrine of form and substance. The principle involved in this doctrine is simple. How far Court may stretch the wording of a Statute to cover a particular set of facts, where those facts have clearly been created by a tax payer in order to avoid or minimise his tax and the literal interpretation of the Statute is not, at first sight apt to cover them? Is it possible to ignore the form of a transaction and determine the substance thereof?

In *Commissioner of Income tax vs. Motor and General Stores (P) Ltd.* (1967) 66 ITR 692 (SC.) the Supreme Court had observed that in the absence of any suggestion of bad faith or fraud the true principle is that the taxing statute has to be applied in accordance with the legal rights of the parties to the transaction. According to the court when the transaction is embodied in a document the liability to tax depends upon the meaning and content of the language used in accordance with the ordinary rules of construction. The House of Lords in *Duke of Westminster vs. ICR* (1936) 19 ATC 498 held that in considering the substance of the transaction, the legal form cannot be disregarded.

It was held in *CIT vs. B.M. Kharwar* (1969) 72 ITR 603 (SC) that the taxing authority is entitled and is indeed bound to determine the true legal relation resulting from a transaction. If the parties have chosen to conceal by device the legal relation, it is open to the taxing authority to

unravel the device and to determine the true character of the relationship. However, the legal effect of a transaction cannot be displaced by probing into 'the substance of the transaction'. This principle applies alike to cases in which the legal relation is recorded in a formal document and to cases where it has to be gathered from the evidence - oral and documentary - and the conduct of the parties to the transaction. However, this view of the Supreme Court has now been expressly disapproved by the Supreme Court in *Mc Dowell & Co. Ltd's* case.

Justice Shah, in *Ram Laxman Sugar Mills vs. CIT* (1967) 66 ITR 613, 617 (SC), has stated that to ascertain the legal effect of a transaction, the court seeks, in the first instance, to determine the intention of the parties and if ambiguous expressions are used, the court may normally adopt such interpretation consistent with the parties thereto having acted on the assumption of its validity. Thus any claim made by a tax-payer will be scrutinized from the point of view of his intention and if there was any intention to defraud the revenue, the court will consider the transaction or the claim as fraud.

Thus, we can say that unless there is clear evidence of *malafide* intention resulting in a form which is a "colourable device" or "mere legal facade" or "non-genuine" form the tax authorities are not justified in disregarding the legal form and probing into the substance of the transaction.

◆ **Principles governing the form and substance :** Theory of interpretation of a taxing statute:

- (i) It is well settled that when a transaction is arranged in one form known to law, it will attract tax liability while, if it is entered into in another form which is equally lawful, it may not. In considering, therefore, whether a transaction attracts tax or not, the form of the transaction put through by the assessee is to be considered and not the substance thereof.
- (ii) The above rule cannot naturally apply where the transaction, as put through by the assessee, is not genuine but colourable or is a mere device. For here, the question is not one between 'form' and 'substance' but between appearance and truth.
- (iii) In deciding whether the transaction is a genuine or colourable one, it will be open to the authorities to pierce the corporate veil and look behind the legal facade at the reality of the transaction.
- (iv) Where the authorities are charged under the Act with the duty of determining the nature or purpose of and payment or receipt on the facts of a case, it is open to them to work at the substance of the matter and the formal aspect may be ignored.
- (v) Where the terms of a transaction are embodied in a document, it should not be construed only in its formal or technical aspect. While the words used should be looked at, too much importance should not be attached to the name or label given by the parties and the document should be interpreted so as to accord with the real intention of the parties as appearing from the instrument.

As noted earlier, the decisions of the Supreme Court in the cases of *Mc Dowell*, *Karthikeya Sarabhai* and *Associated Rubber Industries*, clearly show a preference for the 'substance' over the 'form', if the circumstances of the case warrant such a preference. Where the

transactions are genuine, perfectly authentic and not sham, the mere fact that the transaction results in less liability or no liability to tax should not put the transaction to a legal scrutiny questioning the substance of the transaction, attributing a motive behind it. It is up to the Court to take stock of the situation, weigh out sophisticated legal devices and expose the devices for what they really are.

14.1.7 Successful tax planning — tests to be satisfied: Tax planning in any case will entirely depend on the individual facts and circumstances. It is a tool in the hands of the taxpayer and tax practitioners for selective use. It is essential to comprehend (a) that the facts bearing on the issue are evidenced by proof; (b) that the associated legal consequences, both under the personal and under the tax laws, are fully borne in mind; and (c) that the situation warrants implementation of “tax planning”. Successful tax planning must conform to two outstanding tests viz, (a) conformity with the current law and (b) flexibility.

In order to satisfy the first test, the essential requisite is a comprehensive knowledge of the law, rules and regulations on the part of the tax planner. This knowledge of law extends not only to the provisions of the taxing statutes and the case law that has developed on those statutes, but also to other branches of law, both civil and personal, so that the tax planner's device does not get defeated by the universal principles of jurisprudence. The second test of flexibility seeks to ensure that the success of the tax planning device is not nullified by statutory negation. Though the tax planner may be successful in seeking out a device which in his opinion is in conformity with law, the subsequent statutory negation may nullify his success. In order to counter this exigency, his tax plan must be flexible. Flexibility essentially means that the device provides for suitable changes in accepted forms. Flexibility is a practical concept. Its introduction and utilisation depend upon the circumstances of the case. Under certain circumstances flexibility may be of no avail. As a matter of fact, flexibility may invalidate the tax plan. But when flexibility is permissible the tax planner will do well to remember to keep this test in mind to counter the measures of statutory negation. In view of this position wherever possible, tax planning schemes should be flexible, designed so as to avoid irretrievable situations. The tax planner should therefore be watchful of all significant developments related to his field.

In order to be a successful venture, efforts at tax planning should not ignore the legislative intent; they should be directed in every case to see that not only the tax benefits are obtained but also the tax obligations are discharged without fail so that the penal provisions are not attracted.

14.1.8 Retrospective Legislation: Every tax planner will inevitably have to face the question of retrospective legislation and the specific problems arising from the retrospective application of tax rates and tax amendments. Tax planning often flounders on the rock of retrospective legislation. The cardinal principle of construction is that a statute must always be interpreted prospectively unless the language of the statute makes it retrospective either expressly or by necessary implication. A retrospective operation is not to be given to a statute so as to impair vested rights or the legality of past transactions.

It is judicially settled that the law to be applied to the assessment is the law as it stands in the year of assessment and not that during the year in which the income was earned. Thus, in income-tax matters the law to be applied is the law in force in the assessment year unless otherwise stated or implied i.e., the law as it stands on 1st April, the commencement of the assessment year. Any

amendment that comes into force after 1st April of the year of assessment, will not be applicable even if the assessment is actually made after the amendment comes into force.

Unless the terms of statute expressly so provide or unless there is a necessary implication, retrospective operation should not be given to the statute so as to affect, alter or destroy any right already acquired or to revive any remedy already lost by efflux of time. If the law is amended so as to make it applicable retrospectively to any assessment year, the question at issue in respect of the assessment year will have to be decided in the light of the law so amended and it shall be so even if the matter is at the appellate, revisional or reference stage.

The history of tax laws of our country is replete with instances of retrospective amendment of law. It is obviously competent for the Legislature, in its wisdom, to make the provisions of an Act of Parliament retrospective and no one denies the competency of the Legislature to pass retrospective statutes if they think fit and many time they have done so, but, before giving such a construction to an Act of Parliament one would require that it should either appear very clearly in the terms of the Act or arise by necessary and distinct interpretation. A retrospective operation is not to be given to a statute as to impair existing right or obligation otherwise than as regards matters of procedure unless that effect cannot be avoided without doing violence to the language of the enactment. If the enactment is expressed in language which is fairly capable of either interpretation, it ought to be construed as prospective only.

In our country, the Government generally follows the principle that the changes in the rates of tax, as also the other amended provisions of tax laws, should ordinarily be made operative prospectively in relation to current incomes and not in relation to incomes of the past year. However, there are cases where the Government have thought it fit to introduce retrospective amendments in tax laws. The Supreme Court has upheld the validity of such retrospective laws. Any retrospective legislation has two aspects. For pending assessments, the amended provision would be applied. The difficulty would arise in the case of completed assessments. The effect of a retrospective legislative amendment is that the provisions as amended, shall, for all legal purposes be deemed to have been included in the statute from the date on which the amendment came into force. All orders relating to periods subsequent to the date of retrospective amendment must be in consonance with the specific and clear provisions, as amended retrospectively. Therefore, the case will be construed as if there is mistake apparent from the record which can be rectified under Section 154 [*M.K. Venkatachalam vs. Bombay Dyeing and Manufacturing Co. Ltd. (1958) 34 I.T.R. 134 (S.C.)*]. Conversely, by virtue of a retrospective amendment, an order which was inconsistent with the clear terms of a provision at the time when the order was made, may become one in consonance with that provision and thereafter there remains no scope for passing a rectification order [*SAL. Narayana Rao vs. Ishwarlal Bhawan Das (1965) 57 L.T.R. 149 (S.C.)*].

14.1.9 Systems and methods of tax planning: The systems and methods of tax-planning in any case will depend upon the result sought to be achieved. Broadly, the various methods of tax-planning will either be short-range tax-planning or long-range tax-planning.

The short-range tax planning has limited objective. An assessee whose income is likely to register unusual growth in a particular year on account of say, sale of capital asset like house property, as compared to the preceding year might plan to invest the same in bonds of National Highway Authority of India or Rural Electrification Corporation Limited to claim

exemption under section 54EC. This has a locking period of 3 years. Such a plan does not involve any permanent or long-term commitment and yet it results in substantial tax saving. This is an example of short-range tax planning.

The long-range tax planning, on the other hand, may not even confer immediate tax benefits. But it may pay-off in none too distant a future. For instance in case where an assessee transfers certain shares to his spouse, the income arising from the shares will, of course, be clubbed with the transferor's income. However, if the company subsequently issues bonus shares in respect of those shares the income arising from the bonus shares will not be clubbed with the transferor's income. Similarly the income arising out of the investment of the income from the transferred assets will not also be clubbed with the transferor's income. Long range tax planning may be resorted to even for domestic or family reasons.

In relation to income-tax the following may be noted as illustrative instances of tax-planning measures:

- (a) Varying the residential status (of a limited application).
- (b) Choosing the suitable form of assessable entity (individual, HUF, Firm, Co-operative society, Association of persons, Company, Trust, etc. to obtain the maximum tax concessions e.g. hotel industry in the form of a company to obtain tax holiday benefit.)
- (c) Choosing suitable forms of investment (share capital, loan capital, lease, mortgages, tax exempt investments, priority sector, etc.)
- (d) Programmed replacement of assets to take free advantage of the provisions governing depreciation and provisions governing investment allowance, investment deposit account scheme.
- (e) Diversification of the business activities (hotel industry, agro-based industry, export-oriented industries, etc.)
- (f) Division of income by over-riding title (by the creation of sub-partnership etc.)
- (g) The use of the concept of commercial expediency to claim deduction in respect of expenditure, in computing business income.

14.1.10 Tax planning in the context of administrative legislation: It is a common feature of modern legislative enactment to lay down in the section of the Act, the principles and the policy of the Legislature leaving out details to be filled in or worked out by rules or regulations made either by the Government or by some other authority as may be empowered in the legislation. This kind of subordinate or administrative legislation is justified and even necessitated by the fact that the Legislature has neither the time nor the material to consider and enact rules relating to various details as they may not be acquainted fully with the facts and circumstances relating to the subject matter and may have no time to consider such details. Section 295(1) of the Income-tax Act, 1961 and section 46(1) of the Wealth-tax Act, 1957, vest with the CBDT, the power to make rules for carrying out the requirements of these Acts. This power also enables the Board to give retrospective effect to any of the rules in such a way as not to prejudicially affect the interests of any taxpayer.

The various matters in respect of which the rules may be framed are specified in the relevant sections. Rules are made by the appropriate authority in exercise of the powers conferred on it

under the provisions of the Act. Therefore, they have statutory force and fall within the scope of the law made by the Legislature itself. Thus, they are a part of the enactment which imposes the tax. Since the rules are meant only for the purpose of carrying out the provisions of the Act, they cannot take away what is conferred by the Act nor whittle down its effect. Therefore, rules can only be made in consonance with the provisions of the Act. They must be interpreted in the light of the section under which they are made. If there is an irreconcilable conflict between a rule and a provision in the Act, the provision in the Act is to prevail and the rule which is subordinate to the Act must give way.

Similarly, notifications are also issued in exercise of a valid authority bestowed under the statutes. Such notifications, when validly made within proper right and in exercise of the authority provided for in the law, are binding on all concerned and may be enforced. As for Press Notes, although they have no statutory force behind them, they are binding on the officers.

The following principles emerging from various rulings are relevant in this context.

1. The rule making authority cannot frame a rule which is contrary to the object and provisions of the Act from which its rule making power is derived.
2. A rule cannot over-reach the subject-matter relevant to the particular provision in the Act.
3. A rule cannot whittle down, negate or take away (directly or by implication or causation) the right, privilege, advantage or benefit granted by the section or the enactment relevant to it.
4. A rule cannot create any disability, limitation or other condition not sanctioned by the Act to which it is relevant or not consistent with the Act.
5. A subordinate authority cannot seek to sit in judgement over the rights of the subject nor decide questions of law and fact or otherwise usurp the functions of a Court.
6. No rule can be framed nor regulation promulgated contrary to the rules of natural justice.
7. A rule cannot seek to impose a tax which the Legislature has not thought it fit or expedient to impose.
8. A rule has to strictly confine itself to the subject-matter for which the rule-making authority has been empowered by the enactment.
9. In providing for a rule-making power, however wide the terms of that power be, as long as the Legislature has laid down the necessary guidelines for exercise of such rule-making power of the subordinate authority and as long as the Legislature has clearly laid down in the enactment the legislative object and policy and has retained in itself the ultimate legislative power, the enactment delegating power to a subordinate authority cannot be said to be ultra vires the Legislature or the enactment.
10. Both a rule and a provision of law are equally bound to respect the constitutional protection and fundamental right of the citizen enshrined in article 14 of the Constitution.
11. Merely because a rule is subsequently laid before the Parliament, it cannot be given the status of a law of Parliament.
12. As in the case of an enactment, if a rule classifies persons and objects into identifiable classes and such classification is relevant to the purpose of the enactment and for carrying out the provisions of the Act, it cannot be called in question.

13. A rule has no retrospective operation unless the Act to which it is relevant specifically provides for the making of rules having retrospective operation.
14. The power to notify or to exempt also carries with it necessarily the power to denotify, rescind or withdraw the notification or exemption.

The above principles may be kept in mind while deciding about embarking on tax-planning.

Section 119(1) enacts that all officers and other persons employed in the execution of that Act shall observe and follow the orders and instruction or direction of the Board, provided that no such orders, instructions or directions shall be given so as to interfere with the discretion of the Commissioner (Appeals) 'in the exercise of his appellate functions. It is judicially settled that the Circulars issued by the Board would be binding under Section 119 on all the officers and persons employed in the execution of the Act [*Navnilal vs. Sen* (1965) 56 I.T.R. (198 SC)]. Consequently, if the Assessing Officer contravenes any circular issued by the Board in respect of, say, non-eligibility to tax of a certain item of receipt, he can be called upon by the appellate authority [the Commissioner (Appeals) or the Appellate Tribunal] to obey such a circular. The circular is not such a law that it should be taken judicial notice of; but after the circular has been brought to the notice of appellate authority, it would be competent to the appellate authority to direct the Assessing Officer to correct his mistakes in his not giving effect to the circular. However, it may be noted that opinions expressed by the Board in its individual communication to the assessee on issues affecting (for example, as to when the new industrial undertaking established by the assessee began to manufacture or produce articles within the meaning of Section 80-IA) cannot be considered as directions binding on the Income-tax authorities under Section 119. The Board is not competent to give directions regarding the exercise of any judicial power by its subordinate authorities [*J.K. Synthetics Ltd. and other vs. Central Board of Direct Taxes* (1972) 83 ITR 335 (SC)].

The various judicial rulings which considered the legal aspects of Circulars under the Income-tax Act, 1961 point out the following.

1. The instructions of the Board are binding on the Department but not on the assessee.
2. The instructions in favour of the assessee should therefore be followed by the Department, irrespective of the question of their legality; but the instructions adverse to the assessee can be challenged by the assessee.
3. Instructions adverse to the assessee cannot be issued with retrospective effect, while instructions favourable to the assessee can be so issued.
4. Instruction withdrawn subsequently should be given effect to by the Assessing Officer for the assessment year for which they were in force even though they are withdrawn at the time he makes the assessment.
5. In the exercise of its power, the Board cannot impose a burden or put the assessee in a worse position but the Board can grant relief or relax the rigour of the law.
6. No instruction or circular can go against the provisions of the Act. While the Board can relax the rigours of the law or grant relief which is not to be found in the terms of the statute, no instruction which will be ultra vires of the provisions of the statute could be issued.

7. Circulars and instructions of the Board are envisaged only in regard to administrative aspects and cannot restrict the judicial power or the discretion of an officer -*ALA Firm vs. CIT 102 ITR 622 (Madras), Sirpur Paper Mills Ltd. vs. C.W.T. 77 ITR 6 (SC)*.
8. No such orders, instructions or directions shall be issued — (a) so as to require any income-tax authority to make a particular assessment or to dispose of a particular case in a particular manner or (b) so as to interfere with the discretion of the Deputy Commissioner (Appeals) or the Commissioner (Appeals) in the exercise of his appellate functions.

In making an assessment or levying a penalty, the Assessing Officer exercises a quasi-judicial power conferred on him by the Statute and has to act independently. He cannot act on advice of a stranger even though that person may be an authority superior to him in official hierarchy — *Sheo Shankar Sitaram 95 ITR 523 (All)*.

9. Administrative instructions cannot also override the statutory rules.

In view of this position, the tax planner, while planning his affairs or that of his clients must take into account not only the relevant legal provisions which affect him but also all relevant rules, notifications, circulars, etc. As for circulars, since they are in the nature of administrative or executive instructions, the possibility that they might be withdrawn by the Board at any time, should also be taken into account. They may be challenged in the Courts although, otherwise they are binding at the administrative level (i.e., below the High Court or the Tribunal). In case where the circulars are based on erroneous and untenable footings, they are also liable to be quashed by the Court/Government.

14.1.11 System of advance rulings: A ruling is a statement in writing to a taxpayer from the prescribed tax administering authority which interprets and applies the law and regulation to a specific set of facts and states a conclusion as to the tax consequences of that particular transaction. As the rulings are given in advance of the concerned transactions they are called advance rulings. The advance rulings given are binding on the tax authorities and the applicant who had sought such ruling, with reference to the particular cases in respect of which they are given. A change in the facts can affect the basis of the rulings because the law often pivots on a date, an amount, type of tax payer and so on. Likewise, a ruling issued with respect to one transaction may not be good to the same tax payer for a subsequent transaction even on what might appear to be identical facts.

Advance rulings are an excellent device for fostering and encouraging the self-assessment system and would contribute to good relations between the administration and tax paying public. From the tax payer's point of view these rulings are most desirable because they give more assurance of certainty prior to entering into a transaction and guarantee more uniformity in the application of the tax legislation. They are desirable for the administration also as they minimise the scope for controversy and litigation, reduce the time spent in answering question from tax payers and help to achieve a fair and coordinated tax administration.

Chapter XIX-B of the Income-tax Act, 1961, provides for a scheme of advance rulings. For details students may refer to Chapter 23.

14.1.12 Construction and Interpretation: No tax can be imposed on the subject without words in the Act clearly showing an intention to lay a burden upon him. In other words, the subject cannot be taxed unless he comes within the letter of the law. The argument that he

falls within the spirit of the law cannot be availed by the department. Tax and equity are strangers. In a taxing Act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.

- (a) **Natural Justice:** However, this does not mean that there is no scope for natural justice. Tax laws have to be interpreted reasonably and in consonance with justice. Where a literal construction would defeat the obvious intention of the legislation and produce a wholly unseasonable result, the court must do some violence to the words and so achieve that obvious intention and produce a rational construction. If the interpretation of a fiscal enactment is open to doubts the construction most beneficial to the subject should be adopted, even if it results in his obtaining "a double advantage". A provision for exemption of relief should be construed liberally and in favour of the assessee. Likewise, a provision for appeal should be liberally construed. The law is to be ascertained by interpreting the language used in the Act in its natural meaning, uninfluenced by considerations derived from the previous state of the law. But in cases of doubt regarding the construction, assistance may be sought from previous judicial interpretation or from previous legislation or by adverting to the mischief intended to be suppressed. A subsequent enactment affords no useful guide to the interpretation of earlier law, unless it is on the same subject and the earlier law is ambiguous. An amendment may be made by the legislature only to clarify the position and not to change the law. When legislation follows a continuous practice and repeats the words on which the practice is founded, it may be inferred that the legislature in reenacting the statute intended those words to be understood in their perceived meaning.

Generally speaking, the sections in the Act do not overlap one another and each section completely covers the matter with which it deals. As far as possible the Act should be construed in such a way as to reconcile the various provisions and unravel apparent conflict into harmony bearing in mind that a general provision cannot derogate from a special provision regarding a certain class of cases. If a case appears to be governed by either of two provisions, it is clearly the right of the assessee to claim that he should be assessed under that one which leaves him with a lighter burden.

Those sections which impose the change of levy should be strictly construed but those which deal merely with the machinery of assessment and collection should not be subjected to a rigorous construction but should be construed in a way that makes the machinery workable.

The draft of a Bill which is afterwards enacted in the form of a statute and the report of a commission or select committee appointed to deal with the subject are not admissible as aids in construing the provisions of the Act but they or the statement of objects and reasons may be referred to for the limited purpose of ascertaining the conditions prevailing at the time and the extent and urgency of the evil sought to be remedied.

- (b) **Definition clause and undefined words:** A definition or interpretation clause which extends the meaning of a word should not be construed as taking away its ordinary meaning. Further, such a clause should be so interpreted as not to destroy the basic concept or essential meaning of the expression defined, unless there are competing

words to the contrary. Words used in the sections of the Act are presumed to have been used correctly and exactly as defined in the Act and it is for those who assert the contrary to show that there is something repugnant in the subject or context. Words which are not specifically defined must be taken in their legal sense or their dictionary meaning or their popular or commercial sense as distinct from their scientific or technical meaning unless a contrary intention appears.

- (c) **Legal fiction:** The word “deemed” may include the obvious, the uncertain and the impossible. A legal fiction has to be carried to its logical conclusion but only within the field of definite purpose for which the fiction is created. As far as possible, a legal fiction should not be so interpreted as to work injustice.
- (d) **Marginal Notes:** Marginal notes to the sections cannot control the construction of the statute but they may throw light on the intention of the legislature.
- (e) **Provisos:** A proviso cannot be held to control the substantial enactment or to withdraw by mere implication any part of what the main provision has given. A proviso is not applicable unless the substantive clause is applicable to the facts of the case. The proper function of a proviso is to except and deal with a case which would otherwise fall within the general language of the main enactment and its effect as confined to that case. But a proviso may be read as an independent substantive enactment where the context warrants such construction. Whether a proviso is construed as restricting the main provision or as a substantive clause it cannot be divorced from the provision to which it stands as a proviso. It must be construed harmoniously with the main enactment.

14.1.13 Doctrine of Precedence: Doctrine of Precedence would be applicable in case of tax laws. The following principles which govern the rule of precedence may be noted.

◆ **Supreme Court:**

1. The Supreme Court judgments are absolutely binding on all the courts, Tribunals and authorities.
2. Not only the *ratio decidendi*, but also *obiter dicta* of the Supreme Court are binding on all the Courts.
3. When there are two irreconcilable decisions of the Supreme Court on some point of law, the decision of a larger Bench shall prevail.
4. When there are two irreconcilable decisions of two Benches of similar strength, the decision later in time will have to be followed by the lower courts.
5. The Supreme Court judgments cannot be ignored by the lower courts though such judgments are *per incuriam*.
6. The Supreme Court, though expected to follow its own judgments, is not bound to follow them and in appropriate cases it can review its earlier judgment.

◆ **High Courts:**

1. A Division Bench of a High Court is generally bound by its earlier decision, but it may refuse to follow the same if the earlier judgment is *per incuriam*.
2. If the Division Bench of a High Court does not agree with its earlier judgment it will

have to either follow the same or refer the issue to a Full Bench.

3. A Division Bench of High Court is bound to follow a decision of the Full Bench of the same High Court.
4. A single judge of a High Court is bound by a decision of a Division Bench or of the Full Bench of the same High Court.
5. A single judge of a High Court is not bound to follow the decision of another single judge, though he is expected to follow the same.
6. All the lower authorities, courts and tribunals are absolutely bound to follow the decision of a High Court within whose jurisdiction they function. Here, the High Court decisions include decision of a single judge.
7. The lower authorities and courts can ignore a decision of a High Court only if it is overruled by a larger Bench of the same High Court, or by the Supreme Court or by a later enactment.

Others:

1. The Assessing Officer and the Commissioner, while acting under section 263, cannot refuse to follow the decision of High Court. They cannot pass orders which are inconsistent with the decisions of the High Court within whose jurisdiction they function, even for the purpose of keeping the issue alive.
2. In all Indian Acts like the Income-tax Act, 1961, to keep the uniformity of law, a High Court should normally follow the decision of another High Court, unless it finds an overriding reason not to follow the same.
3. The lower appellate authorities are bound to follow the decision of another High Court, though they do not function within the jurisdiction of the said High Court, if there is no contrary decision of any other High Court.
4. The Assessing Officer or the Commissioner need not follow the decision of another High Court if the department has not accepted the said decision and has taken the matter to Supreme Court.
5. The Bench of the Appellate Tribunal, should generally follow the orders of other Benches of the Tribunal, unless those orders of the Tribunal are *per incuriam*.
6. An order of a Full Bench of a Tribunal is binding on the ordinary Bench of the Tribunal.
7. If an ordinary bench of a Tribunal does not agree with an order of another Bench of the Tribunal, and that order of the another Bench of the Tribunal is not *per - incuriam*, the Bench cannot differ from the view taken by the other Bench. It can only get the matter referred to a larger Bench. But this is subject to the general rule that as far as possible, the Bench should try to follow the orders of the Benches.
8. The Tribunal orders are binding on the Commissioner (Appeals) falling within the territorial jurisdiction of the Tribunal passing the order in question.
9. The Assessing Officer and the Commissioner are bound by the order of the Tribunal (falling within the jurisdiction of the Tribunal unless the Department has not accepted the decision of the Tribunal.)

14.1.14 Diversion of income by overriding title and application of income

The concept of 'diversion of income by overriding title' signifies diversion of income at source by an overriding title before it reaches an assessee. Such a diversion can take place either under a legal compulsion or under a contractual obligation or otherwise. An obligation to apply the income in a particular way before it has accrued or arisen to the assessee results in the diversion of the income. On the other hand, an obligation to apply income which has accrued or arisen or has been received amounts merely to the apportionment or application of the income and not to its diversion. Sometimes the dividing line between diversion by overriding title and the application of income after it has accrued is somewhat thin.

When income or a portion of income is diverted at the source by an overriding title before it started flowing into the channel which was to reach the assessee concerned it could be excluded from his assessable income. Wherever there is such diversion of income, such diverted income, cannot be included in the total income of the assessee who claims that there has been a diversion. On the other hand, where income has accrued or arisen in the hands of the assessee, its subsequent application in any way will not affect the tax liability.

In order to decide whether a particular disbursement amounts to diversion or application of income, the true test is to probe into and decide whether the amount sought to be deducted, in truth, did not reach the assessee as his own income. It is the nature of the obligation that is the decisive fact. There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation cannot be said to be a part of his income. It is the nature of the obligation that is the decisive fact. There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation cannot be said to be a part of his income. Where, by the obligation, income is diverted before it reaches the assessee it is deductible; but where the income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence, in law, does not follow. In order that there is diversion at source of the income the obligation is to attach to the source which yields income and not to the income only. This was so held in *CIT vs. Sital Doss Twath* 41 ITR 367 (SC), *M.K. Brothers Pvt. Ltd. vs. CIT* 86 ITR 38 (SC). In many cases it would really be a matter of proper drafting of the document creating the obligation, though, in substance, the result in both the situations may appear similar.

For the purpose of tax planning, the concept of 'diversion by overriding title' would have better scope for exploitation than the concept of 'application of income'. This is because as pointed out above where income is diverted by overriding title such diverted income is not taxed in the hands of the person who claims such diversion. On the other hand, the concept of application of income envisages first the accruing or arising of income and when once it has come within the grasp of the Income-tax Act, 1961 it is liable to income-tax whatever may be its destination or whatever it may be put to. Therefore if an overriding charge is created by the assessee either voluntarily or in pursuance of an obligation, whether pre-existing or not, the assessee may be able to invoke the principle of diversion of income by overriding charge. This is, of course, subject to the provisions of Sections 60 to 64, which have the effect of getting over this principle in some situations.

Example 1: Let us assume that an assessee owns a plot of land. As he does not have resources to develop and/or construct house property on the land, he approaches his father-in-law to make investment along with him in the construction of house property on the said plot on the basis of equal ownership in the plot and proposed building thereon. An agreement is arrived at between them providing, inter alia (i) that when the building is constructed, both the plot and the building would belong to both the parties in equal shares (ii) that each party has to contribute half share towards the cost of the land and the building and (iii) that each party would be entitled to half share each in the rental income from the said building.

Solution: Having regard to the facts and circumstance of such a case, it is obvious that this is not a case where the assessee constructs the property by merely borrowing money from his father-in-law with or without interest and with no other obligation on his part vis-a-vis the property. Nor is it a case where the assessee, having constructed the house property, agrees to part with a portion of the income in favour of someone else purely out of his volition and in the absence of any compelling circumstances obliging him to do so. On the contrary, in such cases, the payment is made in pursuance of an obligation created by a document, which is entered into before the construction is completed and on the terms and conditions of which both the parties agree to construct the property. In such a case, the payment made by the assessee of the half share of the income to his father-in-law would really be a diversion of income at source and not merely a case of application of income which accrues to him.

Example 2: TC Ltd., a company owned a social and sports club, one of whose activities consisted of conducting horse races with amateur riders. It charged for admission into the enclosure of the club at the time of races, admission fee from the guests introduced by the members as well as from the members of the public. In accordance with the resolution passed at a General meeting, a surcharge on the entrance ticket earmarked for local charities and Indian Red Cross was levied. A separate ticket was issued for the surcharge. The receipts from the surcharge were carried separately to a separate account styled "Charity Account". Are the receipts taxable as the income of TC Ltd.?

Solution: The question for determination is whether the amounts received on account of surcharge reached TC Ltd. as its income. The surcharge here is undoubtedly a payment which a race-goer is required to make in addition to the price of the admission ticket if he wants to witness the race from the club enclosure, but on that account it does not become part of the price for admission. The admission to the enclosure is the occasion and not the consideration for the surcharge taken from the race-goer. The surcharge is clearly a payment made for the specific purpose of being applied to local charities. Then again, it is merely a desire or intention on the part of TC Ltd. to apply the amounts received on surcharge to local charities without there being any legally enforceable obligation binding it to do so. Here a resolution was passed at the General meeting for the levy for a particular purpose. The surcharge then paid was clearly impressed with an obligation in the nature of trust for being applied for the benefit of local charities. It thus became an allocation of a receipt for local charities before it could become income in the hands of the assessee. Such were the views expressed by the Supreme Court in *Commissioner of Income-tax vs. Tollygunge Club Ltd.* (1977) 107 ITR 776 (SC). Similarly, it was held in *Commissioner of Income-tax vs. Bijli Cotton Mills (P) Ltd.* (1979) 116 ITR 60(SC) - dharmada realised from customers along with sale proceeds and credited to

“Dharmada Account” did not constitute a part of the price and so did not form a part of the assessee's income.

Example 3: A legal practitioner decided to reduce his practice and to accept briefs only for paying his taxes and making charities with the fees received on such briefs. In a particular criminal case, he was at first unwilling to defend the accused, but subsequently agreed to appear on the condition that he would be provided with a sum of money for a public charitable trust that he would create. He defended the accused, was paid a sum of money by his client, and he created a trust out of that sum by executing a trust deed. Is the money received by the practitioner assessable to tax as professional income?

Solution: In this case, the client of the practitioner does not create any trust nor does he impose any obligation in the nature of a trust binding on the practitioner. Here, the trust is created by the practitioner himself out of his professional income. There is no diversion of the money to the trust and it becomes professional income in the hands of the practitioner. The case is one of application of professional income as trust property and so the practitioner must pay tax on the sum of money. These were the facts and the decision in the Supreme Court case *Commissioner of Income-tax vs. Thakur Das Bhargava* (1960) 40 ITR 301 (SC).

14.2 Tax Planning Considerations in Respect of Salary Income

The scope for tax planning from the angle of employees is limited. The definition of salary is very wide and includes not only monetary salary but also benefits and perquisites in kind. The only deductions available in respect of salary income are the deduction for entertainment allowance and deduction for professional tax. Therefore, the scope for tax planning in respect of salary income is severely limited. However, the following are some ideas of tax planning in regard to salary income.

14.2.1 Salary Structure: The employer should not pay a consolidated amount as salary to the employee. If it is so paid, the entire amount of salary will become taxable without any exemption. Therefore, he can split the same and pay it as basic salary plus various allowances and perquisites. For example, the employer should include allowances as part of the salary structure of the employees for which exemption can be claimed under Rule 2BB, eg. education allowance, uniform allowance, flight allowance etc. Further, the employer can give such allowances like special compensatory allowance, border area allowance or remote area allowance or difficult area allowance or disturbed area allowance depending upon the posting of the employee. Some exemptions are available in respect of these allowances. In this connection, Rule 2BB specifies the exempt allowances. The employer has to make a careful study and fix the salary structure in such a manner that it will include allowances which are exempt.

The employer will get a deduction of all the above amounts paid in his assessment.

14.2.2 Employees' welfare schemes: There are several employees' welfare schemes such as recognised provident fund, approved superannuation fund, gratuity fund. Payments received from such funds by the employees are totally exempt or exempt upto significant amounts. For example, gratuity received by the employee from private sector is exempt upto ₹ 10 lakh. The entire provident fund received by the employee from recognised provident fund

is exempt. The employer is well advised to institute such welfare schemes for the benefit of the employees. Such amount contributed by the employer towards the above funds are deductible. However, a note of caution is necessary here in view of the restrictive provisions of section 40A(9) which disallows any contribution made to any welfare funds except where such contributions are covered by section 36(1)(iv)/(iva)/(v) or as required by or under any other law for the time being in force. In this connection, it may be noted that section 10(23AAA) exempts any income of a staff welfare fund subject to the satisfaction of certain conditions. However, in the absence of an amendment to section 40A(9), contribution to such welfare trusts can be disallowed by the Assessing Officer. Further, the employer's contribution to provident fund account of the employee can be increased to 12 per cent of salary being the maximum non-taxable portion.

14.2.3 Insurance policies: Any payment made by an employer on behalf of an employee to maintain a life policy will be treated as perquisite in the hands of the employee. Further, payments received from the employer in respect of Keyman Insurance policies constitute income in the hands of the employees. However, the payment of premium by the employer on behalf of the employee will not be treated as a perquisite in the case of accident insurance policies. This is due to the fact that the employer has a vested interest in the safety of the life of his employee who is engaged in such dangerous occupations. Further, any sum paid by the employer in respect of any mediclaim premium paid by the employee to keep in force an insurance on his health or the health of any member of his family under any scheme approved by the Central Government for the purpose of section 80D is not a perquisite in the hands of the employee.

14.2.4 Dearness allowance, dearness pay: The employer should ensure that dearness allowance and dearness pay should form part of "salary". This is because certain items like entertainment allowance, gratuity, commuted pension and the employer's contribution to the recognised provident fund etc. are calculated on the basis of salary. Therefore, if dearness allowance, dearness pay etc. are included in salary, the above benefits will also increase leading to higher exemption in the hands of the employee.

14.2.5 Commission: The Supreme Court in *Gestetner Duplicators Pvt. Ltd. Vs. CIT 11 7ITR 1 (S.C.)* has held that if under the terms of employment commission is payable at a fixed percentage of turnover achieved by an employee such commission should be taken into account for calculating "salary" for the purpose of gratuity etc. The employer will be well advised to provide for such commission.

14.2.6 Leave travel facility: The employer should extend leave travel facility to the employees at all levels. Under section 10(5) of the Income-tax Act, 1961, exemption is provided in the hands of the employee in respect of leave travel concession. Such exemption is available for the employee, spouse, dependent children (to a maximum of 2 children), parents, brothers and sisters.

14.2.7 Rent free accommodation / House Rent Allowance (HRA): An employee should analyse the tax incidence of a perquisite and an allowance, whenever he is given an option, in order to choose the one which is more beneficial to him. In the case of Rent Free Accommodation vs. HRA, it must be noted that the perquisite of rent free accommodation is taxed as per Rule 3(1) of the Income-tax Rules, 1962 and HRA is exempt to the extent mentioned in section 10(13A) read

with Rule 2A. The employee should therefore work out his tax liability under both the options and then decide on whether to receive HRA or choose a rent free accommodation.

14.2.8 Medical Allowances: The employer should avoid paying fixed medical allowance. This is taxable fully. Under clause (v) of the proviso to section 17(2), any sum paid by the employer in respect of any expenditure actually incurred by the employee on his medical treatment or treatment of any member of his family will be exempt to the extent of ₹ 15,000. The employer can reimburse the employee as above. Further, he can also provide free medical facilities which are not taxable.

14.2.9 Uncommuted/Commuted pension: Uncommuted pension is fully taxable. Therefore, the employees should get their pension commuted. Commuted pension is fully exempt from tax in the case of government employees and partly exempt from tax in the case of non-government employees.

14.2.10 Provident Fund: Where an employee who is a member of a recognised provident fund and who resigns before completing five years of continuous service should ensure that he joins a firm which maintains a recognised provident fund. The accumulated balance of the provident fund with the previous employer will be exempt from tax provided the same is transferred to the new employer who also maintains a recognised provident fund.

14.2.11 Retirement benefits: Incidence of tax on retirement benefits like gratuity, commuted pension, accumulated balance of unrecognized provident fund is lower if they are paid in the beginning of the financial year.

The employer and the employees should mutually plan their affairs in such a way that retirement takes place in the beginning of a financial year.

14.2.12 Pension received by non-residents: Pension received in India by a non-resident assessee from abroad is taxable in India. If, however, such pension is first received by or on behalf of the employee in a foreign country and later on remitted to India, it will be exempt from tax.

14.2.13 Accident insurance: In respect of accident insurance policies, the decision of the Supreme Court in *CIT vs. L.W.Russel (1964) 53 ITR 91* points out that the term perquisite applied to only such sums in regard to which there was an obligation on the part of the employer to pay and a vested right on the part of the employee. If the employee has no vested interest in the policy, it cannot be considered as a perquisite. In view of this position, in cases where an employer takes out accident insurance policy covering all workmen and staff members and pays insurance premium and whenever any worker/staff member meets with an accident and the amount of claim is received from the insurance company and the same is paid away by the employer to the said worker or his family members, the premium paid by the employer in respect of group accident policies could not be considered as a perquisite, under section 17 to be added in the salary income of any employee (*CIT vs. Lala Shri Dhar (1972) 84 ITR 192*). The amount received from insurance company on accident or death by employee or his dependents will not also be in the nature of income but a capital receipt and therefore the same will not be taxable.

14.2.14 Exempt perquisites: The following are the perquisites which are exempt from tax–

- (i) Use of computers and laptop by employee;
- (ii) Medical facility in employer's own hospital or a public hospital or Government or other approved hospital;
- (iii) Educational benefit in a school run by employer provided value of benefit does not exceed ₹ 1,000 per month per child.

14.2.15 Considerations for salary structuring: The perquisite valuation rules prescribe the method for valuing the various perquisites provided by the employer to his employees on the basis of the cost of such perquisites to the employee. For a detailed study students are advised to refer to the chapter dealing with 'Salaries'. Accordingly, the entire salary structuring for employees will have to be done after carefully weighing the pros and cons of paying a cash salary or allowing the benefit of perquisites in kind to the employees.

14.3 Tax Planning Considerations in Relation to Business

The scope of income liable to tax under the head "profits and gains of business or profession" covered by Section 28 to 44D of the Income tax Act, 1961 has been discussed earlier. The object of this part of the study material is to discuss from the angle of tax planning the various areas in which tax payer will have to take appropriate decisions to ensure that the incidence of tax in respect of his income chargeable under this head is reduced to the extent possible, by taking advantage of the various allowances, deductions and other tax concessions provided under the law.

For a new business, the spheres in which the question of tax planning is relevant are as follows:

- (i) Form of the organisation
- (ii) Nature of the business
- (iii) Location
- (iv) Financial Structure
- (v) Acquisition of plant and machinery and other fixed assets
- (vi) Setting up and commencement of business

Each of these aspects will be considered briefly in the following paragraphs. In addition, there is lot of scope for planning with reference to the method of accounting to be employed and the various deductions and special incentives provided under the Income-tax Act, 1961. Certain special tax planning considerations relevant to specific management decisions, foreign collaboration agreements and other related matters are also discussed.

14.3.1. Form of Business Organisation: The choice of the appropriate form of business organisation will have to be thought of and decided by the person who intends to carry on business or profession at the beginning itself, because a change in the form of business organisation after the commencement of the business, may attract liability to tax.

A new business can be organised under any of the following forms:

1. Sole proprietorship

2. Hindu undivided family
3. Association of persons or Body of Individuals
4. Partnership firm/LLP
5. Limited liability company
6. Co-operative society

The selection of a particular form of organisation would depend not only on the tax aspect but on other considerations also, e.g., financial requirements and resources, requirement of limited liability and many other practical considerations.

However, depending upon the taxable status and level of tax liability of the owners, a selection can be made from the various forms available for setting up a new unit.

- ◆ **Sole Proprietorship:** In the case of a sole proprietorship concern, one of the important tax disadvantages would be that no allowance or relief would be available to the tax payer in computing his income from business in respect of even a reasonable amount of remuneration attributable to the services rendered by him for carrying on the business. As a result, the taxable income arrived at would be a larger amount than what it would have been if it had been the case of, say, a private company in which the individual himself is the Managing Director. In the case of a private company, the reasonable amount of remuneration to the Managing Director, is allowable as an item of business expenditure and to the extent of this allowance, the taxable income from business would get reduced and correspondingly the incidence of tax would also be reduced.

Under sole proprietorship, the entire income of a business unit gets assessed in the hands of the same person along with other income, while the entire loss and other allowances shall be available for set off in his hands against other income. This may have some advantage in the initial years, after which the possibility of converting it into company/firm may be considered; on such conversion, the questions of possible capital gains tax, etc., will have to be considered.

- ◆ **Hindu Undivided Family:** The Hindu undivided family as a unit of taxation continues to exist for the purpose of carrying on business as well and there is a large number of cases where business is carried on by the members of the family on behalf of the family. Since the law does not specifically provide for the disallowance of such expenses, it is advantageous to carry on a business through the HUF wherever possible. The income of the family is computed and first taxed in the hands of the family at the rates applicable to it. The income of the family may thereafter be divided among the members of the family and the members, in such cases do not attract any liability to tax in view of the specific exemption granted under section 10(2) of the Income-tax Act, 1961. Thus, if a business is carried on by a Hindu undivided family, the advantages which are available in the case of a company could be fully availed of and in addition the members of the family would not become liable to tax when they receive any portion of the family's income.
- ◆ **Partnership Firm/LLP:** All firms and LLPs will be taxed at a flat rate of 30%. *If the total income exceeds Rs.1 crore, surcharge@10% would be attracted.* Further, education cess@2% and secondary and higher education cess@1% would be applicable. There will

be no initial exemption and the entire income will be taxed. In computing the taxable income of a firm, certain prescribed deductions in respect of interest and remuneration have to be allowed. The share income of a firm in the hands of the partners of the firm is fully exempt. For a detailed discussion students are advised to refer to Chapter 13 on "Assessment of Various Entities".

- ◆ **Company:** For any large venture, requiring substantial investment and recourse to borrowed funds from banks and institutions, ordinarily the form of a limited company will have to be adopted. Within the company form of organisation, however, several alternatives exist. On the basis of the ownership and control, a company can either be organised as a widely held company, i.e. a company in which the public are substantially interested within the meaning of Section 2(18) of the Income-tax Act, 1961. Alternatively, it can be organised as a closely held company. Depending upon the choice of the form of organisation of the company, the following important tax consequences would have to be considered from the view point of tax planning:
 1. The applicability of provisions of section 2(22)(e) regarding deemed dividend in respect of advances or loans to shareholders would also depend on the fact whether or not it is a company in which the public are substantially interested. The fact that the scope of these provision has been considerably enlarged by the amendments made in section 2(22)(e) from time to time, should also be kept in mind.
 2. The provisions of section 79 regarding restrictions on carry forward of losses in the event of substantial change in the shareholding of the company also become applicable if the company is one in which the public are not substantially interested. This aspect would assume particular significance in the case of closely held companies where losses are made and shareholdings are transferred before such losses are fully absorbed.
 3. It is significant to note that domestic companies have to pay tax@16.995% (15% plus surcharge@10% plus cess@3%) on dividend declared, distributed or paid except dividend under section 2(22)(e). For further details students may refer to Chapter 13 on "Assessment of Various Entities".

Thus, it can be seen that the concept of deemed dividend under section 2(22)(e) and the provisions of section 79 do not apply to a widely held company.

- ◆ **Subsidiary vs. Branch:** The income-tax rate on foreign corporations is higher at 50% or 40%, as the case may be, (plus surcharge @2% if total income exceeds ₹ 1 crore and 5% *if the total income exceeds ₹10 crore*) as against 30% (plus surcharge@5%, if total income exceeds ₹ 1 crore and @10%, *if total income exceeds ₹10 crore*) on domestic companies. This is so because distributions by the former are generally not liable to tax in India. Further, certain tax incentives available to domestic corporations are not available to foreign companies. Some instances are amortisation of preliminary expenses, expenditure on prospecting for minerals, export incentives, incentives in respect of foreign projects profits, earnings in convertible foreign exchange, tax holiday profits of ships, hotels, etc.. It is advantageous, from tax angle, for foreign corporations intending to do business in India to do so through a subsidiary instead of directly through a branch.

- ◆ **Co-operatives:** The co-operative form of business organisation, i.e., a co-operative society would also be advantageous from the tax angle and, in addition to the general benefits flowing from the co-operative form the society, can claim deduction in respect of the reasonable amount of remuneration payable to the members of the society for their services rendered, including the amount of commission, if any payable to them and the interest on the deposits or loans given by them. The co-operative society is entitled to a further tax benefit arising from section 80P under which the income of a co-operative society is exempted from tax under different circumstances depending upon the nature of the income and/or the amount thereof. In addition to the various tax concessions which are available to all assesses, the co-operative society stands to gain substantially by virtue of the special benefits available to it under section 80P. The profits of the society remaining after payment of tax would be distributed by it amongst its members in the form of dividends subject to the relevant legislation.

However, it may be noted that benefit under section 80P has been withdrawn w.e.f. A.Y.2007-08 in respect of all co-operative banks, other than primary agricultural credit societies (i.e. as defined in Part V of the Banking Regulation Act, 1949) and primary co-operative agricultural and rural development banks (i.e. societies having its area of operation confined to a taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities). This is for the purpose of treating co-operative banks at par with other commercial banks, which do not enjoy similar tax benefits.

From the above analysis of various forms of the organisation and their treatment for income-tax purposes, it may be appreciated that the provisions of the taxation laws have a considerable influence on the entrepreneurs in their choice of particular form of the organisation that they should establish.

14.3.2 Nature of the business: Besides the form of organisation, the choice of the nature of the business also calls for appropriate planning with reference to the various special benefits available under the taxation laws to the particular kinds of industries which are not available to other kinds. Some of these benefits are of such a substantial nature that they constitute one of the major factors in the determination of the nature of the business.

Broadly, business for this purpose may be divided into two categories—trading and manufacturing business. There could be a third category involving combination of both. Deduction is available under section 10AA to newly established units in Special Economic Zones.

A taxpayer carrying on manufacturing or industrial activities would be in a position to avail of the various concessions such as depreciation allowance, benefit of amortisation under Section 32, 35ABB, 35D and 35E, tax holiday benefit under section 80-IA/IB/IC/ID/IE. An important aspect that requires consideration in this context is the decision regarding type of product to be manufactured. The manufacture of any of the non-priority items specified in the Eleventh Schedule to the Income-tax Act, 1961 might disentitle the assessee, excepting small-scale industrial undertakings, to the tax holiday benefit under the provisions of section 80-IB. This is a major factor to be considered while deciding the nature of the business that an assessee should engage in.

While deciding the nature of the business, the benefit of tax exemption or concessional treatment available in respect of certain types of income such as agricultural income, business income from hotel business, new industrial undertakings, ships, business of repairs to ocean going vessels, business of exploration, etc. of mineral oils, etc. should also be taken into account.

14.3.3 Location of business: Besides economic factors and statutory restrictions imposed by Government authorities, the concessions available under the tax laws also play a prominent role in deciding the location of new industrial undertaking. The relevant provisions which require the attention of a tax planner are sections 10AA, 80-IB, 80-IC, 80-ID and 80-IE.

14.3.4 Sources of Funds or Financial Structure: Broadly speaking, the choice in the matter of financing a new unit or business would be between capital and borrowings. New units being set up by existing units or companies would have the possibility of using retained profits. In the case of a company, the means of finance are as follows:

- (i) Share capital.
- (ii) Debentures.
- (iii) Other borrowed moneys.
- (iv) Generation of funds through profits.

The use of borrowings may have the following tax implications:

While the return on share capital is a charge on the profits after tax, the return on loans to the lenders is a charge on the profits before tax. Thus recourse to borrowings would offer a tax advantage which will be reflected in a higher rate of return on the owner's capital.

14.3.5 Acquisition of 'Fixed Assets': Apart from other considerations relevant in the context the consequences may require a careful choice between buying or leasing some or more of the fixed assets. Assets can be bought or hired. If these are bought and are depreciable, e.g. building, plant and machinery and furniture, the assessee can claim depreciation on the cost and over the years the entire cost can be claimed as deduction against the profit. If hired, however, the charge for hire becomes an admissible deduction. Having regard to the fact that the acquisition of an asset requires a larger immediate outlay than what is necessary in the case of hiring, the company may opt for hiring in some cases rather than for straight acquisition. For example, taking the business premises on rent rather than purchasing the same may be a better proposition.

But in the case of plant and machinery, two additional considerations may arise. New plant and machinery in certain industries may enable a company to claim deduction on account of depreciation and additional depreciation which may outweigh other considerations. Similarly, if there can be a new industrial undertaking, substantial tax benefits may be available by way of tax holiday benefit, etc. but that would require employment of new plant and machinery to a large extent. These considerations are out and out tax considerations which may prompt an assessee to make two choices—(i) not to hire plant and machinery but to purchase them and (ii) not to purchase second hand plant and machinery but to purchase them new.

In appropriate cases, the assessee may go in for second hand imported plant and machinery, satisfying the conditions laid down. In cases where an assessee opts to go for old plant and

machinery, the limit regarding the use of old plant and machinery, as laid down in Section 80-IA/80IAB/IB/IC/ID/IE should be taken into consideration. Difficulties may arise in applying the 20% limit for the value of old plant or machinery for the purpose of section 80IA etc. since the concept of value to be adopted for this purpose has not been spelt out in the law and it is not clear whether such value should refer to the cost or market value or the written down value as per books or as per income-tax records. Particular care will have to be taken while planning for such a situation.

The assessee engaged in the specified business mentioned in section 35AD can avail the benefit of deduction of capital expenditure incurred wholly and exclusively of the purpose of such specified business. Capital expenditure incurred prior to commencement of business shall be allowed as deduction during the previous year in which the assessee commences operation of the specified business if, such expenditure incurred is capitalized in the books of accounts of the assessee on the date of commencement of its operation. However, such deduction is not available in respect of capital expenditure incurred on acquisition of any land, goodwill or financial instrument. In case the deduction under this section is claimed, no deduction shall be allowed under Chapter VI-A under "Deduction in respect of certain incomes" in relation to the specified business for the same or any other assessment year.

14.3.6 Setting up and commencement of production: Setting up of business in the context of the Income-tax Act, 1961 is a concept entirely confined to that Act. It is not the same as the commencement of the business and these two concepts have been clearly distinguished for income-tax purpose. Between the date of the setting up and date of commencement, there may be an interregnum during which the assessee may be incurring expenses of a revenue nature.

Under the taxation laws, the expenditure incurred prior to the date of setting up is not normally admissible for income-tax purposes. But if those are incurred on and from the date of setting up, but before commencement of the business, they may be allowed as deduction for tax purposes provided of course they are revenue in nature and are incurred wholly and exclusively for the purposes of business.

It is now practically well settled by various judicial rulings that a business is set up as soon as it is ready to commence production and it is not necessary that actual production should be so commenced. Thus, in the case of a company established for manufacturing cement, the business is set up as soon as acquiring of limestone is commenced even if at that time the plant and machinery may not have been installed so that actual manufacturing operations may commence.

A tax planner should accordingly fix the setting up date in such a manner that the company gets the maximum scope for allowability of expenses incurred contemporaneously to the date of setting up remembering that if those are incurred prior to the setting up date those are inadmissible as direct deductions while, if such expenses are of a revenue nature and they are wholly and exclusively incurred for business purpose, and are incurred subsequent to the date of setting up, they will be admissible as normal deductions. The following examples may be noted:

- (a) Such expenditure may be allowed as a revenue expenditure. Expenditure by way of brokerage, legal charges, etc. for arranging long term loans, interest on borrowing—*India Cement Ltd. vs. CIT 60 ITR 52 (SC)*.

- (b) Such expenditure may form part of the cost of assets on which depreciation and investment allowance may be available - *Challapalli Sugars Ltd. vs. CIT 98 ITR 167 (SC)*.

In this context, the provisions of *Explanation 8* to Section 43(1) to the effect that any interest paid or payable in connection with the acquisition of an asset, which is relatable to any period after such asset is first put to use cannot be capitalised, are relevant.

- (c) Such expenditure may constitute preliminary expenditure and may be eligible for amortisation over a ten year or five year (as the case may be) period under section 35D.
- (d) Such expenditure, if being of a capital nature and if not falling under any of the three categories noted above may be disallowable and there may not be relief either on account of depreciation or amortisation.

Interest on borrowed capital

Under clause (iii) of section 36(1), deduction of interest is allowed in respect of capital borrowed for the purposes of business or profession in the computation of income under the head "Profits and gains of business or profession".

Capital may be borrowed for several purposes like for acquiring a capital asset, or to pay off a trading debt or loss etc. The scope of the expression 'for the purposes of business' is very wide. Capital may be borrowed in the course of the existing business as well as for acquiring assets for extension of existing business. *Explanation 8* to section 43(1) clarifies that interest relatable to a period after the asset is first put to use cannot be capitalised. Interest in respect of capital borrowed for any period from the date of borrowing to the date on which the asset was first put to use should normally be capitalised. However, there was scope for the assessee to claim it as a revenue expenditure.

The proviso to section 36(1)(iii) provides that no such deduction will be allowed in respect of any amount of interest paid, in respect of capital borrowed for acquisition of new asset for extension of existing business or profession (whether capitalised in the books of account or not) for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use. It is significant to note here that even after the amendment the scope for claiming such interest as revenue expenditure in respect of existing business still exists.

The question of commencement of business would also have significance from the tax point of view. In the case of newly established industrial undertakings the benefit of tax holiday under the provisions of Section 10AA/80-IA/80-IB/80-IC/80-ID/80-IE start to be operative at the point of time when the undertaking commences production or manufacture and would continue for the period prescribed in these provisions.

Similarly, under the provisions of section 35, certain capital as well as revenue expenditure incurred on scientific research during the three years immediately preceding the year of commencement of business is allowed as deduction in the year of commencement of business. It may be noted that there may be an interval of time between the date of setting up of a business and the date of actual commencement thereof and merely because there is an interval of time of this type it cannot be said that the business has not been set up.

In the case of a business/profession newly set up or a source of income coming into existence in the financial year immediately preceding the assessment year, the previous year will begin with the date of setting up of the business/profession or the date on which the source of income newly comes into existence and end with the said financial year. There will be no question of change of previous year or different previous year for different sources of income.

14.3.7 Tax planning for business deductions — Some general considerations:

There are several matters which affect the assessee's ability to deduct various expenses for income-tax purposes. Some of the principal considerations to be borne in mind planning for business deductions, are given below:

Successful tax planning for business deductions pre-supposes a clear and thorough understanding of the various statutory provisions governing the deductions and an awareness of the statutory rights as well as various restrictions and conditions governing such rights. The general considerations applicable to tax planning in the field of business deductions, revolve round their-

- (a) allowability.
- (b) year of allowability.
- (c) extent of allowability (disallowing provisions if any), and
- (d) carry-forward to future years.

Often, the question of expenditure being capital or revenue and the consequences attaching to the likely treatment eventually may also be an important part of the tax planning exercise. This aspect has been discussed at a later stage.

One of the important aspects of tax planning would be to see that the maximum deduction or allowance is obtained in the earliest possible time for the purpose of determination of taxable income. Therefore, while deciding about incurring of capital and revenue expenditure, the assessee should consider the tax treatment of such expenditures and the period within which the benefit of deduction or amortisation would be obtained so that he can estimate and work out cash flow position over a period of time. While tax considerations play a major role in investment decisions, the general principles of financial management and their effect on investment decisions should not be ignored.

The tax planner should keep in mind the advantage arising out of minimising the expenditure, especially in the initial years of a business, so that the profits may be maximised and the assessee may be in a position to avail of the various tax incentives like depreciation as also the tax holiday provisions.

Normally, deductions of expenditure is allowable in the year in which it is incurred or paid depending on the method of accounting followed, viz, mercantile or cash. In other words, the expenditure to be claimed as deduction should be claimed in the relevant year. Where the assessee follows the cash system of accounting, the allowance in respect of expenses would be available only when the moneys in respect of them are actually paid by the assessee. Whereas in the case of mercantile system of accounting, if a business liability has definitely arisen in the accounting year, a deduction should be allowed. Where accounts are kept on a mercantile basis, if an expenditure is claimed on the ground that it is legally deductible, it can

be claimed in the year in which the liability for the expenditure is incurred even though the payment itself is made in a subsequent year. If an assessee following mercantile system fails to claim an expense in the year in which it accrues he loses the right to claim it as a deduction altogether. He cannot claim or make any attempt to reopen the accounts of the earlier year to which the expense relates.

The Supreme Court's decision in *C.I.T. vs. Gemini Cashew Sales Corporation* (1967), 651. T.R. 642 emphasizes the principle that if the liability to make the payment has arisen during the previous year, it must be appropriately regarded as the expenditure of that year and merely because the payment in respect of the expenditure is made in the subsequent year, the assessee would not be entitled to claim deduction in respect thereof in the subsequent year. As pointed out earlier, this is subject to the provisions of section 43B.

Normally, deduction can be claimed by the assessee only in respect of those expenses and losses which have been actually incurred by the assessee during the previous year, i.e. after the business is set up. But, there are some exceptions to this rule and a tax planner should be aware of the exceptions and make use of them in appropriate cases. For example, expenditure incurred on scientific research before the commencement of the business — capital or revenue during the three years immediately preceding the commencement of the business and coming within the scope of the *Explanation* to sections 35(1)(i) and 35(1)(ii), capital expenditure incurred prior to commencement of specified business allowed as deduction in the year of commencement of business, in case capitalized under section 35AD, preliminary expenses incurred before commencement of the business and coming within the scope of section 35D, expenditure on prospecting for minerals coming within the scope of section 35E, are cases where the assessee could claim deduction in respect of the expenditure even though the expenditure was not incurred during the previous year.

Similarly, the expenditure in respect of which deduction is claimed by the assessee should not be in the nature of capital expenditure. This is again subject to the statutory exceptions contained in provisions like section 35, 35AD. Again subject to the statutory exceptions, the expenditure should be incurred wholly and exclusively for the purpose of the business.

Various other expenses incurred prior to the commencement of commercial operations may, in appropriate cases, be accumulated and capitalised by being spread over the cost of various assets constructed or acquired during the pre-production period. If this is done on a proper basis, the cost of the various assets including the indirect expenses capitalised can be depreciated for tax purposes to the extent that the cost relates to assets which are themselves depreciable for income-tax purposes. This is a matter which the tax planner should bear in mind in order to ensure that expenses incurred during the construction period are properly accounted and allocated.

It is significant to note that though the normal rule is that only expenditure which is related to a business being is carried on during the previous year is deductible, expenditure during the dormant period of business but before the business has been closed could be claimed as deduction.

Similarly, expenditure incurred by a running company, in connection with a new unit which it proposes to establish may be deducted as part of the normal revenue expenditure of the business even before the new unit has in fact been established and even if the proposed new unit is ultimately abandoned.

It is not always necessary that the expenditure for which deduction is claimed should be entered in the books of accounts, unless specifically required by the law. For instance, in the case of certain deductions, the income-tax law provides that the assessee, in order to be eligible for the deductions, should actually write off the amount in the books of account. For example, in the case of bad debts, deduction under Section 36(1)(vii) will be allowed only if the concerned deficiency amount has been written off in the accounts of the assessee for the relevant previous year. This aspect of the problem should also be kept in mind while planning for deductions.

The Income-tax Act, 1961 lists several specific deductions. A deduction falling under each category is allowable subject to the conditions and limitations, if any which may be specified. At times the restrictive conditions apply to expenditure which is prima facie suspect as, for example, transactions with relatives or associates or within the same group coming within the scope of section 40A(2). Such transaction is considered as specified domestic transaction under section 92BA and the transfer pricing provisions shall be applicable. While planning for business deductions, due regard must be had to these limitations.

In addition to the specific provisions the omnibus provision in section 37 also enables an assessee to claim deduction in respect of expenditure laid out 'wholly and exclusively for the purpose of the business' the tax planner has to take into consideration the principles emerging from the innumerable relevant judicial rulings while availing of the facility of deduction under this provision. Any expenditure incidental to business, maybe deducted except those prohibited by any provision of the Act.

Ordinarily, an expenditure which is specifically provided for should be claimed under the relevant section rather under the omnibus provision. To justify the deduction under the residual clause, all that is required is that the expenditure must have been incurred wholly and exclusively and it is not necessary to prove that the expenditure was also incurred 'necessarily' or 'reasonably'. The expenditure must have been incurred 'for the purpose of business'. These words are wider than the phrase "for the purpose of earning profits". A specific quid *pro quo* is not essential. It is not necessary to show that the expenditure resulted in commensurate benefit or advantage either during the same year or subsequently.

An expenditure is liable to be disallowed if it is either of a personal nature or of a capital nature. The question whether a particular expenditure is of a personal nature must be judged by reference to the assessee himself and not any other person.

- ◆ **Capital or Revenue:** Generally speaking, an expenditure is regarded as being of a capital nature, if it results in the acquisition of an asset or of an advantage or benefit of an enduring nature.

The test with regard to the nature of the expenditure-capital or revenue - is to be applied with reference to its purpose rather than its effect. The test must be applied by reference to the assessee himself and not any other person. For instance, a company must be obliged to construct pipelines for the purpose of its business but under conditions whereby the pipelines ultimately become the property of a municipal corporation rather than the company itself. In such a case, although the pipelines undoubtedly constitute

tangible assets the expenditure may not be regarded as of a capital nature, since the assets do not belong to the company but to some other person. There are many judicial rulings to support this view. A leading case that maybe referred to in this context is *Lakshmiji Sugar Mills Co. P. Ltd. vs. CIT* 82 ITR 376].

If the purpose of the expenditure is to secure a commercial advantage, rather than acquisition of a capital asset, it is likely to be allowed as a revenue expenditure even though the advantage may endure for an indefinite period. However, this rule is by no means inflexible or capable of universal application. Conversely, if the purpose of the expenditure is the acquisition of an advantage or benefit of an enduring nature the expenditure is liable to be treated as capital expenditure even if the period or durability of the asset acquired as the result of the expenditure is very short. For example, if a company making shoes acquires knives and lasts, whose life is only three years, the expenditure may nevertheless be regarded as capital expenditure.

In applying the various case laws on the subject of distinction between capital and revenue, it should be recognised that circumstances do change and the law normally keeps pace with such changing circumstances. The expenditure that was regarded as capital expenditure resulting in long-term benefit during the relatively *laissez faire* days of the 19th century may not perhaps, be regarded as capital expenditure in the context of the rapid technological changes which are the feature of industrial life today. The decision of the Supreme Court in *Shahzada Nund & Sons vs. CIT* 108 ITR 358 also supports this view. A tax planner would do well to keep track of the various cases reported from time to time so as to keep himself informed of the trend of judicial thinking in this regard.

- ◆ **Expenditure specifically allowed:** The Income-tax Act, 1961 specifically allows many types of expenditure such as depreciation, expenditure on scientific research, expenditure on know-how, preliminary expenses, bad debts etc. The Act prescribes several conditions and restrictions for the allowance of such expenditure. The tax-planner should take care to see that all the prescribed conditions are complied with so that deductions may not be denied.
- ◆ **Other business expenses:** As already explained earlier, section 37(1) deals with the various items of expenses which are otherwise not covered by the provisions of Section 30 to 36 of the Income-tax Act, 1961 and specifically provides that all expenses which are incurred wholly and exclusively (though not necessarily) for the purpose of the business or profession carried on by the assessee would be deductible in computing the assessee's business income. In order to qualify for deduction under this provision, the following important conditions will have to be fulfilled:
 1. The expenditure should have been incurred by the assessee in the ordinary course of his business or profession;
 2. The expenditure should be of a revenue nature and should not be of capital nature;
 3. The expenditure should not be of a personal nature;
 4. The expenditure should not be covered by any other provisions of sections 30 to 36 for purposes of allowance and it should not also be covered by any of the provisions of disallowance contained in sections 40 to 44D; and

5. The expenditure should not be one which is in the nature of an appropriation of income or diversion of profits by an overriding title. It should not also be one in respect of which deduction is permissible under Chapter VI-A of the Income-tax Act, 1961 from the gross total income of the assessee.
- ◆ **Commercial expediency:** The concept of 'commercial expediency' helps a tax payer in insisting that a reasonable view is taken of his right to deduct normal expenditure. The trend in judicial thinking has also recognised this concept. This concept reflects the fact that it is virtually impossible for the legislation to list all possible deductions to which an assessee would be entitled in computing his taxable income and therefore the fact that a business has to be run by the assessee himself under normal commercial conditions must be recognised in determining the allowability of certain expenditure. The test of commercial expediency should be applied from the point of view of a normal prudent businessman, by reference to modern concepts of social corporate/business responsibility and not by reference to the subjective standards of the revenue department.

A claim on the ground of commercial expediency is subject to the under-noted conditions and limitations:

- (a) If the expenditure is covered by one of the express provisions in the Act, it must conform to the requirements stipulated therein.
- (b) An expenditure which is expressly disallowed under the Act cannot be claimed on grounds of commercial expediency.
- (c) An expenditure cannot be claimed on grounds of commercial expediency if it is improper or illegal. It may be commercially expedient to pay a bribe or incur a penalty but this does not mean that the bribe or penalty would be normally deductible for tax purposes.

There is also a distinction between a payment made for a violation or breach of law and payment made for a breach of contract. In the latter case, the payment would ordinarily be deductible even though it might be described as a penalty. Courts have taken the view that where the payments are not in the nature of penalties for infraction of any law but made in pursuance of the exercise of an option given in a particular scheme and where the assessee opts for it out of commercial expediency and business consideration, it could be allowed as deduction. For instance, payments made to Export Promotion Council for shortfall in export performance and payment made to Cotton Mills Federation for non-import of allotted quota of requisite cotton, etc. were held to be allowable as payments falling in this category [*CIT vs. Manekia Harilal Spg & Mfg. Co. Ltd.* (1991) 7 *Taxman* 395 (Guj), *CIT vs. Raj Kumar Mills. Ltd.* (1982) 135 *ITR* 812 (M.P.) *CIT vs. Vasanth Mills Ltd.* (1979) 120 *ITR* 311 (Mad.)] and other cases.

Tax consideration governing Management/Investment decision : Though management/investment decisions are not based on tax factor alone, yet it has become imperative to consider tax factors before adopting any course of action because the effect of this factor is not only significant but it may also differ from one alternative to another. To illustrate this

point, tax implications that are relevant while taking some specific management decisions are explained below:

- ◆ **Make or buy decision:** In making 'make or buy' decisions, the variable cost of making the product or part/component of product is compared with its purchase price in the market. The article is brought if the former is greater than the latter. Alternatively, if the decision to make involves establishment of a separate industrial unit for this purpose, a decision may be taken on the basis of total cost rather than variable cost. In such an event the assessee would also be in a position to get the tax benefits arising from allowances such as depreciation, tax holiday benefit and deduction in respect of profits from new industrial undertakings, wherever they are applicable.

There are many other costing and non-costing considerations which are kept in mind at the time of taking the decision, like capacity utilisation, supply position of the article to be bought, terms of purchase, etc. The basis of taking make or buy decision should be 'saving after tax'. The net saving can be ascertained after deducting from gross savings income-tax payable on the amount of saving. The long-term advantages arising out of a decision to make should also be given due weight in arriving at a decision.

At the time of ascertaining variable cost of the product (for taking make or buy decision) all taxes such as excise duty, import duty, customs duty, octroi etc., payable in the process of manufacture should be taken into account and in determining purchase price of the product all taxes to be borne by the purchaser such as sales tax, local taxes should be added for the purpose of comparison and cost of purchasing.

- ◆ **Own or lease:** Another important area of decision making is whether to own or lease (or sale and lease back). There are advantages as well as disadvantages in leasing. Leasing avoids ownership and with it the accompanying risks of obsolescence and terminal value losses. In leasing immediate payment of capital costs is avoided but fixed rental obligation arises. There are many factors which are required to be considered before making 'own or lease' decision such as cost of asset to be owned, rent of the asset to be taken on lease, source of financing the asset, risk involved in the alternatives, impact of tax concessions such as depreciation, tax holiday benefit, etc.

Leasing can also provide important tax advantages. If the asset is taken on lease, the firm can deduct for income-tax purposes the entire rental payment. If the rate of tax is 30 per cent, then the effective rent obligation is reduced to that extent. Another tax advantage of the lease is that the life of the lease can be shortened compared to the depreciable life otherwise allowed if the assessee purchased the asset. Thus, there is a delay in paying taxes and in effect an interest free loan by the Government to the extent of the delay in taxes. There is one more tax advantage arising out of lease which arises from the opportunity to depreciate otherwise non-depreciable assets. The principal asset of this type is land. The lease rental covers the cost of the land which thus becomes deductible. This arrangement may prove particularly attractive where the land value constitutes a high percentage of the total value of the real estate or where the building is already fully depreciated. Leasing is becoming popular in India.

Wherever possible or appropriate, the concept of sale and lease back can also be made use of as a tool for tax planning with its attendant advantages.

- ◆ **Lease rent paid:** As regards the consideration for the lease, there could be two types of receipts in the hands of the lessor—receipt on capital account termed 'premium' or 'salami' in respect of the transfer of rights and receipts on revenue account termed 'rent' for the right or liberty to use the property for a term of years.

The lease rental paid is chargeable to revenue every year. The lease rental may be split into three components—the recovery of principal, cost, the interest chargeable and an element of profit. It is generally believed that the interest rate in-built into the rent would be more than the going market interest rate for term loans for purchase of equipment. Since the entire lease rental is chargeable to revenue the lessee could claim tax benefits on even the principal investment in the equipment. Tax advantage in such cases is reported to be more in a leasing transaction than in a similar loaning transaction.

- ◆ **Retain or Replace Decision:** One of the important decisions which involves alternative choice is whether or not to buy new capital equipment. Both have their own merits and demerits. Generally replacement offers cost saving which results in increase in profit. But replacement requires investment of large funds resulting in extra cost. The decision is based on the relative profitability and other financial and non-financial considerations. Tax considerations should also be taken into account in this context. Some of the important considerations from the tax angle to which attention will have to be paid relate to the allowance of depreciation, as also the allowance on account of expenditure on scientific research. The applicability of the provisions for allowances should be considered and their impact ascertained before any decision is taken.

Tax Planning with reference to Foreign Collaborations: Very often Indian concerns enter into foreign collaboration agreements with foreign parties. Though these agreements have various forms, the principal areas covered by them are as follows:

1. Supply of capital goods by the foreign party.
2. Supply of technical know-how by the foreign party to the Indian concern for (i) preparation of the layout of the factory in India (ii) installation of plant and machinery and putting those in running order; (iii) information about working processes.
3. Supply of raw materials.

The tax implications of these agreements both on the foreign party and on the Indian concern are required to be known in advance. Very often the foreign collaborator wants to make sure about his tax liabilities in India and unless assured of involvement with a not too high amount of tax, the foreign party is not very eager to conclude an agreement with an Indian party. In such a case the foreign collaborator can sort advance ruling under the provisions of Chapter XIX-B of the Income-tax Act, 1961, for determination of tax implication of the transaction to be undertaken by the non-resident applicant. The Indian party must examine all the tax angles and devise a method which will saddle the foreign collaborator with the minimum amount of tax in India. The aim should be to arrange the affairs in such a way within the four corners of the law so as to attract the minimum amount of tax.

- ◆ **Planning:** There is much scope for planning while entering into foreign collaboration agreements. Some of the considerations relevant in this context have been briefly discussed here.
- ◆ **Double Taxation Avoidance Agreements:** For the determination of the taxability of foreign collaborators, the provisions of section 90 are very relevant. This provision empowers the Central Government to enter into double taxation avoidance agreement with foreign countries. In exercise of this power, the Government has entered into such agreements with a number of foreign countries.

Where there is an agreement between the Government of India and the Government of a foreign country, the tax liability of the foreign participant is determined in accordance with and subject to the provisions of the agreement and the Income-tax Act, 1961, to that extent, stands superseded by such agreement. In fact, *Circular No. 333 dated 2.4.1982*, issued by the CBDT clarifies that where a double taxation avoidance agreement provides for a particular mode of computation of income the same should be followed irrespective of the provision of the Income-tax Act, 1961. Where there is no specific provision in the agreement, it is the basic law, i.e., the Income-tax Act, 1961 which will govern the taxation of income.

A non-resident desiring to enter into collaboration agreement should take care to design the same in a manner which obtains the maximum tax benefit to him whether under the normal tax laws in India or under any specific agreement between his country and India for avoidance of double taxation. The non-resident has to furnish a Tax Residency Certificate, as a proof of his being resident in any country outside India or specified territory outside India, as the case may be, for claiming benefit of the double tax avoidance agreement.

Generally, the foreign party happens to be a non-resident for tax purposes. The status in which the chargeability to tax usually arises in the hands of the foreign party is either that of a company, or of an association of persons or of an individual. Body corporates incorporated outside India are treated as 'companies' for the purposes of section 2(17)(ii).

- ◆ **Separate contracts:** The first precaution to be taken is to avoid a composite contract. Each item of work should be separately contracted for. The contracts must be separable into various parts and amount of consideration under the contract should be precisely allocated to the various segments of the contract. If possible, there should be several contracts where several services are rendered by a foreign collaborator. If this is not done there is bound to be a tussle with the Income-tax authorities. A single contract on turn key basis without specifying the various components would expose the foreign party to Indian taxation on the ground that with reference to the completed contract value income will be construed to have accrued or deemed to have accrued in India notwithstanding the fact that a substantial part of the receipt in respect of different components may have been paid abroad or a large portion of the contract may have been executed outside Indian territory.
- ◆ **Supply of capital and/or raw materials:** The goods should be purchased by the Indian party outside India. The contract for procurement and supply of plant and machinery from

abroad should be on F.O.B. basis, delivery to be effected on board the ship outside India or on board the rail outside India, as the case may be. The transaction should not be done by sending R.R. or documents to banks in India with the stipulation that the Indian party should obtain the documents on payment of the price. The price should be paid by opening letters of credit and there should be no cash or constructive payment in India. If C.I.F. basis is adopted the property may be deemed to pass in the taxable territory and may attract tax on profits attributable to the procurement and supply of such plant and machinery on the ground that income accrued in India. If the foreign party agrees to supply spares for the plant during any specified period subsequent to the commissioning of the plant, the contract should be made in such a way that the obligation to supply the spare parts as per the requirements of the Indian party abroad and the payments should be stipulated to be paid and received outside India. In such a case, the supply may not attract any tax liability in India. It would be advisable for the foreign company to purchase the items of plant and machinery from other manufacturers abroad so as to absorb the margin of profit on the purchase as a trading operation before the goods are invoiced to the Indian company on F.O.B. basis.

If the transaction can be so arranged that the ownership of the goods in question passes from the foreign seller to the Indian buyer outside the territories of India, the sale cannot be considered as having taken place in India and so the profits on such sale cannot be said to have accrued in India. Consequently, taxation in India of the foreign company on the profits on such sale on accrual basis is avoided. In practice, to avoid such liability to Indian Income-tax in the hand of the foreign company, a large number of foreign collaboration agreements or supply of goods by the foreign company to the Indian party, stipulate delivery of the goods outside India in a foreign port F.O.B., i.e. "Free on Board". The legal effect on an FOB sale at a port outside India is that as soon as the seller, i.e., the foreign company, delivers the goods to the shipper at the foreign port, the ownership in the goods is transferred by the seller to the buyer in as much as the shipper taking delivery of the goods on board the ship at the foreign port, does so as the buyer, i.e., the Indian party. The time of such transfer is the time of the delivery and the location of such transfer is the place where the delivery takes place which is outside India.

Many concerns, however, are not very careful or particular about the matter of F.O.B. sales, and a considerable number of cases have been noticed where the goods are purchased on C.I.F. basis.

The expression 'C.I.F.' stands for cost, insurance and freight. In such a case, the goods continue to remain in the ownership of the seller, even after delivery to the shipper, and many instances have been found where the goods had arrived in India still continuing to remain the property of the seller. This means that when the goods are ultimately delivered to the Indian party, such delivery takes place in India and consequently, the sale itself takes place here, and so, the profits on such sale accrue in this country and become taxable in the hands of the foreign company on accrual basis. If, of course, even in a C.I.F. sale arrangements can be made for transfer of ownership while the goods are still on the high seas, the liability to Indian income-tax on accrual basis on the profits arising out of sale of goods can still be avoided. In many cases this is not done and there

arises a tax liability in India to the foreign company on the sales so made, a liability which with a little foresight could easily have been avoided.

Something now requires to be said about the time of accrual. This is important for it is by the date on which an income accrues that determination is made of the assessment year in respect of which the tax liability is to be computed. The unit of period in respect of which an assessment is made is known as a 'previous year', which is the financial year. The 'assessment year' in relation to a previous year commences on April 1.

The necessity for ascertaining the time of accrual of income is, as has been stated above, fixation of the assessment year for which the tax is to be levied. Such fixation is important, for the rules for computation of incomes and the rates for imposition of tax, are variable from assessment year to assessment year and very often these vary quite considerably.

Decided cases have established the principle that income accrues at that point of time at which the earner of the income gets the legally enforceable right for the first time to receive the income in question. Thus, when a contractor having completed his work as scheduled and also having received all the payments due on such contract, finds that there has been a loss in executing the contract and on making an application to the other party, obtains an additional sum to compensate him partially for such loss, such additional sum accrues as income not as income of the period during which the contract had been executed, but at the time when the other party agreed to pay an additional sum, i.e. when the legally enforceable right for the additional payment accrued to him.

The discussions above on accrual of income in the context of non-resident company may now be summarised with the following observations.

- (1) The profits on sale of goods accrue at the place where the sale itself takes place, and, the time of such accrual is the time of such sale.
 - (2) If sales by the foreign party are effected F.O.B. at a place outside India, the profits on such sales accrue outside India.
 - (3) If services are rendered by the foreign party to an Indian party in the territories outside India, no income out of such services accrues to the foreign party in India. But there may be a 'deemed accrual' as envisaged under Section 9.
 - (4) If services are rendered by the foreign party in India the remuneration for such services actually accrues in India.
 - (5) If a foreign technician is sent to India to serve in this country for a certain period, the salaries earned for such services for the said period accrue in India. By a special provision, in Section 9 such salaries are also deemed to accrue in India
- ◆ **Shares allotted to Non-Resident:** Where shares are allotted to a non-resident participant, at the time of incorporation of an Indian company in consideration for the transfer abroad of technical know-how or services or delivery abroad of machinery and plant, the income embedded in the payments would be received in India as the shares in the Indian companies are located in India and would accordingly attract liability to income-tax as income received in India.

As regards other payments in the nature of interest, royalty and fees for technical services, as pointed out earlier, collaboration agreements made on or after 1.4.76 (excepting those where agreement is made in accordance with the proposals approved by the Govt. before that date) are governed by the specific provisions of Section 9(1) (v), (vi) and (vii).

The implications of the provisions of clauses (v) to (vii) of sub-section (1) to Section 9 should be carefully considered with reference to the agreement. Under these provisions, the term 'Royalty' and 'fees for technical services' are given wide meaning.

- ◆ **Receipt—Capital or Revenue:** One important question which is relevant in determining the foreign participant's tax liability, is whether the amount received for the supply of technical know-how is a receipt on capital account or revenue account. The answer would depend on the facts of the case. The nature of the outgoing in the hands of the Indian participant will not always be determinative of the nature of receipt in the hands of the foreign party.

Broadly, it may be stated that a receipt from the sale of know-how would be a capital receipt only where the sale of the technical know-how or the imparting of technical knowledge and information results in the transfer or parting with of the asset or any special knowledge or property or skill which would ripen into a form of property and that, after such transfer, the transferor is deprived of using the asset. In all other cases where no capital asset or property is parted with and the transaction is merely a method of trading by which the recipient acquires the particular sum of money as profits and gains of that trade in the ordinary course of his business—the consideration received for the sale of technical know-how will be on revenue account.

It is significant to note that under provisions as they stand today, the place of contract and/or payment is no longer material in respect of income from royalties and technical fees. In some cases liability would arise in respect of foreign collaborator's income outside India, only because the payment is made by an Indian resident, even where the income arises under the contract which is made and performed entirely outside India and neither the contract nor the receipt has any connection with India. Further the term, royalty and 'fees for technical services' have been specifically defined in a broad manner for the purposes of these provisions.

- ◆ **Foreign Personnel:** If the foreign collaboration agreement contemplates making available the services of foreign personnel to the Indian party, it would be advisable to plan in such a way as to make the foreign personnel available to the Indian concern abroad so that such personnel would be working in India as employees of the Indian concern. It is desirable to have a separate agreement in this regard. If for any reason, a single agreement becomes unavoidable, as far instance, normally in the case of agreements with Central or State Governments or Government undertakings, it would be advisable to incorporate and spell out separate, distinct and divisible services with separate consideration for each services. Such a precaution would be desirable since the problems of the foreign collaborators ultimately turn to be the problems of the Indian party as the former generally stipulates for 'tax free payments'. Even if the taxes are to be borne by the foreign party, such safeguards are equally desirable as the ultimate tax

burden is bound to be reflected in the form of increased cost.

If the foreign personnel continue to be in the employment of the foreign concerns while working in India, the services rendered by the said personnel would amount to operations carried out in India, attracting Indian tax.

In appropriate cases, the benefits of exemption under section 10 can be claimed by the foreign technicians.

It is significant to note that by virtue of the provisions of Section 9(l)(ii), income chargeable under the head 'salaries' payable for services rendered in India will be regarded as income earned in India and consequently will be deemed to accrue or arise in India. Therefore, even if the liability to pay such salary arises outside India, it will become taxable in India.

Generally, it would be extremely inadvisable for any Indian party to undertake a blanket liability for all the Indian income-tax of the foreigner likely to arise out of the agreement. Insistence on the part of the foreign party to receive payments net of Indian tax in respect of the taxable items will lead to the payments to be received being gross upon 'tax-on tax basis' at the applicable rate. Assuming that the applicable rate of tax is 25%, a net payment of ₹ 75 to the foreign company will be construed as a gross payment of ₹ 100 and consequently the Indian company will have to bear tax to the extent of 25% of ₹ 100 and not to the extent of 25% on ₹ 75.

Even in cases where the Indian party meets the tax liability of the foreign party, in his capacity as agent of the non-resident, efforts should be made to recover the tax paid from the resources of the non-residents. Failure to recover such tax would result in loss to the Indian assessee as the assessee cannot claim the same either as a bad debt or as a business expenditure or loss incidental to trade. The decisions of the Supreme Court in *CIT vs. Abdullabhai Abdul Kadar (1961) 41 ITR 545* and *Indian Aluminium Co. Ltd. vs. CIT (1971) 79 IT 514* point out this position.

- ◆ **Advance Rulings:** In appropriate cases, the facility of getting Advance Rulings, envisaged by section 245N-245V could also be availed of.
- ◆ **Double taxation relief :** Taxpayers deriving income chargeable to tax both in India and in a foreign country by virtue of their business being carried on in more countries than one or otherwise, should avail of the benefit of double taxation relief granted under sections 90, 90A and 91 of the Income-tax Act, 1961. In order to get the benefit of relief, before starting to carry on business operations in a foreign country, the assessee should be certain whether India has entered into a double taxation relief agreement with the foreign country and, if so, the extent to which and the manner in which the relief has to be availed of. Taxpayers should prefer to derive income from those countries with which India has entered into agreement for granting relief from double taxation as compared to those countries with which no such agreement exists. Even in cases where the income is derived from a country with which India has not entered into double taxation relief agreement the assessee should claim the unilateral relief available under section 91 by proving that he has paid tax in that country on the income which accrued or arose there during the previous year. In such a case he would be entitled to a deduction from the

Indian-tax-payable by him of a sum calculated on such double taxed income at the Indian rate of tax or at the rate of tax of the concerned country, whichever is the lower, or at the Indian rate of tax, if both the rates are equal. The claiming of this statutory relief would help to reduce the total incidence of tax on such doubly taxed income.

Another aspect which will require consideration is the effect of double taxation avoidance agreements wherever they exist. To the extent specific provisions exist in such agreements, the corresponding provisions in the national law will not have application. Therefore, in understanding the tax liability in respect of technical tie-ups with foreign parties, attention will have to be paid to the relevant provisions of the double taxation avoidance agreements.

Tax planning in case of losses: The provisions of sections 70, 71 and 72 of the Income-tax Act, 1961 regulate the manner in which losses incurred in the business carried on by any tax payer will have to be dealt with for tax purposes. The consideration to be given by tax payers in the matter of taking the full benefit of set-off of losses permissible under the law is as important as the considerations for tax planning which are taken into account in regard to business expenses or claiming the maximum allowances and deductions particularly in view of the fact that the provisions of set-off of losses offer valuable scope for planning.

Under section 73, losses incurred in speculation business are to be set off only against the income from the business of speculation, if any, which the assessee may derive in the same year or in the subsequent four years. In view of the prohibition in the matter of set-off of losses incurred in speculation business, it would be in the interest of the assessee to avoid indulging in the business of speculation if it is likely to result in losses and there is no possibility of setting it off against future speculation profits within the specified period. For the purposes of set-off of losses, one of the general conditions that will have to be fulfilled is that the business or profession in the course of which the loss was incurred must continue to be carried on by the same assessee subsequently when the loss is sought to be set off against the other incomes from business. This condition does not, however, apply to speculation losses and consequently if the assessee was previously carrying on a particular type of speculation business, say, speculation in shares and stocks he may subsequently carry on speculation in commodities so that the profits from the subsequent speculation business could be utilised to set off the losses previously incurred. In other words, where the business of speculation carried on by the assessee is not profitable, he could discontinue the business of speculation in the same line so that the quantum of losses could be reduced and the assessee could resort to speculation in any other profitable field thereby taking the benefit of exception provided under the law.

The Supreme Court held in *CIT vs. Shantilal P. Ltd. (1983) 145 ITR 57* that a transaction cannot be described as a 'speculative transaction' within the meaning of Section 43(5), where there is a breach of a contract and on a dispute between the parties damages are awarded as compensation by an arbitration award. But where there is no dispute and damages on a pre-determined basis are payable under the contract, without actual delivery of the goods contracted for, the transaction would be a speculative one. If any loss arises out of such a speculative transaction, such speculation loss would not be available for adjustment against other business profits, if any.

The assessee should exercise his right of set off of carried forward loss at the first available opportunity. The Madras High Court held in *Tyresoles (India) vs. CIT [1963] 49 ITR 15* that where losses sustained are not set off against the profits of the immediately succeeding year or years, they cannot be set off against profits at a later date. This has been followed by the Punjab and Haryana High Court in *B.C.S. Kartar Chit Fund and Finance Co. (P.) Ltd. vs. CIT [1989] 79 CTR (P & H) 232*. Hence, as a matter of proper tax planning the assessee should exercise the right under section 72 in the immediately succeeding year/years when the profits allow such a set off.

It is also significant to note that under section 79, a closely held company will not be entitled to claim the benefit of carry forward and set off of losses, if shares carrying at least 51% of the voting power is not held on the last day of the previous year by the same persons who held such shares on the last day of the previous year in which the loss was incurred. This benefit will not be denied if the change has occurred on account of death of a shareholder or on account of transfer by a shareholder to his relative by way of a gift. This benefit will also not be denied if the change in shareholding of an Indian company, which is a subsidiary of a foreign company, is the result of an amalgamation or demerger. However, this is subject to the condition that 51% shareholders of the amalgamating or demerged foreign company continue to be the shareholders of the amalgamated or resulting foreign company. It should be kept in mind that section 79 applies to carry forward and set off of losses and not to the benefit of deduction in respect of unabsorbed depreciation.

- ◆ **Loss Returns:** In the context of discussion on losses it would be relevant to point out that the tax planner would do well to keep in mind the implications of the provisions of section 139(3) read with section 80.

If an assessee is to get the benefit of the determination of the loss and its carry forward under section 72(1) or 73(2) or 74(1), or 74A(3), he should file a return voluntarily within the period specified in section 139(1).

14.4 Ethics In Taxation

14.4.1 Concept and significance of “Ethics” in taxation: “Ethics” in taxation relates to the extent of compliance of tax laws i.e. the ethical factor in taxation is *pari passu* to the extent of compliance of tax laws. The ethical quotient in tax management is directly proportional to tax compliance (i.e. higher the degree of compliance with tax laws, the higher is the ethical quotient and vice versa) and inversely proportional to tax avoidance (i.e. higher the degree of tax avoidance, the lower is the ethical quotient). Compliance with tax laws does not literally mean paying high taxes. Tax compliance can also be ensured by effective tax planning. Tax planning is a lawful method to keep the incidence of tax at the minimum level by making effective use of various tax exemptions, deductions, rebate, relief, beneficial circulars and judicial rulings and at the same time discharge the tax obligations properly. Tax avoidance, on the other hand, is a device which takes advantages of the loopholes in the law to reduce/avoid or transfer one's tax burden. Tax evasion is, on the extreme end, avoiding tax liability by dishonest means like concealment of income, falsification of accounts etc. Tax evasion devices are unethical and evasion, once proved, attracts heavy penalties and also prosecution.

Justice O. Chinnappa Reddy of Supreme Court has, while briefing the evil consequences of tax avoidance in *Mc.Dowell & Co. Ltd. v. CTO (1985) 154 ITR 148 (SC)*, observed that one such evil consequence is the ethics (or the lack of it) of transferring the burden of tax liability to the shoulders of the guideless, good citizens from those of artful dodgers. As regards the ethics of taxation, he observed "We now live in a welfare State whose financial needs, if backed by law, have to be respected and met. We must recognize that there is behind taxation laws as much moral sanction as behind any other welfare legislation and it is a pretence to say that avoidance of taxation is not unethical and that it stands on no less moral plane than honest payment of taxation".

A similar observation was made by Lord Chancellor in *Latilla vs. Inland Revenue Commissioner (1943) 011 ITR (E.C) 0078* -

"There is, of course no doubt that they are within their legal rights but that is no reason why their efforts, or those of the professional gentlemen who assist them in the matter, should be regarded as a commendable exercise of ingenuity or as a discharge of the duties of the good citizenship. On the contrary, one result of such methods, if they succeed, is of course to increase *pro tanto* the load of tax on the shoulder of the body of good citizens who do not desire or do not know how to adopt these maneuvers."

14.4.2 Fundamental ethical principles to be complied with by the members of the profession: Certain fundamental ethical principles have to be adhered to by the practicing members of the CA profession to ensure compliance with tax laws and effective tax management. The fundamental principles to be observed when developing ethical requirements relating to tax practice include all the fundamental principles by which a member is governed in the conduct of his professional relations with others. These fundamental principles are -

Integrity: A professional accountant should be straightforward and honest in performing professional services.

Objectivity: A professional accountant should be fair and should not allow prejudice or bias, conflict of interest or influence of others to override objectivity.

Professional Competence and Due Care: A professional accountant should perform professional services with due care, competence and diligence and has a continuing duty to maintain professional knowledge and skill at a level required to ensure that a client or employer receives the advantage of competent professional service based on up-to-date developments in practice, legislation and techniques.

Confidentiality: A professional accountant should respect the confidentiality of information acquired during the course of performing professional services and should not use or disclose any such information without proper and specific authority unless there is a legal or professional right or duty to disclose.

Professional Behaviour: A professional accountant should act in a manner consistent with the good reputation of the profession and refrain from any conduct which might bring discredit to the profession. The obligation to refrain from any conduct which might bring discredit to the profession requires IFAC member bodies to consider, when developing ethical requirements,

the responsibilities of a professional accountant to clients, third parties, other members of the accountancy profession, staff, employers and the general public.

These fundamental principles have to be kept in mind by the tax practitioner while advising his client. Such fundamental principles when interpreted in the form of responsibilities/duties of a member as a tax practitioner/tax adviser, can be translated as given below -

- (i) A member rendering professional tax services is entitled to put forward the best position in favour of his client, provided he can render the service with professional competence, it does not in any way impair his standard of integrity and objectivity, and is in his opinion consistent with the law. He may resolve doubt in favour of his client, if in his judgment, there is reasonable support for his position.
- (ii) A member should not hold out to clients the assurance that the tax return he prepares and the tax advice he offers are beyond challenge. Instead, he should ensure that his clients are aware of the limitations attached to his tax advice and services so that they do not misinterpret an expression of opinion as an assertion of fact.
- (iii) A member who undertakes or assists in the preparation of a tax return should advise his client that the responsibility for the content of the return rests primarily with the client. The member should take the necessary steps to ensure that the tax return is properly prepared based on the information received from the client.
- (iv) Tax advice or opinions of material consequence given to a client should be recorded either in the form of a letter to the client or in a memorandum for the files.
- (v) A member must not associate himself with any return or communication which he has reason to believe:
 - (a) contains a false or misleading statement;
 - (b) contains statements or information furnished by the client hastily or without any real knowledge of whether they are true or false; or
 - (c) omits or obscures information required to be submitted and such omission or obscurity would mislead the tax department.

If any of the above situations prevails, the member's responsibility is to resign from acting as the client's tax representative.

- (vi) A member may prepare tax returns involving the use of estimates only if such use is expressly authorized by the tax laws. For example, under the Income-tax Act, 1961, presumptive tax provisions can be applied to assessee's carrying on an eligible business under section 44AD and business of plying, hiring or leasing goods carriages by applying the presumptive rates specified in the Act. The limitation regarding the amount of gross receipts, number of vehicles to be owned etc. will have to be taken into account to find out whether presumptive tax provisions would apply in the assessee's case.
- (vii) In preparing a tax return, a member ordinarily may rely on information furnished by his client provided that the information appears reasonable. Although the examination or review of

documents or other evidence in support of the client's information is not required, the member should encourage his client to provide such supporting data, where appropriate.

In addition, the member:

- (a) should make use of his client's returns for prior years whenever feasible.
 - (b) is required to make reasonable inquiries where the information presented appears to be incorrect or incomplete.
- (viii) The member's responsibility when he learns of a material error or omission in a client's tax return of a prior year (with which he may or may not have been associated), or of the failure of a client to file a required tax return, is as follows:
- (a) He should advise his client to file a revised return (if the time limit has not expired and assessment has not been completed) rectifying such error or omission.
 - (b) If the client does not correct the error:
 - (i) the member should inform the client that he cannot act for him in connection with that return or other related information submitted to the authorities;
 - (ii) the member should consider whether continued association with the client in any capacity is consistent with his professional responsibilities; and
 - (iii) if the member concludes that he can continue with his professional relationships with the client, he should take all reasonable steps to assure himself that the error is not repeated in subsequent tax returns.

14.4.3 Ethical considerations from the tax payer's angle and the steps taken by the Government to counteract ethical failure on the part of the tax payers: Now, let us proceed to study the ethical considerations from the tax payer's angle. The tax payer's ultimate goal is minimization of tax liability. However, ethical considerations should not be compromised for attaining this goal since an honest mistake can always be explained but the intentional error cannot. There are two roads to the taxpayer's final destination of minimizing tax liability – one is through legitimate tax planning and the other is through tax avoidance or tax evasion, which is against the law. In India, where the tax system is based largely on voluntary compliance, the taxpayer's standards of tax ethics are extremely important. The tax payer should always declare true particulars about his income, wealth, turnover or receipts and disclose correctly all material facts in the prescribed returns. He should provide correct information and furnish authentic records to the revenue, whenever statutorily required to do the same. He should not resort to concealment, misrepresentation or willful omission of any portion of his income, wealth, turnover or receipts.

There are many instances where the tax payer has compromised on compliance with these standards and this has prompted the Government to plug the loopholes which have led to erosion of tax revenue. The Government has attempted to do so by incorporation of clubbing provisions, transfer pricing provisions in relation to international transaction and specified domestic transaction, introduction of new taxes, provision of mechanism for enforcing furnishing of annual information return, increasing the scope and enforcing compliance of tax

deduction provisions etc. Some of the provisions which have been incorporated in the tax laws to counteract ethical failures on the part of the tax payer are discussed hereunder –

(i) Incorporation of clubbing provisions

Clubbing provisions have been enacted to counteract the tendency on the part of the tax-payers to dispose of their property or transfer their income in such a way that their tax liability can be avoided or reduced. For example, in the case of individuals, income-tax is levied on a slab system on the total income. The tax system is progressive i.e. as the income increases, the applicable rate of tax increases. Some taxpayers in the higher income bracket have a tendency to divert some portion of their income to their spouse, minor child etc. to minimize their tax burden. In order to prevent such tax avoidance, clubbing provisions have been incorporated in the Act, under which income arising to certain persons (like spouse, minor child etc.) have to be included in the income of the person who has diverted his income for the purpose of computing tax liability.

(ii) Incorporation of transfer pricing provisions

Transfer pricing provisions were brought in by the Finance Act, 2001 with a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of multinational enterprises carrying on business in India, whose profits can be controlled by the multinational group, by manipulating the prices charged and paid in intra-group transactions, which may lead to erosion of tax revenue. Thus, non-compliance of ethical tax practices by multinational companies led to introduction of transfer pricing provisions. The transfer pricing provisions have been now extended to apply in case of certain specified domestic transaction. Therefore, the transfer pricing provisions have to be kept in mind by the assessee while entering into an international transaction or a specified domestic transaction.

(iii) Imposition of new/alternate taxes

- (a) Minimum Alternate tax (MAT) was imposed on companies consequent to the substantial increase in the number of zero-tax companies and companies paying marginal tax, inspite of having earned substantial book profits and having paid handsome dividends.

Alternate minimum tax (AMT) has been imposed on all persons other than companies claiming profit-linked deduction under Chapter VI-A or under section 10AA. The provisions of AMT are on similar lines as of MAT however, the tax base for computation of AMT is adjusted total income and not book profits as in case of MAT.

In recent years, several new taxes have been introduced with the objective of checking income-tax avoidance or establishing an audit trail.

- (b) Securities Transaction Tax was introduced by the Finance (No.2) Act, 2004, on the value of taxable securities transaction i.e. purchase or sale of equity shares in a company or units of an equity oriented fund, entered into in a recognized stock exchange. This tax has to deducted at source and consequently, an assessee cannot escape paying this tax in respect of a transaction entered into in a recognized stock exchange.
- (c) In the sales tax system, there was a huge revenue loss on account of a large number of instances of unaccounted transactions. State-Level Value Added Tax has been

introduced with effect from 1.4.2005 to check this evasion and reduce the cascading effects of taxes. It has increased the revenues of the State exchequer as the coverage of this tax extends to value addition at all stages of sale in the production and distribution chain. VAT is a simple and transparent tax on the final consumption of goods/services and ultimately borne by the customer, although collected at every stage of production as well as distribution and tax credit granted at each stage for tax paid earlier in the chain of transfer/sale of goods and services. Due to the inherent transparency and accountability in the system, VAT leads not only to a better tax administration but also higher levels of compliance and lesser evasion.

Tax evasion is a grave problem in a developing country like ours as it leads to a creation of a 'resource crunch' for developmental activities of the State. Reputed international institutions like the World Bank and IMF point out that the VAT regime prevents tax evasion and boosts revenues to help cash starved Governments to come out of their debt-trap. Under the VAT regime, the traders and dealers, in order to claim credit, demand invoices from the vendors thereby putting an end to the unaccounted transactions and unethical practices on account of the same.

(iv) Provision of mechanism for enforcing the furnishing of an Annual Information Return

Section 285BA provides a mechanism for enforcing the furnishing of an Annual Information Return by any assessee who enters into any prescribed financial transaction. This mechanism has been enforced for unearthing black money and counteracting unethical tax evasion by tax payers. Penalty@ ₹100 per day of continuing default is attracted for failure to furnish annual information return on or before 31st August following the financial year. ***Further, penalty@Rs.500 per day of continuing default is attracted for failure to furnish annual information return within the time specified in the notice under section 285BA(5).***

The excise laws also provide for furnishing of an Annual Financial Information Statement by the assessee paying 100 lakhs or more as excise duty either through Personal Leger Account (PLA) or CENVAT or both together. This Statement requires the assessee to disclose all material information regarding the value of inputs, major raw materials independently constituting for 10% or more of total value of raw materials, expenditure under specific heads, goods manufactured through job worker, sales of major finished goods which independently account for 10% or more of total value of finished goods sold, other income, job work undertaken for others etc. All such information is expected to be useful for unearthing black money.

(v) Enforcing compliance of TDS provisions

This has been enforced by denying deduction of expenditure to an assessee in case of failure to deduct tax at source or remit such tax deducted within the prescribed time. However, such expenditure would be allowed as deduction in the year in which such tax is deducted and paid. This provision is to prevent loss of tax revenue on account of failure of the assessee to deduct/remit tax. The introduction of this provision is one step to encourage ethical tax practices by assesseees.

Further, TDS provisions under section 194C are attracted where the value of the contract exceeds ₹ 30,000. The tax payers resorted to splitting up large contracts into contracts of smaller value to escape tax deduction. In order to prevent such unethical practice of splitting

up composite contracts into contracts valued at less than ₹ 30,000 to avoid tax deduction, this section requires tax deduction at source where the amount credited or paid or likely to be credited or paid exceeds ₹ 30,000 in a single payment or ₹ 75,000 in the aggregate during the financial year.

(vi) Introduction of new valuation provisions for service tax

Section 67 providing for valuation of taxable services (w.e.f. 18.04.2006) was introduced vide Finance Act, 2006. Further, Service Tax Valuation Rules were also notified w.e.f. 19.04.2006. These provisions were introduced to curb the unethical practices adopted by the service tax assesses while valuing their services for the purpose of charging service tax. Service providers in order to avoid service tax liability did not show the full amount of the consideration as the value of the taxable service, instead it used to be split up in the form of reimbursements. The new provisions ensure that the gross amount charged for the services is liable to service tax including the reimbursements. Only if the expenses have been incurred by the service provider as a "pure agent" the reimbursements would be excluded from the value of the service tax.

(vii) Clubbing of clearances/taxable services in case of SSI exemption

Small scale exemption is available if aggregate value of clearances of excisable goods for home consumption by a manufacturer from one or more factories, or from a factory by one or more manufacturers does not exceed the prescribed limit of ₹ 400 lakh. Sometimes to avail this benefit, manufacturers split up their clearances by opening another sham or fake unit under different partnerships or under different companies. Similar is the case with service tax. Clubbing of clearances or turnover in case of excisable goods and taxable services checks such unethical practices.

14.4.4 Role of judiciary in enforcing ethical compliance by tax payers: Tax payers also tend to distort "ethics" by resorting to unfair accounting and business practices like -

1. Claiming personal expenditure as business expenditure;
2. Claiming capital expenditure as revenue expenditure;
3. Treating revenue receipt as capital receipt;
4. Accounting for amount paid as "Salaries" as business expenditure by classifying the same under different account heads like conveyance, tour and travel, employee welfare etc.;
5. Altering the form of transaction;
6. Breaking up of large value contracts into smaller contracts to avoid attracting TDS provisions;
7. Breaking up of cash payments in respect of an expenditure to escape disallowance of such expenditure;
8. Transferring their income/property to avoid tax, etc.
9. Splitting up the turnover of excisable goods and taxable services in order to claim small scale exemption;
10. Not disclosing correct turnover figures in case of excisable goods and taxable services;
11. Resorting to unfair practices while valuing goods or services for the purpose of paying

excise duty, customs duty and service tax respectively;

12. Misclassifying goods and services to avoid excise duty, customs duty and service tax.

The Courts have condemned such unethical practices by tax payers and have respected the importance of compliance with ethical standards in their judgements. Let us consider some cases in this perspective. There are several cases where companies/firms have claimed foreign travel expenses of spouses of directors/partners as a business expenditure. In some cases, the Courts have allowed such expenditure as deduction and in others, such expenditure has been disallowed. Expenditure incurred by the assessee-firm on the foreign tour of the wife of the senior partner was held non-deductible by the Madras High Court in *CIT v. T.S. Hajee Moosa & Co. (1985) 153 ITR 422*. In *CIT v. Ram Bahadur Thakur Ltd. (2003) 261 ITR 390 (Ker.)*, the High Court held that it was the assessee's obligation to prove the business expediency of overseas travel by the wives of directors. The assessee has to discharge such obligation in good faith keeping in mind the ethical standards.

In *CIT v. Madras Refineries Ltd. (2004) 266 ITR 0170*, social costs incurred by a company have been allowed as deduction. The High Court held 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. This decision has recognized the concept of corporate social responsibility, which also highlights compliance of ethical standards by corporates.

In *M.M.Fisheries (P) Ltd. v. CIT (2005) 277 ITR 0204*, the company claimed depreciation in respect of an asset owned by its director in his personal capacity. The High Court held that the company was not entitled to claim depreciation since it had no dominion over the vehicle and even the beneficial ownership did not vest with the company. This is a case where the assessee sought to claim personal expenses of the director as business expenses, which is an indicator of low ethical quotient. Similar disallowance was made by the Madhya Pradesh High Court in *Bhilai Motors v. CIT (1987) 167 ITR 147*, where motor cars belonging to the assessee firm were used by its partners for personal purposes.

The concept of mutuality means that the contributors and the beneficiaries are identical. Since one cannot make a profit by dealing with oneself, there is no taxable profit involved wherever such concept applies. This concept has however been misused in many cases to avoid tax liability. In *CIT v. Trivandrum Club (2006) 153 Taxman 481*, the Kerala High Court observed that the doctrine of mutuality would not apply in a case where the marriage hall was being rented out to non-members by making them temporary members only for the purpose of letting out the marriage hall and the amounts received from the non-members formed part of the income of the assessee-club. In this case, the Court has corrected the negative ethical factor brought in by the assessee.

In *CIT v. A.N. Naik Associates (2004) 136 Taxman 107*, the Bombay High Court observed that the word "otherwise" in section 45(4) takes into its sweep not only cases of dissolution but also cases of subsisting partners of a partnership, transferring assets in favour of retiring partners. When an asset is transferred to a retiring partner, such transfer falls within the expression "otherwise" and the rights of the subsisting partners in that asset of the firm are extinguished. Therefore, there is clearly a

transfer and capital gains tax is attracted. In this case, the High Court applied the “mischief rule” about interpretation of Statutes and pointed out that the idea behind the introduction of section 45(4) was to plug in the loophole and block the escape route through the medium of the firm.

It is significant to note that if the tax payers standard of tax ethics goes up, it would drastically reduce the spate of litigations, of the nature described above, pending in various judicial forums. In fact, such was the large number of tax-related litigations pending with the Courts that the Government decided to create a separate appellate forum for tax related issues known as National Tax Tribunal so as to expedite the judicial process.

14.4.5 Government’s role in strengthening ethical standards of the tax payer: The most important factor which would increase the ethical quotient of the tax payer is the increase in the level of trust reposed by the tax payer on the Government. If the tax payer is convinced that the tax he pays is put to productive use in the economy, of which he is an important part, his compliance with tax laws would go up substantially.

Further, reduction in the rates of tax would also ensure more compliance, since high rates of taxes act as a deterrent to the tax payer from disclosing his full income. It may be noted that keeping this factor in mind, the rates of income-tax have been reduced and exemption limits have been increased over the last few years. Even the excise duty and customs duty have been reduced considerably in the last few years. This has improved compliance and increased tax revenue substantially.

The tax system in India is generally perceived to be complex and difficult to understand. Often, these complexities force the assessee to adopt unethical means for avoiding taxes. This may be done with the intention of evading tax or merely to escape the tiresome, difficult and exhaustive process of computing correct tax liability. This issue has been a cause of great concern for the Government in the last few years. Therefore, the Government is proposing to bring in a new legislation (i.e. Direct Taxes Code) which would be more simple and tax-payer friendly. Further, it may be noted that it is with this objective that the Government has already introduced self-assessment procedure in Excise and done away with statutory excise records.

The ethics of levy of taxes by the Government can be measured by the relationship between outlays and the quality of outcomes. In fact, the Finance Minister, Mr. P. Chidambaram, in his budget speech (Budget 2006), had laid emphasis on “quality of outcome” of the various social sector programmes, which is very much necessary for building confidence amongst the tax payers.

Since emphasis has been placed on strict monitoring of outcome and performance, it is hoped that the outlays would translate into positive “outcomes”, which would effectively fulfill the moral responsibility of the tax collector and increase the ethical standards of the tax payer.

Note: This discussion relating to ethics in taxation takes into account both direct and indirect taxes.

FINAL COURSE STUDY MATERIAL

PAPER 7

Direct Tax Laws

Assessment Year 2014-15

[Relevant for May 2014 and
November 2014 examinations]

Volume – II



BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

This study material has been prepared by the faculty of the Board of Studies. The objective of the study material is to provide teaching material to the students to enable them to obtain knowledge and skills in the subject. Students should also supplement their study by reference to the standard text book(s). In case students need any clarifications or have any suggestions to make for further improvement of the material contained herein they may write to the Director of Studies.

All care has been taken to provide interpretations and discussions in a manner useful for the students. However, the study material has not been specifically discussed by the Council of the Institute or any of its Committees and the views expressed herein may not be taken to necessarily represent the views of the Council or any of its Committees.

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SYLLABUS

PAPER – 7 : DIRECT TAX LAWS

(One paper — Three hours – 100 Marks)

Level of Knowledge: Advanced knowledge

Objectives:

- (a) To gain advanced knowledge of the provisions of direct tax laws,
- (b) To acquire the ability to apply the knowledge of the provisions of direct tax laws to various situations in actual practice.

Contents:

- I. The Income-tax Act, 1961 and Rules thereunder (90 marks)
- II. The Wealth-tax Act, 1957 and Rules thereunder (10 marks)

While covering the direct tax laws, students should familiarise themselves with considerations relevant to tax management. These may include tax considerations with regard to specific management decisions, foreign collaboration agreements, international taxation, amalgamations, tax incentives, personnel compensation plans, inter-relationship of taxation and accounting, with special reference to relevant accounting standards and other precautions to be observed to maximise tax relief. Further, they should have a basic understanding about the ethical considerations in tax management and compliance with taxation laws.

Note – If new legislations are enacted in place of the existing legislations relating to income tax and wealth tax, the syllabus will accordingly include such new legislations in the place of the existing legislations with effect from the date to be notified by the Institute.

A WORD ABOUT STUDY MATERIAL

Direct tax laws is one of the core competence areas of the Chartered Accountants. A thorough knowledge of direct tax laws is, therefore, necessary for the students of the CA Final course. In the Final course, "Direct Tax Laws" constitutes Paper-7. Students are expected to acquire advanced knowledge of the provisions of direct tax laws after undergoing this course and apply such knowledge to various situations in actual practice.

The first part of this Study Material deals with income-tax. There are 28 chapters under income-tax. The second part of this Study Material is on wealth-tax. There are 3 chapters under wealth-tax. The subject matter in this study material is based on the law as amended by the Finance Act, 2013, and applicable for A.Y.2014-15. In this study material, efforts have been made to present the complex direct tax laws in a lucid manner.

The Study Material on Direct Tax Laws is made in three volumes for ease of handling by the students. Volume-I contains Chapters 1 – 14 of Income-tax, and Volume-II contains Chapters 15 – 28 of Income-tax and Chapters 1 – 3 of Wealth-tax. Volume-III is the Practice Manual.

The taxation laws in our country undergo many amendments. In order to help the students to update their knowledge relating to the statutory and judicial developments in the field of direct and indirect tax laws, the Board of Studies brings out, every year, two publications, namely "Supplementary Study Paper" and "Select Cases in Direct and Indirect Tax Laws". This is an essential read for all our students.

A word of advice to the students – please make it a habit of referring to the bare acts as often as possible. This will not only facilitate the process of understanding the law and the sequence of sections in these Acts, but will also equip them with the professional expertise that is expected.

The main features of this edition of the Study Material are -

- The amendments made by the Finance Act, 2013 and incorporated in this study material have been tabulated chapter-wise with the corresponding section reference and given as "Significant Amendments in this Edition" in the next two pages.
- In the Study Material, the latest amendments i.e., the amendments made by the Finance Act, 2013 and notifications and circulars issued between 1.7.2012 and 30.4.2013 have been given in ***bold and italics***. Tabular presentations and diagrams have been inserted at the relevant places for explaining the amendments.
- The new illustrations as well as the illustrations which have undergone changes due to these amendments have been given in a shaded background.
- Feedback form is given at the end of the Study Material. The students are encouraged to give their feedback/suggestions.

These features would aid the students in the learning process. Finally, we would welcome suggestions to make this book more helpful and 'student-friendly'. In case you need any further clarification/guidance, you may send your queries at priya@icai.in

Happy Reading and Best Wishes!

SIGNIFICANT AMENDMENTS INCORPORATED IN THIS EDITION

Chapter No.	Particulars	Section
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	Exclusion of a certain time period in computing the period of limitation, where more than one reference for exchange of information is made in a particular case	153 & 153B
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Note: In the above table the amendments/additions have been indicated against the chapters where they have been primarily dealt with at length. Some of the amendments may have also been referred to or discussed in other related chapters.

Volume – 2

INCOME TAX

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15.1 Concept of Double Taxation Relief

In the present era of cross-border transactions across the globe, the effect of taxation is one of the important considerations for any trade and investment decision in other countries. One of the most significant results of globalisation is the visible impact of one country's domestic tax policies on the economy of another country. This has led to the need for continuously assessing the tax regimes of various countries and bringing about necessary reforms. Where a taxpayer is resident in one country but has a source of income situated in another country it gives rise to possible double taxation. This arises from the two basic rules that enables the country of residence as well as the country where the source of income exists to impose tax namely, (i) the source rule and (ii) the residence rule. The source rule holds that income is to be taxed in the country in which it originates irrespective of whether the income accrues to a resident or a non-resident whereas the residence rule stipulates that the power to tax should rest with the country in which the taxpayer resides. If both rules apply simultaneously to a business entity and it were to suffer tax at both ends, the cost of operating on an international scale would become prohibitive and would deter the process of globalisation. It is from this point of view that Double Taxation Avoidance Agreements (DTAA) become very significant.

DTAAs lay down the rules for taxation of the income by the source country and the residence country. Such rules are laid for various categories of income, for example, interest, dividend, royalties, capital gains, business income etc. Each such category is dealt with by separate article in the DTAA.

Double taxation means taxing the same income twice in the hands of an assessee. In India, a person is taxed on the basis of his residential status. Likewise, it may so happen that he is taxed on this basis or some other basis in another country on the same income. However, it is a universally accepted principle that the same income should not be subjected to tax twice. In order to take care of such situations, the Income-tax Act, 1961 has provided for double taxation relief.

15.2 Types of Relief

Relief from double taxation can be provided in mainly two ways: (i) Bilateral Relief; and (ii) Unilateral relief

15.2.1 Bilateral Relief: Under this method, the Governments of two countries can enter into an agreement to provide relief against double taxation by mutually working out the basis on which the relief is to be granted. India has entered into agreements for relief against or avoidance of double taxation with more than 50 countries which include Sri Lanka, Switzerland, Sweden, Denmark, Japan, Federal Republic of Germany, Greece, etc.

Bilateral Relief may be granted in either one of the following methods:

- (a) Exemption method, by which a particular income is taxed in only one of the two countries; and
- (b) Tax relief method, under which, an income is taxable in both countries in accordance with their respective tax laws read with the double taxation avoidance agreement. However, the country of residence of the tax payer allows him credit for the tax charged thereon in the country of source.

In India, double taxation relief is provided by a combination of the two methods.

15.2.2 Unilateral Relief: This method provides for relief of some kind by the home country even where no mutual agreement has been entered into by the two countries.

15.3 Double Taxation Relief Provisions under the Act

Sections 90 and 91 of the Income tax Act, 1961 provide for double taxation relief in India.

15.3.1 Agreement with foreign countries or specified territories - Bilateral relief [Section 90]

- (i) Section 90(1) provides that the Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India,—
 - (a) for the granting of relief in respect of—
 - (i) income on which income-tax has been paid both in India and in that country or specified territory; or
 - (ii) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory to promote mutual economic relations, trade and investment; or
 - (b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory; or

Accordingly, the Central Government has notified that where such an agreement provides that any income of a resident of India may be taxed in the other country then, such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961, and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement [*Notification No. 91/2008, dated 28.8.2008*].

- (c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory or investigation of cases of such evasion or avoidance; or
- (d) for recovery of income-tax under this Act and under the corresponding law in force in that country or specified territory.

The Central Government may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

- (ii) Where the Central Government has entered into such an agreement with the Government of any country outside India or specified territory outside India for granting

relief of tax, or for avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.

- (iii) Any term used but not defined in this Act or in the agreement referred to above shall have the same meaning as assigned to it in the notification issued by the Central Government in the Official Gazette in this behalf, unless the context otherwise requires, provided the same is not inconsistent with the provisions of this Act or the agreement. *The meaning assigned would be deemed to have come to effect from the date on which the said agreement came into force and not from the date of the said notification.*

- (iv) The DTAA's under section 90 are intended to provide relief to the taxpayer, who is resident of one of the contracting country to the agreement. Such tax payer can claim relief by applying the beneficial provisions of either the treaty or the domestic law. However, in many cases, taxpayers who were not residents of a contracting country also resorted to claiming the benefits under the agreement entered into by the Indian Government with the Government of the other country. In effect, third party residents claimed the unintended treaty benefits.

Therefore, section 90(4) provides that the non-resident to whom the agreement referred to in section 90(1) applies, shall be allowed to claim the relief under such agreement if a Tax Residence Certificate (TRC) obtained by him from the Government of that country or specified territory is furnished declaring his residence of the country outside India or the specified territory outside India, as the case may be.

- (v) *Also, section 90(5) requires the assessee referred to under section 90(4) to provide such other documents and information as may be prescribed.*
- (vi) *Therefore, a certificate issued by the Government of a foreign country would constitute proof of tax residency, without any further conditions regarding furnishing of "prescribed particulars" therein. In addition to such certificate issued by the foreign Government, the assessee would be required to provide such other documents and information, as may be prescribed, for claiming the treaty benefits.*
- (vii) The charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.

However, the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.

The position of law is that the double taxation avoidance treaties entered into by the Government of India override the domestic law. This has been clarified by the CBDT Circular No.333 dated April 2, 1982, which provides that a specific provision of the DTAA will prevail over the general provisions of the Income-tax Act, 1961. Therefore, where a DTAA provides for a particular mode of computation of income, this mode will take precedence over the Income-tax Act, 1961. However, where there is no specific provision in the treaty, then the Income-tax Act will apply.

◆ **Models of Treaties**

Tax treaties are generally based on certain models. The most common ones are:

- (i) OECD model (Organisation of Economic Co-operation and Development) - Most of India's treaties are based on this model.
- (ii) U.N. models Double Taxation Convention, 1980 between developed and developing countries.

15.3.2 Double taxation relief to be extended to agreements (between specified associations) adopted by the Central Government [Section 90A]

- (i) Section 90A provides that any specified association in India may enter into an agreement with any specified association in the specified territory outside India and the Central Government may, by notification in the Official Gazette, make the necessary provisions for adopting and implementing such agreement for -
 - (1) grant of double taxation relief,
 - (2) avoidance of double taxation of income,
 - (3) exchange of information for the prevention of evasion or avoidance of income- tax, or
 - (4) recovery of income-tax.

Section 90A(1) provides that an agreement may be entered into by any specified association in India with any specified association in the specified territory outside India which may be adopted by the Central Government by way of notification in the Official Gazette, for granting relief of tax or, as the case may be, for avoidance of double taxation. The Central Government has, vide *Notification No.90/2008 dated 28.8.2008*, notified that where such an agreement provides that any income of a resident of India may be taxed in the other country then, such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961, and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement.

- (ii) In relation to any assessee to whom the said agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to that assessee.
- (iii) Any term used but not defined in the Income-tax Act, 1961 or in the said agreement shall have the same meaning as assigned to it in the said notification, unless the context requires otherwise, and it is not inconsistent with the provisions of the Act or the said agreement. The meaning assigned would be deemed to have come to effect from the date on which the said agreement came into force and not from the date of the said notification.
- (iv) The DTAAs under section 90A are intended to provide relief to the taxpayer, who is resident of one of the contracting country to the agreement. Such tax payer can claim relief by applying the beneficial provisions of either the treaty or the domestic law. However, in many cases, taxpayers who were not residents of a contracting country also resorted to claiming the benefits under the agreement entered into by the Indian Government with the Government of the other country. In effect, third party residents claimed the unintended treaty benefits.

Therefore, section 90A(4) provides that the non-resident to whom the agreement referred to in section 90A(1) applies, shall be allowed to claim the relief under such agreement if a Tax Residence Certificate (TRC) obtained by him from the Government of that country or specified territory is furnished, declaring his residence of the country outside India or the specified territory outside India, as the case may be.

- (v) *Also, section 90A(5) requires the assessee referred to under section 90A(4) to provide such other documents and information as may be prescribed.*
- (vi) *Therefore, a certificate issued by the Government of a foreign country would constitute proof of tax residency, without any further conditions regarding furnishing of "prescribed particulars" therein. In addition to such certificate issued by the foreign Government, the assessee would be required to provide such other documents and information, as may be prescribed, for claiming the treaty benefits.*
- (vii) The charge of tax at a higher rate for a company incorporated in the specified territory outside India as compared to a domestic company would not be considered as less favourable charge or levy of tax in respect of such company.
- (viii) For the purpose of this section, the 'specified association' means any institution, association or body, whether incorporated or not, functioning under any law for the time being in force in India or the laws of the specified territory outside India and which may be notified as such by the Central Government and 'specified territory' means any area outside India which may be notified by the Central Government.

15.3.3 Countries with which no agreement exists – Unilateral Agreements

[Section 91]: In the case of income arising to an assessee in countries with which India does not have any double taxation agreement, relief would be granted under Section 91 provided all the following conditions are fulfilled:

- (a) The assessee is a resident in India during the previous year in respect of which the income is taxable.
- (b) The income accrues or arises to him outside India.
- (c) The income is not deemed to accrue or arise in India during the previous year.
- (d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee.
- (e) The assessee has paid tax on the income in the foreign country.
- (f) There is no agreement for relief from double taxation between India and the other country where the income has accrued or arisen.

In such a case, the assessee shall be entitled to a deduction from the Indian income-tax payable by him. The deduction would be a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax in the said country, whichever is lower, or at the Indian rate of tax if both the rates are equal.

Sub-section (2) provides that where a person who is resident in India in any previous year has any agricultural income in Pakistan in respect of which he has paid the income tax payable in that country, he shall be entitled to a deduction from the Indian income-tax payable by him to

the following extent:

- (i) of the amount of tax paid in Pakistan on such income which is liable to tax under this Act, also; or
- (ii) of a sum calculated on that income at the Indian rate of tax, whichever is less.

Sub-section (3) provides for relief to a non-resident assessee in respect of his share in the income of a registered firm assessed as resident in India in any previous year, provided all the following conditions are fulfilled –

- (i) The share income from the firm should include income accruing or arising outside India during that previous year;
- (ii) Such income should not be deemed to accrue or arise in India;
- (iii) The income should accrue or arise in a country with which India has no agreement under section 90 for the relief or avoidance of double taxation;
- (iv) The assessee should have paid income-tax in respect of such income according to the law in force in that country.

In such a case, the assessee will be entitled to a deduction from the Indian income-tax payable by him. The deduction will be a sum calculated on such doubly taxed income so included, at the Indian rate of tax or the rate of tax of the said country, whichever is lower, or at the Indian rate of tax, if both the rates are equal.

15.4 Taxation of Business Process Outsourcing Units in India

The provisions containing taxation of IT-enabled business process outsourcing units are not contained in the Income-tax Act, 1961 but are given in *Circular No.5/2004 dated 28.9.2004* issued by CBDT. The provisions are briefed hereunder -

- (a) A non-resident entity may outsource certain services to a resident Indian entity. If there is no business connection between the two, the resident entity may not be a Permanent Establishment of the non-resident entity, and the resident entity would have to be assessed to income-tax as a separate entity. In such a case, the non-resident entity will not be liable under the Income-tax Act, 1961.
- (b) However, it is possible that the non-resident entity may have a business connection with the resident Indian entity. In such a case, the resident Indian entity could be treated as the Permanent Establishment of the non-resident entity.
- (c) The non-resident entity or the foreign company will be liable to tax in India only if the IT enabled BPO unit in India constitutes its Permanent Establishment.
- (d) A non-resident or a foreign company is treated as having a Permanent Establishment in India if the said non-resident or foreign company carries on business in India through a branch, sales office etc. or through an agent (other than an independent agent) who habitually exercises an authority to conclude contracts or regularly delivers goods or merchandise or habitually secures orders on behalf of the non-resident principal. In such a case, the profits of the non-resident or foreign company attributable to the business activities carried out in India by the Permanent Establishment becomes taxable in India.

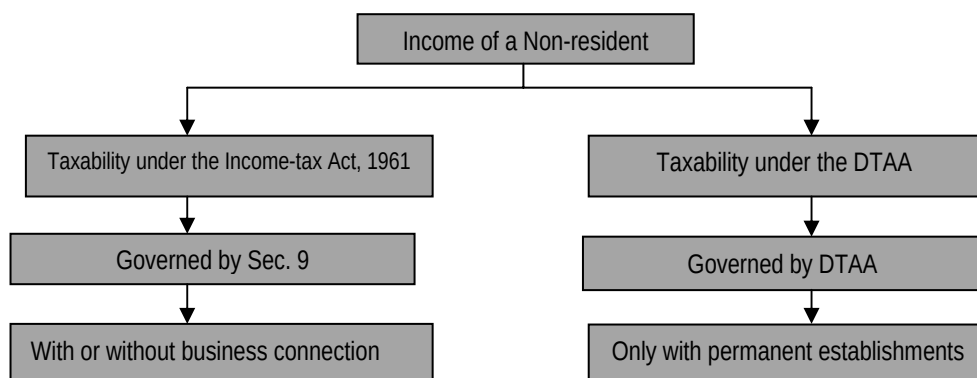
- (e) If a foreign enterprise carries on business in another country through a Permanent Establishment situated therein, the profits of the enterprise may be taxed in the other country but only so much of them as is attributable to the Permanent Establishment.
- (f) Profits are to be attributed to the Permanent Establishment as if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a Permanent Establishment.
- (g) In determining the profits of a Permanent Establishment there shall be allowed as deduction, expenses which are incurred for the purposes of the Permanent Establishment including executive and general administrative expenses so incurred, whether in the State in which the Permanent Establishment is situated or elsewhere.
- (h) The expenses that are deductible would have to be determined in accordance with the accepted principles of accountancy and the provisions of the Income-tax Act, 1961.
- (i) The profits to be attributed to a Permanent Establishment are those which that Permanent Establishment would have made if, instead of dealing with its Head Office, it had been dealing with an entirely separate enterprise under conditions and at prices prevailing in the ordinary market. This corresponds to the "arm's length principle".
- (j) Hence, in determining the profits attributable to an IT-enabled BPO unit constituting a Permanent Establishment, it will be necessary to determine the price of the services rendered by the Permanent Establishment to the Head office or by the Head office to the Permanent Establishment on the basis of "arm's length principle".

15.5 Concept of Permanent Establishment

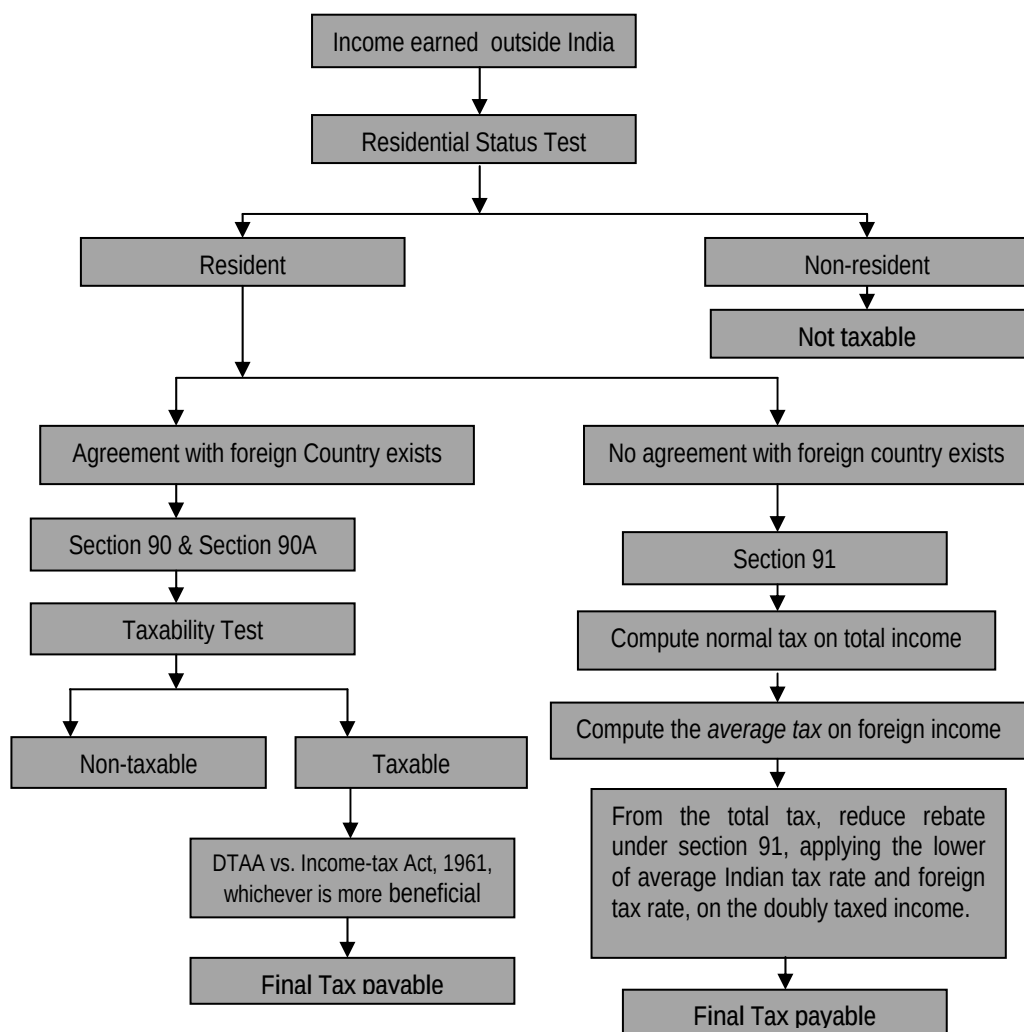
In order to determine the taxability of business income of foreign enterprises operating in India, it is important to determine the existence of a Permanent Establishment ('PE'). Article 5(1) of the DTAA provides that for the purpose of this convention the term 'Permanent Establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on. The term 'Enterprise' has been defined in section 92F(iii) [See discussion under section 92A in Chapter 16].

According to Article 5(2), which enumerates various instances of PE, the term PE includes (a) a place of management; (b) a branch; (c) an office; (d) a factory; (e) a workshop; (f) a sales outlet; (g) a warehouse; (h) a mine, an oil or gas well, a quarry or other place of extraction of natural resources (but not exploration).

- (1) Permanent establishment means a fixed place of business through which the business of an enterprises is wholly or partly carried on.
- (2) Every DTAA has a specific clause, which will deal with an explanation of permanent establishment for the purpose of such DTAA.
- (3) Business Income of a non resident will not be taxed in India, unless such non-resident has a permanent establishment in India.
- (4) Taxability of income under business connection and permanent establishment is explained here below :



15.6 Taxing Foreign Income



15.7 Meaning of Important Terms

- (i) "Indian rate of tax" means the rate determined by dividing the amount of Indian income-tax after deduction of any relief due under the provisions of the Act but before deduction of any double taxation relief due to the assessee.
- (ii) "Rate of tax of the said country" means income-tax and super-tax actually paid in that country in accordance with the corresponding laws in force in the said country after deduction of all relief due, but before deduction on account of double taxation relief due in the said country, divided by the whole amount of income assessed in the said country.
- (iii) The expression "income-tax" in relation to any country includes any excess profits tax or business profits tax charged on the profits by the Government of any part of that country or a local authority in that country.

Transfer Pricing and Other Provisions to Check Avoidance of Tax

In the present age of commercial globalisation, it is a universal phenomena that Multinational Companies (MNCs) have branches/subsidiaries/divisions operating in more than one country. In such a situation, it is a common event for MNCs to transfer goods produced by a branch in one tax jurisdiction to an associate branch operating in another tax jurisdiction. While doing so, the MNC concerned has in mind the goal of minimizing tax burden and maximizing profits but the two tax jurisdictions/countries have also the consideration of maximizing their revenue while making laws that govern such transactions. It is an internationally accepted practice that such 'transfer pricing' should be governed by the Arm's Length Principle (ALP) and the transfer price should be the price applicable in case of a transaction of arm's length. In other words, the transaction between associates should be priced in the same way as a transaction between independent enterprises.

The principles governing the taxation of MNCs are embodied in the OECD Model Tax Convention of Income and Capital (OECD Model Convention), which serves as the basis for the bilateral income-tax treaties between OECD member countries and between OECD member and non-OECD member countries. According to these guidelines, "Transfer prices" are the prices at which an enterprise transfers physical goods and intangible property or provides services to associated enterprises. Two enterprises are "associated enterprises" if one of the enterprises participates directly or indirectly in the management, control or capital of the other or if both enterprises are under common control. Since international transfer pricing involves more than one tax jurisdiction, any adjustment to the transfer price in one jurisdiction requires a corresponding adjustment in the other jurisdiction. If a corresponding adjustment is not made, double taxation will result.

16.1 Meaning of the term "Arm's Length Principle"

The Arm's Length Price of a transaction between two associated enterprises is the price that would be paid if the transaction had taken place between two comparable independent and unrelated parties, where the consideration is only commercial.

The Arm's Length Principle (ALP), in the context of taxation, is explained in the OECD Model Tax Convention as under:

"Where conditions are made or imposed between two associated enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued

to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.”

The OECD transfer pricing guidelines provides guidance on the application of the arm's length principle in order to arrive at the proper transfer pricing range between associated enterprises. Market forces determine business relations between independent parties. The Arm's length principle seeks to adjust the profits between two associated enterprises by comparing the same as if the transaction is carried out between two independent enterprises. It treats each enterprise as a separate independent entity rather than as inseparable parts of a single unified business.

16.2 Significance of Arm's Length Principle

There are several reasons as to why the OECD member countries and other countries have adopted the ALP.

Parity between MNCs and independent enterprises – A major reason is that the ALP provides broad parity of tax treatment for MNCs and independent enterprises. Since the ALP puts associated and independent enterprises on a more equal footing for tax purposes, it avoids the creation of tax advantages and disadvantages that would otherwise distort the relative competitive positions of these entities. The ALP, thus promotes the growth of international trade and investment by removing these tax considerations from economic decisions.

Determines real taxable profits - The transfer price adopted by a multinational has a direct bearing on the proportional profit it derives in each country in which it operates. If inadequate or excessive consideration is paid for the transfer of goods, services or intangible property between the members of an MNC group, the income calculated for each of those members will be inconsistent with their relative economic contributions. An 'arm's length' price – a price two independent firms operating at arm's length would agree on – is needed to determine taxable profits earned in each country. The arm's length doctrine permits the taxing authorities to rectify the accounts of the enterprise so as to reflect correctly the income that the establishment would have earned if it were an independent enterprise.

Reduction of artificial price distortion - If the ALP is not followed, an MNC will sell goods/provide services to a controlled entity in a high tax regime at a high price (which exceeds the market price) and to an entity in a low-tax regime or a tax haven at a low price (which is lower than the market price). This would result in extreme price distortion of goods and services in the international market.

Minimization of double taxation – The ALP is an international concept and it represents the international norm. The potential for double taxation is minimized, since in international transfer pricing, adjustment to the transfer price in one tax jurisdiction requires a corresponding adjustment in the other tax jurisdiction.

Accurate measurement of economic contribution – The ALP provides accurate measurement of the fair market value of the economic contribution units of an MNC. The focus of the ALP is to ensure that the proper amount of income is attributed to where it is earned.

This results in each unit of the MNC earning a return commensurate with its economic contribution and risk assumed.

16.3 Practical difficulties in application of ALP

There are however, certain practical difficulties in applying the ALP, which are described hereunder:

True comparison difficult in certain cases – The commercial and financial conditions governing a transaction between independent enterprises are, by and large, never similar to those existing between associated enterprises. As a result, there cannot be a true comparison. The economies of scale and integration of various business activities of the associated enterprise may not be truly appreciated by arm's length principle. Further, associated enterprises may enter into transactions which independent enterprises may not enter into, like say, licensing of valuable intangible or sharing the benefits of research. The owner of an intangible may be hesitant to enter into licensing arrangements with independent enterprises for fear of the value of the intangible being degraded. In contrast, he may be prepared to offer terms that are less restrictive to associated enterprises because the use of the intangible can be closely monitored. Further, there is no risk to the overall group's profit from a transaction of this kind between members of an MNC group. In such situations, where independent enterprises seldom undertake transactions of the type entered into by associated enterprises, the ALP is difficult to apply because there is little or no direct evidence of what conditions would have been established by independent enterprises.

Availability of data and reliability of available data – There may be difficulty in getting adequate and reliable information and data in order to apply arm's length principle. The comparison of controlled and uncontrolled transactions between associated and independent enterprises usually requires a large quantum of data. Easily accessible information may be incomplete and difficult to interpret while the relevant and required information may be difficult to obtain due to geographical constraints or secrecy and confidentiality aspects. In other cases, information about an independent enterprise which could be relevant may not exist at all. Due to these difficulties, the tax administration and tax payers may have to exercise reason and judgment when applying the ALP.

Absence of market price - There must be a reasonably reliable and comparable uncontrolled market price. The ALP does not meet this condition because of the nature of the market place. A market price is an outcome of unique negotiations. It may be possible to know the price range, but it is very difficult to know the actual market price unless a market transaction actually takes place.

Absence of comparable market price for "intangible" transactions - The ALP reaches a comparable uncontrolled market price that is reasonably reliable for standard transactions where the price range is narrow and market price is certain. However, the ALP generally fails to achieve a comparable market price for transactions involving intangibles because they are unique. The unique nature of these transactions creates a very wide price range.

Administrative burden - In certain cases, the arm's length principle may result in an administrative burden for both the taxpayer and the tax administrations of evaluating significant numbers and types of cross-border transactions.

Time lag - Although an associated enterprise normally establishes the conditions for a transaction at the time it is undertaken, at some point the enterprise may be required to demonstrate that these are consistent with the arm's length principle. The tax administration may also have to engage in the verification process perhaps some years after the transactions have taken place. It may result in substantial cost being incurred by the tax payer and the tax administration. It is also difficult to appreciate the business realities which prevailed at the time when the transactions were entered into. This may lead to bias against the tax payer.

In spite of the practical difficulties listed above, OECD member countries are of the view that the ALP does provide a sound basis to appreciate the transfer pricing between associated enterprises. It has so far provided acceptable solutions to both taxpayers and the tax administrations. The experience gained so far should be effectively used to remove the practical difficulties and improve the administration.

16.4 The Indian Scenario

16.4.1 Transfer pricing in relation to International Transactions: In order to provide a statutory framework empowering the tax authorities to determine reasonable, fair and equitable profits and tax in respect of cross-border transactions, sections 92 to 92F had been included in Chapter X of the Income-tax Act, 1961, through the Finance Act, 2001, providing for a transfer pricing mechanism based on computation of income from cross-border transactions. The following conditions must be satisfied in order to attract the special provisions of Chapter X relating to avoidance of tax:

- (i) There must be an international transaction;
- (ii) Such international transaction should be between two or more associated enterprises either or both of whom are non-residents;
- (iii) Such international transaction should be in the nature of:
 - (a) purchase, sale or lease of tangible or intangible property; or
 - (b) provision of service; or
 - (c) lending or borrowing money; or
 - (d) any other transaction having a bearing on the profits, income, losses or assets of such enterprise
- (iv) Further, such transaction may also involve allocation or apportionment of, or any contribution to any cost or expenses incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of the associated enterprises on the basis of mutual agreement or arrangement between such associated enterprises.

(v) Such international transaction must be done at arm's length price and if such international transaction has been done at less than the arm's length price, it shall require determination of income or apportionment of cost or expense on the basis of arm's length price.

(vi) The above adjustment should either result in an increase of income or decrease of loss returned by the assessee. In other words, the adjustment should not have the effect of reducing the income chargeable to tax or increasing the loss.

The Finance Act, 2001, has introduced provisions relating to pricing of international transaction between the assessee and associated enterprises. These provisions are contained in sections 92 to 92F of the Income-tax Act, 1961. These provisions apply to international transactions entered into with effect from 1st April, 2001. Rules 10A to 10E have been inserted in the Income-tax Rules, 1962 by a notification dated 21st August, 2001. These sections and rules of the Income-tax Act, 1961 and the Income-tax Rules, 1962 respectively, will affect all non-corporate and corporate assesseees who have dealings with non-residents for import or export of goods, properties or services. In other words, price paid for import of goods, properties or services and price received for export of goods, properties or services will now be subject to scrutiny by the Assessing Officer. Therefore, it is necessary to make a detailed study of these provisions. All assesseees who have such dealings with non-residents will have to keep detailed records as prescribed under the Rules and will have to furnish audit report every year with the return of income about their international transactions.

The presence of multinational enterprises in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions prompted the Government to set up an Expert Group to examine the issues relating to transfer pricing. There is a possibility that two or more entities belonging to the same multinational group can fix up their prices for goods and services and allocate profits among the enterprises within the group in such a way that there may be either no profit or negligible profit in the jurisdiction which taxes such profits and substantial profit in the jurisdiction which is tax haven or where the tax liability is minimum. This may adversely affect a country's share of due revenue. The increasing participation of multinational groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. The profits derived by such enterprises carrying on business in India can be controlled by the multinational group, by manipulating the prices charged and paid in such intra-group transactions, which may lead to erosion of tax revenue. Therefore, transfer pricing provisions have been brought in by the Finance Act, 2001 with a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multinational enterprises.

16.4.1.1 Computation of income from transaction with non-resident [Section 92]:

Section 92 provides that any income arising from an "international transaction" shall be computed having regard to "the arm's length price". For this purpose the allowance for any expense or interest shall be determined on the basis of arm's length price. The section further provides that in an international transaction between two or more 'associated enterprises' when there is a mutual agreement or arrangement for the allocation or apportionment of, or any contribution to, any cost or expenses in connection with a benefit, service or facility provided to any one or more of such

enterprises, the allocation of cost, expenses etc. shall be determined having regard to arm's length price of such benefit, service or facility. Similarly, the price received for exports and amounts received for services rendered to associated enterprise will be determined on the basis of arm's length price. It will be noticed that in the international transaction, the income or expense will have to be at arm's length price if the transaction is between associated enterprises.

While determining Arm's Length Price under the provisions of transfer pricing regulations, if the income works out to a figure lower than the income shown in the books of accounts, the provision of transfer pricing regulations will not apply.

The Assessing Officer will have wide powers to determine what is an arm's length price for such transactions and make adjustments for computation of income. The keywords in section 92 are (i) associated enterprises, (ii) international transactions and (iii) arm's length price. These terms are defined in sections 92A, 92B and 92C.

16.4.1.2 Associated Enterprises [Section 92A]: The term "associated enterprise" in relation to another enterprise is defined in section 92A(1). It means an enterprise -

- (a) which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or
- (b) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control of the other enterprise.

Section 92A(2) provides that two enterprises shall be deemed to be associated enterprises for the purposes of sub-section(1) if, at any time during the previous year -

- (i) one enterprise holds, directly or indirectly, shares carrying not less than twenty six per cent of the voting power in the other enterprise; or
- (ii) any person or enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in each of such enterprises; or
- (iii) a loan advanced by one enterprise to the other enterprise constitutes not less than fifty one per cent of the book value of the total assets of the other enterprise; or
- (iv) one enterprise guarantees not less than ten per cent of the total borrowing of the other enterprise; or
- (v) more than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise; or
- (vi) more than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two enterprises are appointed by the same person or persons; or
- (vii) the manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of know-how, patent, copyrights, trademarks,

licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights; or

- (viii) ninety per cent, or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise are supplied by the other enterprise, or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise; or
- (ix) the goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise; or
- (x) where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual; or
- (xi) where one enterprise is controlled by a Hindu undivided family, the other enterprise is controlled by a member of such Hindu undivided family, or by a relative of a member of such Hindu undivided family, or jointly by such member and his relative; or
- (xii) where one enterprise is a firm, association of persons or body of individuals, the other enterprise holds not less than ten per cent interest in such firm, association of persons or body of individuals; or
- (xiii) there exists between the two enterprises, any relationship of mutual interest, as may be prescribed. It may be noted that the Rules 10A to 10E do not refer to any relationship of mutual interest.

Section 92A(1) lays down the circumstances when two enterprises can be considered as associated enterprises. The mere fact of participation by one enterprise in the management, control or capital of the other enterprise, or participation by one or more persons in the management, control or capital of both the enterprises is not sufficient unless the tests laid down in section 92A(2) are fulfilled. In other words, the deeming tests contained in section 92A(2) are exhaustive and should be applied to determine the association between two or more enterprises

- ◆ **Enterprise** : The term “enterprise” is defined in section 92F to mean a person (including its certain specified Permanent Establishment) who is, or has been, or is proposed to be, engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or know-how, patents, copy rights, trade-marks, licences, franchises or any other business or commercial rights of similar nature or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights, or the provision of services of any kind, or in carrying out any work in pursuance of a contract, or in investment, or providing loan or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate, whether such activity or business is carried on, directly or through one or more of its units or divisions or

subsidiaries, or whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or places.

“Permanent establishment” includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

16.4.1.3 Definition of International Transaction [Section 92B]

- (1) Section 92B defines the term “international transaction” to mean a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises. It shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expenses incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.
- (2) Sub-section (2) provides for circumstances where, even a transaction with an enterprise which is not an associated enterprise as defined above, may be construed as transaction with an associated enterprise. It provides that a transaction entered into by an enterprise with a person other than an associated enterprise shall be deemed to be a transaction entered into between two associated enterprises, if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise; or the terms of the relevant transaction are determined in substance between such other person and the associated enterprise.
- (3) The scope of “international transaction” shall include:

	Transactions	Amplification of scope of terms used
(1)	Purchase, sale, transfer, lease or use of tangible property	Tangible property includes - • building, • transportation vehicle, • machinery, equipment, tools, plant, • furniture, • commodity or • any other article, product or thing;
(2)	Purchase, sale, transfer, lease or use of intangible property, including transfer of ownership or the provision of use of certain rights	“Use of certain rights” refer to – • land use, • copyrights, patents, trademarks, licences, franchises, • customer list, marketing channel, brand, commercial secret, • know-how, • industrial property right,

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		• exterior design or practical and new design or • any other business or commercial rights of similar nature.
(3)	Capital financing	• any type of long-term or short-term borrowing, • lending or guarantee, • purchase or sale of marketable securities or • any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business.
(4)	Provision of services	• provision of market research, • market development, • marketing management, • administration, • technical service, • repairs, • design, • consultation, • agency, • scientific research, • legal or accounting service.
(5)	Business restructuring or reorganization entered into by an enterprise with an associated enterprise	All such transactions are included in the definition of "international transaction", whether or not it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date.

(4) The expression "intangible property" shall include:

	Type of intangible asset in relation to	Examples of each type of intangible asset
(1)	Marketing	• Trademarks • trade names • brand names • logos
(2)	Technology	• Process patents • patent applications • technical documentation such as laboratory notebooks • technical know-how

(3)	Artistic	• literary works and copyrights • musical compositions • copyrights • maps • engravings
(4)	Data processing	• proprietary computer software • software copyrights • automated databases • integrated circuit masks and masters
(5)	Engineering	• industrial design • product patents • trade secrets • engineering drawing and schematics • blueprints • proprietary documentation
(6)	Customer	• customer lists • customer contracts • customer relationship • open purchase orders
(7)	Contract	• favourable supplier • contracts, • licence agreements • franchise agreements • non-compete agreements
(8)	Human	• trained and organised work force • employment agreements • union contracts
(9)	Location	• leasehold interest • mineral exploitation rights • easements • air rights • water rights
(10)	Goodwill	• institutional goodwill • professional practice goodwill • personal goodwill of professional • celebrity goodwill • general business going concern value

(11)	methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, or technical data;
(12)	any other similar item that derives its value from its intellectual content rather than its physical attributes.

- ◆ Transaction: The word “transaction” has been defined in section 92F to include an arrangement, understanding or action in consent
 - (i) Whether or not such arrangement, understanding or action is formal or in writing; or
 - (ii) Whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings.”

It may be noted that one of the parties to the international transaction should be a non-resident. Therefore, transactions between a resident assessee (“A” Ltd.) and its foreign branches or between its two or more foreign branches will not be considered as international transactions. This is for the reason that when “A” Ltd. is a resident in India, all its foreign branches will be deemed to be resident in India and transactions between Head Office and branches or between branches inter-se will be considered as transactions between residents. Even otherwise there can be no avoidance of income in the transactions between Indian Head Office and foreign branches.

On the other hand, if an Indian branch of a foreign company (“B” Ltd.) is having a transaction with the head office the same will be covered by the definition of international transaction between associated enterprises. This is because the Indian branch (permanent establishment of “B” Ltd.) will be liable to tax in India in respect of its Indian operations and, therefore, any transaction between the Indian branches of “B” Ltd. with its head office in U.K. or with any of the branches of “B” Ltd. outside India will be considered as an international transaction and it will have to establish that the transaction is at an arm’s length price. This will be the position even in respect of transactions between a parent company (“A” Ltd.) and its foreign subsidiary and, therefore, such transactions will have to comply with the provisions of transfer pricing regulations.

16.4.1.4 Arm’s Length Price [Section 92C]: “Arm’s length price” is defined in section 92F(ii) to mean price which is applied or proposed to be applied in a transaction between persons other than associated enterprises in uncontrolled conditions. Section 92C deals with the method for determining arm’s length price and the factors which are to be considered for applicability or non-applicability of a particular method to a given situation. The factors as well as methods incorporated in this section are not exhaustive and the CBDT may prescribe further factors and methods. Section 92C provides that the arm’s length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe.

- (a) comparable uncontrolled price method;
- (b) resale price method;
- (c) cost plus method;
- (d) profit split method;

- (e) transactional net margin method;
- (f) such other method as may be prescribed by the Board. Accordingly, the Board has prescribed a method which takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts. [Rule 10AB]

Out of the above, the most appropriate method shall be selected in the manner as may be prescribed by the Rules. However, if under the most appropriate method, two prices of the goods, services or intangibles are possible then the arithmetical mean of such prices shall be taken as Arm's Length Price.

Section 92C(2) provides that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such price. However, if the arithmetical mean, so determined, is within such percentage as may be notified by the Central Government in the Official Gazette in this behalf, then the transfer price shall be deemed to be the arm's length price and no adjustment is required to be made. However, the percentage to be notified by the Central Government in this regard cannot exceed 3% of the transfer price.

Example

In case of sale of goods to an associated enterprise by an Indian company during the F.Y.2013-14, what would be the arm's length price in the following cases, if the rate of permissible variation prescribed by the Central Government is 3%.

Case	Transfer Price	ALP determined by applying the arithmetical mean	ALP for the Transfer Pricing Adjustment
1	100	103.1	103.1
2	100	102.9	100

Rule 10B(1) provides for determination of arm's length price under section 92C. This rule explains how the arm's length price under the five methods stated in (a) to (e) above is to be determined in respect of any goods, property or services (hereinafter referred to as "items") purchased or sold under any international transaction.

(i) Comparable Uncontrolled Price Method

- (a) Under this method the price charged or paid for any item under any comparable uncontrolled transaction or transactions should be identifiable.
- (b) Adjustment to account for differences between the international transaction and comparable uncontrolled transactions or between the enterprises entering into such transactions which could materially affect the price in the open market can be made.
- (c) The adjusted price as worked out under (b) will be considered as an arm's length price for the item.

(ii) Resale Price Method

- (a) Under this method, the price at which the item purchased by the enterprise from an associated enterprise is resold to an unrelated enterprise should be identifiable.

- (b) The following adjustments can be made to such resale price.
- ◆ For normal gross profit margin
 - ◆ For expenses incurred in connection with the purchase of the item.
 - ◆ For functional and other differences, including differences in accounting practices which could affect the gross profit margin in the open market.
- (c) The adjusted price as stated in (b) above will be considered as the arm's length price for the item.
- (iii) Cost Plus Method
- (a) Under this method, the direct and indirect costs of production incurred by the enterprise for the item should be determined.
- (b) The amount of a normal gross profit mark-up to such costs arising from the same or similar item or by an unrelated enterprise in comparable uncontrolled transaction should be determined.
- (c) The above normal gross profit mark-up can be adjusted to take into account the functional and other differences which could materially affect such profit mark-up in the open market.
- (d) Costs referred to in (a) above should be increased by the adjusted profit mark-up as stated in (c) above and the price so arrived at will be considered as an arm's length price of the item.
- (iv) Profit Split Method
- (a) This is a method which may be applicable mainly in international transactions involving transfer of unique intangibles or in multiple international transactions which are so inter-related that they cannot be evaluated separately for the purpose of determining the arm's length price of one transaction.
- (b) Under this method, combined net profit of the associated enterprises arising from the international transactions in which they are engaged is first determined.
- (c) The relative contribution of each associated enterprise to the earning of such combined net profit is then evaluated on the basis of the functions performed, assets employed and risks assumed by each enterprise. This evaluation is to be made on the basis of reliable external market data which can indicate how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances.
- (d) The combined net profit is then split amongst the enterprises in proportion to their relative contributions. The profit thus apportioned to the assessee is taken into consideration to arrive at an arm's length price in relation to the international transaction.
- (e) In certain cases the combined net profit referred to in (b) above may, in the first instance, be partially allocated to each enterprise so as to provide it with a basic return appropriate for the type of international transaction in which it is engaged. This has to be determined with reference to market returns achieved for similar types of transactions by independent enterprises. Thereafter, the residual net profit remaining after such allocation may be split amongst the enterprises as stated in (c) and (d) above. In such a case the aggregate of net

profit allocated in the first instance together with the residual profit allocated should be considered for arriving at the arm's length price of the international transaction.

(v) Transactional Net Margin Method

- (a) In this method, the net profit margin realised by the enterprise from an international transaction with an associated enterprise is computed having regard to costs incurred or sales effected or assets employed or having regard to any other relevant base.
- (b) The net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction by applying the same base as in (a) above is computed. This profit margin is adjusted to take into account the differences which could materially affect the net profit margin in the open market having regard to international transaction and comparable uncontrolled transactions or having regard to the enterprise entering into such transactions.
- (c) If the net profit margin realised by the enterprise as in (a) above is established to be the same as the net profit margin as in (b) above, then the same is taken into consideration to arrive at an arm's length price in relation to the international transaction.

For applying the above methods, the comparability of the international transaction with an uncontrolled transaction is to be judged with reference to the following factors:

- (i) The specific characteristics of the property transferred or services provided in either transaction;
- (ii) The functions performed, taking into account assets employer or to be employer and the risks assumed, by the respective parties to the transactions;
- (iii) The contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;
- (iv) Conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

Rule 10B also provides that an uncontrolled transaction shall be comparable to an international transaction if none of the differences between the transactions being comparable or the enterprises entering into such transactions is likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market or reasonably accurate adjustments can be made to eliminate the material effects of such differences. Further, the data to be used for the above comparison should relate to the financial year in which the international transaction has been entered into. It is also provided that similar data relating to earlier two years can also be used for the comparison if such data is relevant for the purpose.

- ◆ **Determination of the most appropriate method:** Rule 10C deals with the determination of most appropriate method. Under this Rule, the method which is best suited to the facts and circumstances and which provides the most reliable measure of

an arm's length price in relation to the international transaction will be considered to be the most appropriate method.

For the purpose of selecting the most appropriate method, the following factors should be taken into account.

- (i) The nature and class of the international transaction;
- (ii) The class, or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;
- (iii) The availability, coverage and reliability of data necessary for application of the method;
- (iv) The degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions;
- (v) The extent to which reliable and accurate adjustments can be made to account for difference, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions;
- (vi) The nature, extent and reliability of assumptions required to be made in application of a method.

16.4.1.5 Reference to Transfer Pricing Officer [Section 92CA] :This section provides for a procedure for reference to a Transfer Pricing Officer (TPO) of any issue relating to computation of arm's length price in an international transaction. The procedure is as under -

- (1) The option to make reference to TPO is given to the Assessing Officer. He may make this reference if he considers it necessary or expedient to do so. This option is not available to the assessee.
- (2) The Assessing Officer has to take the approval of the CIT before making such a reference.
- (3) Any Joint /Deputy/Assistant Commissioner of Income Tax, authorised by CBDT, can be appointed as TPO.
- (4) When such reference is made, TPO can call upon the assessee to produce evidence in support of the computation of arm's length price made by him.
- (5) The TPO can also determine the ALP of other international transactions identified subsequently in the course of proceedings before him [Sub-section (2A)].
- (6) Where in respect of an international transaction, the assessee has not furnished the report under section 92E and such transaction comes to the notice of the TPO during the course of proceeding before him, the transfer pricing provisions shall apply as if such transaction is referred to the TPO by the Assessing Officer under section 92CA(1) [Sub-section (2B) inserted retrospectively w.e.f. 01.06.2002].
- (7) Further, the retrospective insertion of sub-section (2B) shall not empower the Assessing Officer either to assess or reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year for which the proceedings have been completed before 1st July, 2012. Therefore, the power given to the TPO under sub-

section (2B) to determine arm's length price in respect of the transaction not reported by the assessee, can be exercised only in respect of the cases pending before the Assessing Officer and completed assessments cannot be reopened by exercising such power [Sub-section (2C)]

- (8) The TPO has to pass an order determining the arm's length price after considering the evidence, documents, etc. produced by the assessee and after considering the material gathered by him. He has to send a copy of his order to Assessing Officer as well as the assessee.
- (9) The order of the Transfer Pricing Officer determining the arm's length price of an international transaction is now binding on the Assessing Officer and the Assessing Officer shall proceed to compute the total income in conformity with the arm's length price determined by the Transfer Pricing Officer [Sub-section (4)].
- (10) In order to provide sufficient time to the Assessing Officer to complete the assessment in a case where reference is made to the Transfer Pricing Officer, sub-section (3A) has been inserted in section 92CA to provide for determination of arm's length price of international transactions by the Transfer Pricing Officer at least 60 days before the expiry of the time limit under section 153 or section 153B for making an order of assessment by the Assessing Officer. This provision would apply in a case where reference is made on or after 1.6.2007 or in a case where reference is made before that date but the order of the Transfer Pricing Officer is pending on that date [Sub-section (3A)].
- (11) The TPO has power to rectify his order under section 154 if any mistake apparent from the record is noticed. If such rectification is made, the Assessing Officer has to rectify the assessment order to bring it in conformity with the same.
- (12) The TPO can exercise all or any of the powers specified in clause (a) to (d) of section 131(1) or section 133(6) or section 133A for determination of arm's length price once the above reference is made to him.

16.4.1.6 Safe Harbour Rules for determination of arm's length price in case of international transactions [Section 92CB]

- (i) Section 92C provides for adjustment in the transfer price of an international transaction with an associated enterprise if the transfer price is not equal to the arm's length price. This has resulted in a large number of such transactions being subjected to adjustment giving rise to considerable dispute.
- (ii) Therefore, section 92CB has been introduced to empower the CBDT to formulate safe harbour rules to determine the arm's length price under section 92C and 92CA. Safe harbour means circumstances in which the income-tax authorities shall accept the transfer price declared by the assessee.

16.4.1.7 Introduction of Advance Pricing Agreements [Sections 92CC & 92CD]

- (i) An Advance Pricing Agreement (APA) is an agreement between a taxpayer and a taxing authority on an appropriate transfer pricing methodology for a set of transactions over a

fixed period of time in future. They offer better assurance on transfer pricing methods and provide certainty and unanimity of approach.

- (ii) Keeping in mind the benefits offered by the APAs, sections 92CC and section 92CD have been introduced in the transfer pricing regime to provide a framework for formulation of APAs between the tax payer and the income-tax authorities.
- (iii) Section 92CC enables the Board (with the approval of the Central Government), to enter into an APA with any person undertaking an international transaction.
 - (1) The APA shall relate to an international transaction to be entered into by such person. The APA shall be entered into for the purpose of determination of the arm's length price or specifying the manner in which arm's length price shall be determined, in relation to such international transaction.
 - (2) The manner for determination of arm's length price referred above may include methods referred to in section 92C(1) or any other method with necessary adjustments or variations.
 - (3) In case an APA has been entered into in respect of any international transaction, the arm's length price in relation to that transaction shall be determined in accordance with that APA notwithstanding any contrary provisions contained in section 92C or section 92CA i.e., the provisions of the APA shall apply overriding the provisions of section 92C or section 92CA, which are normally applicable for determination of arm's length price.
 - (4) The APA shall be valid for such period as specified in the agreement, which shall in no case exceed five consecutive previous years.
 - (5) The APA so entered into shall be binding on:
 - (a) the person in whose case, and in respect of the transaction in relation to which, the APA has been entered into; and
 - (b) the Commissioner and the income-tax authorities subordinate to him, in respect of the said person and the said transaction.
 - (6) The APA shall not be binding if there is any change in law or facts having bearing on such APA.
 - (7) In case the Board finds that the APA so entered into has been obtained by the person by way of fraud or misrepresentation of facts, the Board is empowered to pass an order declaring any such APA to be void ab initio, with the approval of Central Government.
 - (8) As a result of declaration of an APA as void ab initio:
 - (a) all the provisions of the Act shall apply to such person as if such APA had never been entered into.
 - (b) The period beginning with the date of such APA and ending on the date of order declaring the APA as void ab initio, shall be excluded for the purpose of computation of any period of limitation under this Act (for example period of limitation specified in the section 153, 153B etc). This is irrespective of anything contained in any other provision of the Act.

- (c) In case the period of limitation after exclusion of the above mentioned period is less than 60 days, such remaining period of limitation shall be extended to 60 days.
- (9) The Board is empowered to prescribe a scheme specifying the manner, form, procedure and any other matter generally in respect of the APA.
- (10) If an application is made by a person for entering into an APA, then, the proceeding, in respect of such person for the purpose of this Act, shall be deemed to be pending.
- (iv) Section 92CD provides for the following procedure for giving effect to an APA -
 - (1) In case a person has entered into an APA and prior to the date of entering into such APA, he has furnished the return of income under the provisions of section 139 in respect of any assessment year relevant to a previous year to which the APA applies, then, such person shall, within a period of three months from the end of the month in which the said agreement was entered into, furnish a modified return, notwithstanding any contrary provision contained in section 139.
 - (2) Such modified return shall be in accordance with and limited to the provisions of such APA i.e., modifications can only be made on account of such APA in the return to be filed.
 - (3) All other provisions of this Act shall apply as if the modified return is a return furnished under section 139, unless anything to the contrary is provided in this section.
 - (4) If the assessment or reassessment proceedings for an assessment year relevant to a previous year to which the APA applies have been completed before the expiry of period allowed for furnishing of modified return, the Assessing Officer shall, in a case where modified return is filed in accordance with the provisions of this section, proceed to assess or reassess or re-compute the total income of the relevant assessment year having regard to and in accordance with the APA.

Such order for assessment or reassessment or re-computation of total income shall be passed within a period of 1 year from the end of the financial year in which the modified return was furnished. This shall apply notwithstanding the period of limitation contained under section 153 or 153B or 144C.

The appeal against such order shall lie to Commissioner (Appeals) [Section 246A]

- (5) The assessment or reassessment proceedings for an assessment year shall be deemed to have been completed where -
 - (i) an assessment or reassessment order has been passed; or
 - (ii) no notice has been issued under section 143(2) till the expiry of the limitation period provided under the said section.
- (6) Where the assessment or reassessment proceedings for an assessment year relevant to the previous year to which the APA applies, are pending on the date of filing of modified return, the Assessing Officer shall proceed to complete the assessment or reassessment proceedings in accordance with the APA taking into consideration the modified return so furnished.

In this case, the time period of completion of pending assessment or reassessment mentioned under section 153 or 153B or 144C shall be extended by 12 months. This shall apply notwithstanding the period of limitation contained under section 153 or 153B or 144C.

Advance Pricing Agreement Scheme for the purpose of section 92CC prescribed [Notification No.36/2012 dated 30.8.2012]: Section 92CC(9) empowers the CBDT to prescribe a scheme, specifying the manner, form, procedure and any other matter generally in respect of the advance pricing agreement.

Accordingly, in exercise of the powers conferred in section 92CC(9) read with section 295 of the Income-tax Act, 1961, the CBDT has prescribed rules specifying an Advance Pricing Agreement (APA) Scheme. Some of the important provisions of the scheme are briefed hereunder -

- (1) Persons eligible to apply: Any person who has undertaken an international transaction or is contemplating to undertake an international transaction, shall be eligible to enter into an agreement under these rules.
- (2) Pre-filing Consultation
 - (a) Every person proposing to enter into an agreement under these rules shall, by an application in writing, make a request for a pre-filing consultation in the prescribed form to the Director General of Income-tax (International Taxation).
 - (b) The pre-filing consultation shall, among other things,-
 - (i) determine the scope of the agreement;
 - (ii) identify transfer pricing issues;
 - (iii) determine the suitability of international transaction for the agreement;
 - (iv) discuss broad terms of the agreement.
 - (c) The pre-filing consultation shall -
 - (i) not bind the Board or the person to enter into an agreement or initiate the agreement process;
 - (ii) not be deemed to mean that the person has applied for entering into an agreement.
- (3) Application for advance pricing agreement
 - (a) Any person, who has entered into a pre-filing consultation may, if desires to enter into an agreement shall furnish an application in the prescribed form along with proof of payment of requisite fee as specified, to the Director General of Income-tax (International Taxation) in case of unilateral agreement and to the competent authority in India in case of bilateral or multilateral agreement.
 - (b) The application may be filed at any time -
 - (i) before the first day of the previous year relevant to the first assessment year for which the application is made, in respect of transactions which are of a continuing

nature from dealings that are already occurring; or

- (ii) *before undertaking the transaction in respect of remaining transactions.*

Note - *The applicant may withdraw the application for agreement at any time before the finalisation of the terms of the agreement.*

- (4) *The agreement shall be entered into by the Board with the applicant after its approval by the Central Government.*

(5) *Terms of the agreement*

(a) *An agreement may among other things, include -*

- (i) *the international transactions covered by the agreement;*
- (ii) *the agreed transfer pricing methodology, if any;*
- (iii) *determination of arm's length price, if any;*
- (iv) *definition of any relevant term to be used in item (ii) or (iii);*
- (v) *critical assumptions i.e., the factors and assumptions that are so critical and significant that neither party entering into an agreement will continue to be bound by the agreement, if any of the factors or assumptions is changed;*
- (vi) *the conditions, if any, other than provided in the Act or these rules.*
- (b) *The agreement shall not be binding on the Board or the assessee if there is a change in any of critical assumptions or failure to meet conditions subject to which the agreement has been entered into.*
- (c) *The binding effect of agreement shall cease only if any party has given due notice of the concerned other party or parties.*
- (d) *In case there is a change in any of the critical assumptions or failure to meet the conditions subject to which the agreement has been entered into, the agreement can be revised or cancelled, as the case may be.*

- (6) *Furnishing of Annual Compliance Report* : *The assessee shall furnish an annual compliance report in quadruplicate in the prescribed form to Director General of Income-tax (International Taxation) for each year covered in the agreement, within 30 days of the due date of filing income-tax return for that year, or within 90 days of entering into an agreement, whichever is later.*

(7) *Compliance Audit of the agreement*

- (a) *The Transfer Pricing Officer having the jurisdiction over the assessee shall carry out the compliance audit of the agreement for each of the year covered in the agreement. For this purpose, the Transfer Pricing Officer may require -*
 - (i) *the assessee to substantiate compliance with the terms of the agreement, including satisfaction of the critical assumptions, correctness of the supporting data or information and consistency of the application of the transfer pricing method;*

- (ii) *the assessee to submit any information, or document, to establish that the terms of the agreement has been complied with.*
- (b) *The compliance audit report shall be furnished by the Transfer Pricing Officer within six months from the end of the month in which the Annual Compliance Report is received by the Transfer Pricing Officer.*
- (8) *Revision of an agreement*
 - (a) *An agreement, after being entered, may be revised by the Board either suo moto or on request of the assessee or the competent authority in India or the Director General of Income-tax (International Taxation), if.-*
 - (i) *there is a change in critical assumptions or failure to meet a condition subject to which the agreement has been entered into;*
 - (ii) *there is a change in law that modifies any matter covered by the agreement but is not of the nature which renders the agreement to be non-binding ; or*
 - (iii) *there is a request from competent authority in the other country requesting revision of agreement, in case of bilateral or multilateral agreement.*
 - (b) *Except when the agreement is proposed to be revised on the request of the assessee, the agreement shall not be revised unless an opportunity of being heard has been provided to the assessee and the assessee is in agreement with the proposed revision.*
 - (c) *The revised agreement shall include the date till which the original agreement is to apply and the date from which the revised agreement is to apply.*
- (9) *Cancellation of an agreement*
 - (a) *An agreement shall be cancelled by the Board for any of the following reasons:*
 - (i) *the compliance audit has resulted in the finding of failure on the part of the assessee to comply with the terms of the agreement;*
 - (ii) *the assessee has failed to file the annual compliance report in time;*
 - (iii) *the annual compliance report furnished by the assessee contains material errors; or*
 - (iv) *the assessee is not in agreement with the revision proposed in the agreement.*
 - (b) *The Board shall give an opportunity of being heard to the assessee, before proceeding to cancel an application.*
 - (c) *The order of cancellation of the agreement shall be in writing and shall provide reasons for cancellation and for non-acceptance of assessee's submission, if any.*
 - (d) *The order of cancellation shall also specify the effective date of cancellation of the agreement, where applicable.*
 - (e) *The order under the Act, declaring the agreement as void ab initio, on account of fraud or misrepresentation of facts, shall be in writing and shall provide reason for such declaration and for non-acceptance of assessee's submission, if any.*
- (10) *Mere filing of an application for an agreement under these rules shall not prevent*

the operation of Chapter X of the Act for determination of arms' length price under that Chapter till the agreement is entered into.

- (11) *The negotiation between the competent authority in India and the competent authority in the other country or countries, in case of bilateral or multilateral agreement, shall be carried out in accordance with the provisions of the tax treaty between India and the other country or countries.*

16.4.1.8 Records to be maintained [Section 92D]: Section 92D imposes responsibility on every person who enters into an international transaction to keep and maintain such information and documents in respect thereof as may be prescribed by CBDT. The Board is empowered to prescribe the period for which the information and documents shall be kept and maintained. Further, the Assessing Officer or the Commissioner (Appeals) may, in the course of any proceedings under the Income-tax Act, require any person who has entered into an international transaction to furnish any such prescribed information or documents within a period of thirty days from the date of receipt of a notice issued in this regard. The requisition period may, on request, be extended further for a period not exceeding thirty days by the Assessing Officer or the Commissioner (Appeals).

Rule 10D(1) provides for the information and documents to be kept and maintained by the assessee. Under this Rule following information and documents have to be maintained:

- (i) A description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held therein by other enterprises;
- (ii) A profile of the multinational group of which the assessee enterprise is a part along with the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions have been entered into by the assessee, and ownership linkages among them;
- (iii) A broad description of the business of the assessee and the industry in which the assessee operates, and the business of the associated enterprises with whom the assessee has transacted;
- (iv) The nature and terms (including prices) of international transactions entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction;
- (v) A description of the functions performed, risks assumed and assets employed or to be employed by the assessee and by the associated enterprises involved in the international transactions;
- (vi) A record of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the assessee for the business as a whole and for each division or product separately, which may have a bearing on the international transactions entered into by the assessee;
- (vii) A record of uncontrolled transactions taken into account for analysing their comparability with the international transactions entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the international transactions;

- (viii) A record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction;
- (ix) A description of the methods considered for determining the arm's length price in relation to each international transaction or class of transaction, the method selected as the most appropriate method along with explanation as to why such method was so selected, and how such method was applied in each case;
- (x) A record of the actual working carried out for determining the arm's length price, including details of the comparable data and financial information used to apply the most appropriate method, and adjustments, if any, which were made to account for differences between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions;
- (xi) The assumptions, policies and price negotiations, if any, which have critically affected the determination of the arm's length price;
- (xii) Details of the adjustments, if any, made to transfer prices to align them with arm's length prices determined under the Income-tax Rules and consequent adjustment made to the total income for tax purposes;
- (xiii) Any other information, data or documents, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price.

Rule 10D(2) provides that in a case where the aggregate value of international transactions does not exceed Rs.1 crore, it will not be obligatory for the assessee to maintain the above information and documents. Considering the wording of this Rule it appears that this limit will apply with reference to the aggregate value of the international transactions with each associated enterprise and not with reference to the aggregate value of the international transactions with all associated enterprises during the financial year put together.

However, it is provided that in the above cases also the assessee will have to substantiate that the income arising from the international transactions with associated enterprises, as disclosed by the accounts, is in accordance with section 92. This will mean that, even if the aggregate value of the international transactions is less than Rs.1 crore, the assessee will have to maintain adequate records and evidence to show that the international transactions with associated enterprises are on the basis of arm's length principle.

The information to be maintained by the assessee, is to be supported by authentic documents. These documents may include the following:

- (i) Official publications, reports, studies and data bases from the Government of the country of residence of the associated enterprise, or of any other country;
- (ii) Reports of market research studies carried out and technical publications brought out by institutions of national or international repute;
- (iii) Price publications including stock exchange and commodity market quotations;
- (iv) Published accounts and financial statements relating to the business affairs of the associated enterprises;
- (v) Agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transactions similar to the international transactions;

- (vi) Letters and other correspondence documenting any terms negotiated between the assessee and the associated enterprise;
- (vii) Documents normally issued in connection with various transactions under the accounting practices followed.

It is also provided that the information and documents to be maintained should be contemporaneous and should exist latest by the date specified for getting the audit report. In the case of international transactions which continue to have effect over more than one financial year, fresh documents will not be required to be maintained for each year if there are no significant change which may affect the determination of arm's length price. The above information and documents are required to be maintained for a period of eight years from the end of the relevant assessment year.

16.4.1.9 Power of Assessing Officer: Section 92C(3) and (4) gives power to the Assessing Officer to determine the arm's length price under the following circumstances and also empowers the Assessing Officer to re-compute total income of the assessee having regard to arm's length price determined by him. It also provides that deduction under section 10AA and Chapter VI-A shall not be allowed from the additional income computed by him. For example, if the total income declared by the assessee in his return of income is, say Rs.7 lakhs and the total income computed by the Assessing Officer applying the arm's length principle is, say Rs.9 lakhs, the difference of Rs.2 lakhs will not qualify for deduction under section 10AA or Chapter VI-A.

The circumstances under which the Assessing Officer may invoke the power to determine arm's length price are as follows:

- (a) The price charged or paid in an international transaction has not been determined in accordance with section 92(1) and (2); or
- (b) Any information and documents relating to an international transaction has not been kept and maintained by the assessee in accordance with the provisions contained in section 92D(1) and the rules made in this behalf (Rule 10D); or
- (c) The information or data used in computation of the arm's length price is not reliable or correct; or
- (d) The assessee has failed to furnish within the specified time, any information or documents which he was required to furnish by a notice issued under section 92D(3).

Section 92C provides that if the total income of an associated enterprise is computed under this section on the determination of arm's length price paid to another associated enterprise, from which tax is deducted at source, the income of the other associated enterprise shall not be recomputed on this count. Therefore, if "A" Ltd. has paid royalty to "B" Ltd. (Non-Resident) @ 10% of sales and tax is deducted at source, "B" Ltd. cannot claim refund if the Assessing Officer has determined 8% as arm's length price in the case of "A" Ltd. and disallowed 2% of the royalty amount.

16.4.1.10 Audit Report [Section 92E]: Under section 92E, every person who enters into an international transaction during a previous year is required to obtain a report from a chartered accountant and furnish such report on or before the specified date on the prescribed form.

Rule 10E provides that the auditor's report shall be in Form No.3CEB. This report is in two parts. The first part requires the auditor to state that he has examined the accounts and records of the assessee relating to the international transactions entered into by the assessee during the relevant year. He has also to give his opinion whether the prescribed information and documents relating to the above transactions have been kept by the assessee. Further, he has to state that the particulars stated in the Annexure to his report are true and correct.

In the second part of the report i.e. Annexure, the particulars about the international transactions are required to be stated. Broadly stated these particulars include list of associated enterprises, particulars and description of transactions relating to purchase, sales, provisions of service, loans, advances, etc.

"Specified date" shall have the same meaning as assigned to due date in *Explanation 2* below sub-section (1) of section 139. The due date for filing of transfer pricing report under section 92E in Form 3CEB is 30th November of the assessment year.

16.4.1.11 Penalties: Stringent penalties are provided in various sections for non-compliance with the above provisions. These are as under:

Section 271(1) provides for penalty in the cases where the Assessing Officer adjusts total income by determining arm's length price.

The penalty for such concealment is minimum 100% and maximum 300% of tax on such concealed income.

The penalty provisions in respect of international transaction are broadly covered under section 271BA providing for levy of penalty of ₹ 1 lakh in cases where any person fails to furnish a report from an accountant as required by section 92E, section 271AA providing for penalty for failure to keep and maintain information and document in respect of international transaction and section 271G which provides for penalty in case of failure to furnish information or document under section 92D.

In order to provide a check on such a practice and ensure compliance with the transfer pricing regulations, section 271AA provides that, the Assessing Officer or Commissioner (Appeals) may direct the person entering into a international transaction to pay a penalty@2% of the value of the international transaction entered into by him, if the person:

- (1) fails to keep and maintain any such document and information as required by section 92D(1) and section 92D(2);
- (2) fails to report such international transaction which is required to be reported; or
- (3) maintains or furnishes any incorrect information or document.

The penalty under section 271AA shall be in addition and not in substitution of penalty under section 271BA and 271.

In all the above cases, if the assessee can show that there was reasonable cause for the failure, no penalty will be leviable.

16.4.2 Transfer pricing for Specified Domestic Transactions

- (i) Under section 40A(2), the Assessing Officer is empowered to disallow expenditure incurred between related parties to the extent the same is not reasonable. Further, under Chapter VI-A, the Assessing Officer can re-compute the income (on the basis of fair market value) of the undertaking to which profit-linked deduction is provided if there are transactions with the related parties or other undertakings of the same entity at a value that does not correspond to the market value of the goods or services. However, these sections do not provide for any particular method to determine reasonableness of expenditure or fair market value to re-compute the income of the undertaking in such related transactions.
- (ii) In *CIT vs. Glaxo SmithKline Asia (P) Ltd (2010) 195 Taxman 35*, the Supreme Court had opined that in order to reduce litigation, the Ministry of Finance should consider the applicability of the transfer pricing regulations to such related party domestic transactions. This suggestion was made after examining the complications arising in cases where fair market value is to be assigned to transactions between domestic related parties. Accordingly, the transfer pricing provisions have been made applicable to specified domestic transactions with effect from A.Y.2013-14.
- (iii) **Income from domestic related party transactions to be subject to transfer pricing [Section 92(2A)]**: Section 92 provides that any income arising from an international transaction shall be computed having regard to the arm's length price. In order to provide objectivity in determination of income from domestic related party transactions and determination of reasonableness of expenditure between related domestic parties, the provisions of section 92 have been extended to include within its ambit the specified domestic transactions. Sub-section (2A) has been inserted in section 92 to provide that, any allowance for an expenditure or interest or allocation of any cost or expense or any income in relation to the specified domestic transaction shall be computed having regard to the arm's length price. However, as per section 92(3), the provisions of this section would not apply if such allowance for expense or interest under section 92(2A) has the effect of reducing the income chargeable to tax or increasing the loss, as the case may be.
- (iv) **Meaning of "specified domestic transaction" [Section 92BA]** : Section 92BA provides the meaning of "specified domestic transaction". As per section 92BA, for the purpose of sections 92, 92C (Computation of arm's length price), 92D (Maintenance and keeping of information and documents) and 92E (Furnishing of report from an accountant), in case of an assessee the specified domestic transaction shall mean any of the following transactions, not being an international transaction, namely,-
 - (1) any expenditure in respect of which payment has been made or is to be made to a related person referred to in section 40A(2)(b);
 - (2) any transaction referred to in section 80A i.e., inter-unit transfer of goods and services by an undertaking or unit or enterprise or eligible business to other business carried on by the assessee or vice versa, for consideration not corresponding to the market value on the date of transfer;

- (3) any transfer of goods or services referred to in section 80-IA(8) i.e., inter-unit transfer of goods or services between eligible business and other business, where the consideration for transfer does not correspond with the market value of goods and services;
- (4) any business transacted between the assessee carrying on eligible business and other person as referred to section 80-IA(10);
- (5) any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of section 80-IA(8) or section 80-IA(10) are applicable; or
- (6) any other transaction as may be prescribed,
- (v) However, the above mentioned transactions shall not be treated as specified domestic transaction in case the aggregate of such transactions entered into by the assessee in the previous year does not exceed a sum of ₹ 5 crore.
- (vi) Arm's length price and income of a specified domestic transaction to be computed in the same manner as applicable to an international transaction [Sections 92 & 92C]: In order to determine the arm's length price in respect of the specified domestic transaction, the provisions of section 92 and 92C shall apply to the specified domestic transaction as they apply to the international transaction. Accordingly, the methods of computation of arm's length price for an international transaction would be applicable to a specified domestic transaction also.
- (vii) Persons entering into a specified domestic transaction to maintain information and documents and furnish report of an accountant [Section 92D & 92E] : With a view to create legally enforceable obligation on assessee entering into a specified domestic transaction to maintain proper documentation and obtain and furnish report of a Chartered Accountant on or before the specified date, the provisions of section 92D and 92E have been made applicable to a specified domestic transaction as they apply to an international transaction.
- (viii) Reference to Transfer Pricing Officer for computation of arm's length price of specified domestic transaction [Section 92CA]: According to section 92CA, where any person has entered into an international or a specified domestic transaction in any previous year, the Assessing Officer can with the previous approval of the Commissioner, if he considers necessary or expedient to do so, refer the computation of the arm's length price of such transaction to the Transfer Pricing Officer (TPO).

When such reference is made, TPO can call upon the assessee to produce evidence in support of the computation of arm's length price made by him in respect of such transaction.

The TPO has to pass an order determining the arm's length price in respect of the specified domestic transaction after considering the evidence, documents, etc. produced by the assessee and after considering the material gathered by him. He has to send a copy of his order to the Assessing Officer as well as the assessee.

However, the powers available to the TPO to determine the ALP of other international transactions identified subsequently in the course of proceedings before him, is not available in respect of other specified domestic transaction i.e., the TPO can determine the ALP in

respect of other international transaction that came to his notice subsequently during the course of proceedings but such power is not available in respect of specified domestic transaction subsequently identified.

- (ix) **Penalty provisions to apply to specified domestic transactions as they apply to an international transaction [Sections 271, 271AA, 271BA & 271G]:** The penalty provisions under section 271, 271AA, 271BA and 271G shall apply to the specified domestic transaction as they apply to an international transaction defined under section 92B.

Accordingly, the amount added or disallowed in computing total income under section 92C(4) in the case of an assessee who has entered into a specified domestic transaction shall be deemed to represent concealed income and penalty under section 271(1)(c) ranging between 100% to 300% of the amount of tax sought to be evaded would be attracted.

Failure to furnish the report under section 92E from an accountant would attract penalty of ₹ 1,00,000 under section 271BA.

In addition,

- (i) in case of failure to keep and maintain information, document as required under section 92D(1) or 92D(2); or
- (ii) failure to report such specified domestic transaction which is required to be reported; or
- (iii) maintain or furnishes incorrect information or document

penalty under section 271AA at 2% of the value of each transaction would be attracted.

Penalty@2% of value of specified domestic transaction would be attracted under section 271G for failure to furnish the prescribed information or document as required under section 92D(3) within the period of 30 days from the date of receipt of notice or the extended period not exceeding another 30 days, as the case may be.

- (x) **No adjustment to expenditure under section 40A(2) if the transaction is carried out at arm's length price:** The proviso to section 40A(2)(a) provides that no disallowance on account of any expenditure in respect of payment which has been made or is to be made to a related person, being excessive or unreasonable having regard to the fair market value, shall be made in respect of a specified domestic transaction referred to in section 92BA, if such transaction is at arm's length price i.e., no adjustment shall be made under section 40A(2) in relation to the specified domestic transaction in case the same is carried out at arm's length price even though the arm's length price so determined may be at variance with the fair market value.

The related person as mentioned in section 40A(2) includes, inter alia, a company, firm, association of persons or Hindu undivided family having a substantial interest in the business or profession of the assessee or any director, partner or member of such company, firm, association or family, or any relative of such director, partner or member. The said meaning is amended to include that the related person in relation to a company shall include any other company carrying on business or profession in which the first mentioned company has substantial interest.

- (xi) Market value to be the arm's length price of goods or services in a specified domestic transaction [Section 80A & 80-IA(8)]: As per the provisions of section 80A(6), in a case where the goods or services held for the purpose of the undertaking or unit or enterprise or eligible business are transferred to any other business carried on by the assessee or where any goods or services held for the purposes of any other business carried on by the assessee are transferred to the undertaking or unit or enterprise or eligible business, the transfer price of such goods and services shall be determined at the market value of such goods or services as on the date of transfer.

Clause (iii) of *Explanation* to section 80A(6) clarifies that "market value" in relation to any goods or services sold, supplied or acquired, means the arm's length price as defined under section 92F of such goods or services, if it is a specified domestic transaction referred to in section 92BA i.e., the aggregate value of all such transaction specified in section 92BA exceeds ₹ 5 crore.

Therefore, in case the transfer of goods and services between undertaking or unit or enterprise or eligible business and any other business of the assessee takes place at the arm's length price, such arm's length price shall be the market value for the purpose of section 80A(6), and no further adjustment would be required in respect of the same, if the transaction is a specified domestic transaction.

- (xii) Similarly, for the purpose of section 80-IA(8), the market value, in relation to any goods or services transferred between the eligible business and any other business carried on by the assessee, shall mean -

- (1) the price that such goods or services would ordinarily fetch in the open market; or
- (2) the arm's length price as defined under section 92F, where the transfer of such goods or services is a specified domestic transaction referred to in section 92BA.

- (xiii) Profit from transactions between an assessee carrying on "eligible business" and other assesseees to be determined as per arm's length price [Section 80-IA(10)]: Under section 80-IA(10), the Assessing Officer is empowered to make an adjustment while computing the profit and gains of the eligible business on the basis of the reasonable profit that can be derived from the transaction, in case the transaction between the assessee carrying on the eligible business under section 80-IA and any other person is so arranged that the transaction produces excessive profits to the eligible business.

It has now been provided that if the aforesaid arrangement between the assessee carrying on the eligible business and any other person is a specified domestic transaction referred to in section 92BA, then, the amount of profit of such transaction shall be determined having regard to arm's length price as defined under section 92F and not as per the reasonable profit from such transaction.

16.5 Transfer of Income to Non-Residents [Section 93]

Section 93 hits at transactions which are effected with a view to avoiding liability to taxation. For the purpose, the word "non-resident" also includes a person who is not-ordinarily resident. In order to attract the provisions of this section, all the following conditions must be satisfied:

- (a) There is a transfer of assets - whether movable or immovable and whether tangible or intangible.
- (b) The transfer is made by any person in India or outside irrespective of his residential status or citizenship.
- (c) The transfer is made either alone or in connection with associated operations.
- (d) The assets transferred directly yield income chargeable to tax under this Act.
- (e) The transfer of assets is effected in such a manner that the income becomes payable to a person outside India who is either a non-resident or a not ordinarily resident in India.
- (f) The transferor acquires any right by virtue of which he gets the power to enjoy the income whether immediately or in future.
- (g) The Assessing Officer is satisfied that avoidance of liability to tax in India is the purpose of the transfers.

In particular, this section deems any income of a non-resident person which, if it were the income of a resident person, would be chargeable to tax in India (in the absence of this Section), as the income of the resident person in India for all purposes of the Act provided that all the conditions stated above are satisfied. This section also covers a variety of transactions constituting a transfer including cases where assets are transferred to a non-resident person and the transferor indirectly derives income under the guise of obtaining loans or repayment of loans. If the aforesaid conditions are fulfilled, the income from the assets transferred should be treated as the income of the transferor and would accordingly be taxable in his hands. Therefore, where assets are transferred to a non-resident limited company, in consideration of shares allotted by it to the transferor, he (the transferor), will become assessable under this section in respect of the income of the company derived by it from those assets. This section will not, however, apply to cases where (i) the transfer is effected bonafide for adequate consideration and (ii) it is provided to the satisfaction of the Assessing Officer that the transfer was effected for *bonafide* commercial purpose and with no intent to avoid tax.

The income which is deemed to be that of the transferor under this section may arise either as a result of the transfer in connection with associated operations. However, in both the cases, the treatment of the income would be the same. The expression 'associated operation,' in relation to a transfer as defined in sub-section (4)(b) of the section means an operation of any kind effected by any person in relation to:

- (i) any of the assets transferred;
- (ii) any assets representing, whether directly or indirectly any of the assets transferred;
- (iii) any income arising from such assets;
- (iv) any assets representing, whether directly or indirectly, the accumulation of income arising from such assets.

In order to determine the liability of the assessee in respect of the deemed income it is immaterial if the income or benefits from the transfer (i) are actually received or not or (ii) are received or are receivable in cash or kind or (iii) are receivable directly or indirectly. For purposes of this section, a person is deemed to have the power to enjoy the income of a non-resident if:

- (i) the income, in fact, so dealt with by any person as to be calculated at some point of time to enure for the benefit of the transferor, whether in the same form of the income or otherwise;
- (ii) the receipt or accrual of the income operates to increase value of any assets held by the transferor or for his direct or indirect benefit;
- (iii) the transferor receives or is entitled to receive at any time any benefit out of the income or out of any money available for the purpose by reason of the effect or successive effects of the associated operations on that income and the assets which represent that income;
- (iv) the transferor is in a position to obtain for himself the beneficial enjoyment of the income by exercising any power of appointment or power of revocation or otherwise, whether with or without the consent of any other person, or
- (v) the transferor is able to control directly or indirectly the application of the income in any manner whatsoever.

But in determining whether a person has the power to enjoy the income due regard shall be had to the substantial result and effect of the transfer and any associated operations must be taken into consideration irrespective of the nature or form of the benefits.

However, where an assessee has been charged to tax in respect of a sum deemed to be his income under this section, the subsequent receipt of that sum by the assessee, whether as income or in any other form, shall not be liable to tax in his hands at the time of receipt.

16.6 Transactions in Securities [Section 94]

Section 94 aims at preventing avoidance of tax by an assessee by sale or purchase of securities in devices and under different circumstances. In all cases where there is a transfer of shares or securities before the due date of payment of interest whereby the transferor avoids tax or shifts the burden of tax to some other person, the income from the securities transferred shall be deemed to be that of the transferor and shall be assessable in his hands accordingly.

Bond washing transactions: Bond washing transactions, i.e. cases of sale of securities and shares cum-interest or cum-dividend would fall within the provisions of the section. Income by way of interest on securities or dividends does not accrue day by day but on a certain fixed date or on the date of declaration, as the case may be. Accordingly, the seller of securities cum-interest or shares cum-dividends, on accrual of the interest, is not assessable on the interest or dividend income on the securities or shares sold by him since that part of the consideration received would be part of the capital price realised on sale. As a result, if a person, on the eve of payment of interest, sells or otherwise transfers his securities to another and buys back or re-acquires the same after the interest income had been received by the transferor would escape tax thereon. This would amount to either total avoidance of tax or shifting the burden of tax by the transferor indirectly and transactions of this type are commonly known as bond washing transaction. In order to prevent this type of avoidance of tax by the assessee, sub-section (1) specifically provides that where the owner of any shares or securities sells or otherwise transfers them and then buys them back or otherwise re-acquires them, the interest received by the transferee shall be the income of the transferor.

Similarly, in cases where shares or securities are sold by the owner of such shares or securities or by a person having beneficial interest therein and, as a result of the sale, the transferor receives either no income or less income from the securities or shares than that which would have been received by him, had the sale not been made, then the income from such securities or shares of such year shall be deemed to be the income of the transferor. Thus, sub-section (2) applies only to cases where (i) the income accrues or falls due periodically and (ii) the income in question is of a recurring nature, though the interval of time between the two dates of accrual may not equal (e.g., dividends). However, the notional dividends specified in section 2(22) would not be covered by this section and the assessment of such fictional dividends should be made only in the hands of the person who is entitled to the same and not in the hands of the transferor.

There is however, one exception to both the above provisions given in sub-section (3). According to the exception, the provisions of sub-section (1) and (2) would not apply (i) if there has been no avoidance of tax, (ii) if the avoidance was exceptional and not systematic and there was no avoidance of income-tax by the assessee during the three years immediately preceding the previous year. It is for the assessee to prove to the satisfaction of the Assessing Officer that there had been no avoidance of tax or that the avoidance of tax is exceptional and not systematic.

Where any person carrying on business, wholly or in part, as a dealer in shares and securities, buys or acquires any security and sells back or re-transfers the same, then, the interest, received or receivable by him in respect of such securities, which is deemed to be the income of the transferor, shall not be taken into account for computing his business income.

The Assessing Officer is empowered to issue a notice in writing requiring any person to furnish to him within a specified time (not being less than 28 days) in respect of all securities of which such person was the owner or in which he had a beneficial interest at any time during the period specified by him in the notice, such particulars as he may consider necessary for purposes of this Section and for the purpose of ascertaining whether tax has been borne in respect of interest or dividends on all those securities or shares.

- (a) If any person buys or acquires any securities or unit within a period of three months prior to the record date and
- (b) such person sells or transfers –
 - (i) such securities within a period of three months after such date, or
 - (ii) such unit within a period of nine months after such date and
- (c) the dividend or income on such securities or unit received or receivable by such person is exempted,

then, the loss, if any, arising therefrom shall be ignored for the purposes of computing his income chargeable to tax. Such loss should not exceed the amount of dividend or income received or receivable on such securities or unit [Sub-section (7)].

- (a) Where any person buys or acquires any units within a period of three months prior to the record date;
- (b) such person is allotted additional units without any payment on the basis of holding such

units on such date;

- (c) such person sells or transfers all or any of the units referred to in (a) above within a period of nine months after such date, while continuing to hold all or any of the additional units referred to in (b), then –
 - (i) the loss on sale of original units sold within a period of 9 months after the record date will be ignored and
 - (ii) the amount of such loss will be considered as the cost of purchase or acquisition of the bonus units held by him on the date of such sale or transfer.

For the purposes of this section,-

- (a) “interest” includes a dividend;
- (b) “record date” means such date as may be fixed by a company or a Mutual Fund or the Unit Trust of India for the purposes of entitlement of the holder of the securities or the unit holder, to receive dividend or income, as the case may be; It also includes such date on which a unit holder is allotted or is entitled to additional units without any payment;
- (c) “securities” includes stocks and shares;
- (d) securities shall be deemed to be similar if they entitle their holders to the same rights against the same persons as to capital and interest and the same remedies for the enforcement of those rights, notwithstanding any difference in the total nominal amounts of the respective securities or in the form in which they are held or in the manner in which they can be transferred.

16.7 Introduction of specific anti-avoidance measures in respect of transactions with persons located in notified jurisdictional area [Section 94A]

The objective of anti-avoidance measures is to discourage assessee from entering into transactions with persons located in countries or territories which do not have effective information exchange mechanism with India. The following are the anti-avoidance measures introduced -

- (i) The Central Government empowered to notify any such country or territory outside India as a NJA (Notified Jurisdictional Area), having regard to the lack of effective exchange of information with such country or territory.
- (ii) A transaction where one of the parties thereto is a person located in a NJA would be deemed to be an international transaction and all parties to the transaction to be deemed as associated enterprises, and accordingly, all the provisions of transfer pricing to be attracted in case of such a transaction. However, the benefit of permissible variation between the ALP and the transfer price [provided for in the second proviso to section 92C(2)] based on the rate notified by the Central Government would not be available in respect of such transaction.
- (iii) Such transaction may be in the nature of –
 - (1) purchase, sale or lease of tangible or intangible property or

- (2) provision of service or
- (3) lending or borrowing money or
- (4) any other transaction having a bearing on the profits, income, losses or assets of the assessee. It may include a mutual agreement or arrangement for allocation or apportionment of, or contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided by or to the assessee.
- (iv) Person located in a NJA shall include a person who is a resident of the NJA and a person, not being an individual, which is established in the NJA. It would also include a permanent establishment of any other person in the NJA.
- (v) Payments made to any financial institution located in a NJA would not be allowed as deduction unless the assessee authorizes the CBDT or any other income-tax authority acting on its behalf to seek relevant information from the financial institution on behalf of the assessee.
- (vi) No deduction in respect of any other expenditure or allowance, including depreciation, arising from the transaction with a person located in a NJA would be allowed unless the assessee maintains the relevant documents and furnishes the prescribed information.
- (vii) Any sum credited or received from a person located in a NJA to be deemed to be the income of the recipient-assessee if he does not explain satisfactorily the source of such money in the hands of such person or in the hands of the beneficial owner, if such person is not the beneficial owner.
- (viii) The rate of TDS in respect of any payment made to a person located in the NJA, on which tax is deductible at source, will be the higher of the following rates –
 - (1) rates specified in the relevant provision of the Income-tax Act, 1961; or
 - (2) rate or rates in force; or
 - (3) 30%.

Examples

- (1) *A Ltd., an Indian company, provides technical services to a company, XYZ Inc., located in a NJA for a consideration of ₹ 40 lakhs in October, 2013. It charges ₹ 41 lakhs and ₹ 43 lakhs for similar services rendered to PQR Inc. and MNO Inc., respectively, which are not located in a NJA. PQR Inc. and MNO Inc. are not associated enterprises of A Ltd.*

Assuming that the variation notified by the Central Government for such class of international transactions is 3% of the transaction price, discuss the tax implications under section 94A read with section 92C in respect of the above transaction of provision of technical services by A Ltd. to XYZ Inc.

Answer

Since XYZ Inc. is located in a NJA, the transaction of provision of technical services by the Indian company, A Ltd., would be deemed to be an international transaction and XYZ Inc. and A Ltd. would be deemed to be associated enterprises. Therefore, the provisions of transfer pricing would be attracted in this case.

The prices of ₹ 41 lakhs and ₹ 43 lakhs charged for similar services from PQR Inc and MNO Inc, respectively, being independent entities located in a non-NJA country, can be taken into consideration for determining the arm's length price (ALP) under Comparable Uncontrolled Price (CUP) Method.

Since more than one price is determined by the CUP Method, the ALP would be the arithmetical mean of such prices.

Therefore, the ALP = ₹ 42,00,000 i.e., $(41,00,000 + 43,00,000)/2$

Transfer price = ₹ 40,00,000

Since the ALP is more than the transfer price, the ALP of ₹ 42 lakhs would be considered as the income arising from the international transaction between A Ltd. and XYZ Inc.

It may be noted that the benefit of permissible variation between the ALP and the transfer price at the rate notified by the Central Government for a particular class of international transaction would not be available where transfer pricing provisions are attracted under section 94A. Therefore, it is not necessary to determine the impact, if any, of such permissible variation.

- (2) *Mr.X, a non-resident individual, is due to receive interest of ₹ 5 lakhs during March 2014 from a notified infrastructure debt fund eligible for exemption under section 10(47). He incurred expenditure amounting to ₹ 10,000 for earning such income. Assuming that Mr.X is a resident of a NJA, discuss the tax implications under section 94A, read with sections 115A and 194LB.*

Answer

The interest income received by Mr.X, a non-resident, from a notified infrastructure debt fund would be subject to a concessional tax rate of 5% under section 115A on the gross amount of such interest income. Therefore, the tax liability of Mr.X in respect of such income would be ₹ 25,750 (being 5% of ₹ 5 lakhs plus education cess@2% and SHEC@1%).

Under section 194LB, tax is deductible @5% on interest paid by such fund to a non-resident. However, since X is a resident of a NJA, tax would be deductible@30% as per section 94A, and not @ 5% specified under section 194LB. This is on account of the provisions of section 94A(5), which provides that "Notwithstanding anything contained in any other provision of this Act, where a person located in a NJA is entitled to receive any sum or income or amount on which tax is deductible under Chapter XVII-B, the tax shall be deducted at the highest of the following rates, namely –

- (a) at the rate or rates in force;
- (b) at the rate specified in the relevant provision of the Act;
- (c) at the rate of thirty per cent."

Mr. X can, however, claim refund of excess tax deducted along with interest.

17.1 Introduction

The globalisation of economic reforms throughout the world has led to an increasing degree of inter-dependence between countries in the fields of technology, manpower, finance, etc. The Indian economy too has been and is continuing to be liberalised by successive Governments through the mode of reducing custom duties and of other levies, relaxing foreign exchange regulations and by encouraging boost in exports. The survival and growth of the industrial sector depends to a great extent upon technological advancement. This is possible through collaborations with developed countries to import their expertise and aid. While drafting foreign collaboration agreements both parties have to necessarily take into consideration the tax laws in the respective countries. This is necessary so as to ensure, on the one hand, that the statutory requirements under the various tax laws in India and the other country are met, as also, on the other hand, to minimise the burden of tax which falls on the income, profits and gains arising from the collaboration. The chapter studies the different forms in which foreign collaborations may be made and the tax implications involved therein.

17.2 Tax Liability Based on Residential Status

17.2.1 Non-resident: Foreign collaborators are generally non-residents in India. In this context, 'non-resident' means a person who is a non-resident as per section 2(30) of the Income-tax Act, 1961. You are already familiar with the concept of residential status as laid down in section 6 of the Income-tax Act, 1961. Foreign collaborators are generally companies incorporated outside India. Therefore, they could be regarded as non-resident within the meaning of section 6(3) since, in the case of foreign companies, the whole of the control and management of the affairs of such a company would not be situated in India, the place of carrying on the business and having transactions and operations being immaterial for the purpose. If, however, the foreign collaborator is a partnership firm or an association of persons, it would be regarded as being resident in India in every case where even a negligible portion of the control and management of the affairs of the firm or association is situated in India; in other words, only if the whole of the control and management of the affairs of the foreign collaborator, firm or association is situated outside India, the status of non-resident could be claimed for purposes of income-tax in India. Foreign collaborations are generally not brought about between individuals, although there is no prohibition in the law for doing so.

If, however, a foreign collaborator is an individual, the residential status of the foreign collaborator will have to be determined under section 6(1) on the basis of the number of days of his stay in India during the relevant accounting year.

17.2.2 Test for residence: The tests for residence as aforesaid should be applied to determine the residential status of the taxpayer in respect of each assessment year because the assessee who is resident in one year may be regarded as non-resident in another and vice versa. The determination of residential status should, in every case, be made with reference to the previous year followed by the foreign collaborator for his sources of income in India. The fact that the taxpayer has been assessed as a resident in an earlier year would not preclude him from claiming the status of a non-resident in the subsequent year if the status for that year is really that of a non-resident.

A person would be "not ordinarily resident" in India in any previous year if such person is an individual who has been non-resident in India in nine out of the ten previous years preceding that year, or has during the seven previous years preceding that year been in India for a period of, or periods amounting in all to, seven hundred and twenty-nine days or less.

Thus, this provision has the effect of restricting the benefit of the status of 'not ordinarily resident' in the case of a non-resident Indian coming back to India or foreign citizens working in India to only a period of 2 years. Hence, a non-resident coming back to India will have to pay tax on their global income after a period of 2 years. Similarly, foreign citizens working in India will be required to pay tax on their global income if they continue to be resident in India beyond a period of 2 years.

17.2.3 Scope of income chargeable : As already discussed in earlier chapters, the scope of income chargeable to tax in the case of a non-resident is laid down in section 5(2).

According to this provision, the total income of any previous year of any person who is non-resident must be taken to include all income from whatever source derived which – (i) is received or deemed to be received in India in such year by or on behalf of the non-resident; or (ii) accrues or arises or is deemed to accrue or arise to the non-resident in India during the previous year.

Explanation 1 to section 5 seeks to clarify that income accruing or arising outside India would not be deemed to be received in India for purposes of determination of the total income of the assessee under section 5 merely by reason of the fact that it has been taken into account in a balance sheet prepared in India. In other words, for determining whether a particular income accrues or arises in India or outside, one should not be guided by the entries in the books of accounts and disclosure thereof in the final accounts; it is, therefore, essential to determine the place of actual accrual of the income for purposes of inclusion or exclusion of the same within the scope of total income assessable to tax. *Explanation 2* to section 5 further clarifies that income which has been included in the total income of a taxpayer on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him, should not be again so included on the basis of its actual or deemed receipt in India either by the assessee or on his behalf.

Exemption available to non-residents: Apart from the scope of tax liability being less in the case of non-residents, there are other concessions available to persons who are non-resident. They are entitled to concessional rates of tax in respect of their income chargeable to tax in India.

Interest on fixed deposits with banks abroad would be taxable in India if such income by way

of interest is received in India or the right to receive the same is exercised by the individual in India. Interest on non-resident (external) non-repatriable deposits as well as Non-resident (External) Rupee Deposits in the banks in India would be exempt under section 10(4) of the Income-tax Act, 1961, subject, however, to the limits and conditions specified therein. In respect of assets acquired by investment through foreign exchange remittances the concessional rates of income tax would continue to be available to non-resident Indians in respect of their investment income including capital gains under section 115C read with sections 115D, 115E and 115H.

17.2.4 Choice of residential status: An assessee can change his residential status by changing the place of control and management of the affairs of the business (in the case of persons other than individuals) or by increasing or decreasing the number of days of stay in India (in the case of individuals). This may be done from the point of view of what is beneficial to him. In this context it may be kept in mind that if the foreign collaborator is incurring losses outside India, a change in status from non-resident to resident would allow the losses incurred outside India to be set off against income earned in India.

17.3 Choice of place where income is to be received

The scope of liability to tax of the non-resident should be clearly identified in the foreign collaboration agreement in every case as part of the process of tax planning by foreign collaborators. Under section 5(2) of the Income-tax Act, 1961, a non-resident is chargeable to tax in respect of income on two grounds, namely (i) receipt of income, whether actual or deemed, by or on behalf of the assessee; and (ii) accrual of such income, whether actual or deemed, in India to the assessee. The efforts at tax planning should, in every case, ensure that wherever practicable, the income of a non-resident which accrues or arises outside India and is not deemed to accrue or arise in India, is not first received in India. This is because of the fact that the mere receipt of income by or on behalf of the non-resident in India would attract liability to tax regardless of the question whether the income is due to be received in India or not and also whether it is received in cash or in kind.

When once it is established that income has been received as such, outside India, the mere remittance thereof to India would not attract any tax in India for the simple reason that the same income cannot be received more than once as was held by the Supreme Court in the case of *Banaras State Bank Ltd. v. CIT* (1970) 75 ITR 167 (SC).

Another important point to be kept in mind is whether the amount to be received is in the nature of a capital sum not being a capital gain. Receipts of a capital nature may be received in India without attracting any tax liability. Further, the Apex Court has ruled that wherever the receipt of income is in some form other than cash and liability to tax is attracted thereon, the market value of the items received should be determined and that alone should be taken as the amount of income assessable to tax. [*CIT v. Central India Industries Ltd.* (1971) 82 ITR 555 (SC)]

In the case of payments made by cheque, the general principle for determining the place of receipt of income by cheque is that the income is received at the place where the bank on which the cheque is drawn is situated; if, however, the cheque is encashed by the foreign

collaborator by discounting the same in the foreign country with his bank situated outside India, the income must be regarded as having been received at the place where the money attributable to the cheque is credited and withdrawn. Wherever it is the intention of the parties to secure that the foreign collaborator does not receive the moneys due to him under the agreement within India, the amount can be sent by a demand draft payable in the foreign country by the branch of a bank which is located at the place or near the place of office or residence of the foreign collaborator. Thus, the making of payment by drafts instead of cheques would help to shift the place of receipt of income by the foreign collaborator.

17.4 Choice of Method of Accounting

Under section 145 of the Income-tax Act, 1961, read with sections 28 and 56 thereof, the determination of the liability to tax in India depends not only upon the receipt of accrual of income but also upon the method of accounting followed by the assessee. The foreign collaborator can choose whether to follow the cash system or the mercantile system of accounting.

Thus, in a case where the foreign collaborator adopts the cash system of accounting, the receipt of income during a particular accounting year would make him chargeable to tax in respect of the moneys received as income. On the other hand, if the accounts of the foreign collaborator are maintained on mercantile basis, the income would be taxable immediately when the right to receive the same has accrued or arisen, the actual receipt being immaterial. Where the income has first accrued or is deemed to have accrued in India and is taxable because of the assessee adopting the mercantile system of accounting for that source, its subsequent receipt would be immaterial because the income having already been taxed on the basis of accrual, it cannot again be taxed on the basis of receipt in view of the express provisions of *Explanation 2* to section 5.

However, it must be kept in mind that once a particular method of accounting has been opted for, it cannot be changed without sufficient reason.

17.5 Choice of form of business organisation

While embarking on any joint venture project in a foreign country, it is most essential to identify and pre-determine the form of business organisation which would be most appropriate to carry on the joint venture activities in the foreign country.

The income-tax law in India impose liability to tax based purely on the residential status of the taxpayer and the tests for ascertaining whether a particular taxpayer is resident or non-resident in India have to be determined by applying different criteria prescribed for different categories of taxpayers. It is for the assessee in India as well as the other party in the foreign country to identify and decide in advance the form of business organisation which would be advantageous from the tax angle.

The joint venture may be in the form of incorporating a new company or may be in the form of a partnership firm. A third form is the establishment of an association of persons or body of individuals such as a society or a trust. Though there is no restriction for an individual or HUF to carry on joint ventures outside India, it becomes practically rather difficult and uncertain in terms of accountability and permanency.

In the case of a company, the test of residence specified in section 6 of the Income-tax Act, 1961, requires that for the company to be regarded as resident in India, the company must be either an Indian company within the meaning of section 2(26) or a company the control and management of which is wholly situated in India. If, therefore, the control and management of the affairs of the company is carried out even to a very negligible extent from outside India, the company would be regarded as non-resident and would accordingly be liable to tax in India only on the income which accrues or arises or is deemed to accrue or arise to it in India. Although a non-resident company is subject to tax at higher rates of income-tax as compared to a resident company, the tax base for a non-resident company is confined to its Indian income and, therefore, its foreign income would not suffer tax in India. It is to take advantage of this scheme of income-tax law that one should consider the establishment of a foreign company in the country where the foreign project has to be carried out so that the income by way of profits or losses arising from or attributable to that foreign project is kept outside the purview of Indian tax laws.

On the other hand, if the foreign project in the form of a joint venture is established as a partnership firm, the test applicable for residence would be exactly opposite and materially different. This is because of the fact that in the case of a partnership firm, it is considered to be resident in India within the meaning of section 6 of the Income-tax Act, 1961, in every case where even a negligible portion of the control and management of the affairs of the firm is carried out from India. If it is desirable to have a taxable entity which would be in a position to claim set off of foreign losses against the Indian income or Indian losses against the foreign income, it would be advisable for the assessee to do so having regard to the facts and circumstances of the case and a reasonable estimation which one could make by proper financial analysis and project planning of the profits and losses of the taxpayers concerned in India and outside.

The other forms of organisations such as trusts, co-operative societies or societies of a general nature and other associations of persons or bodies of individuals could also be thought of to suit the convenience of the parties because even in the case of those associations, bodies or societies, the criteria for determining the residential status would be the same as the one followed in the case of the partnership firms.

But the advantage is that these kinds of entities would also keep the taxpayers free from the difficult circumstances or problems arising from the assessments of partnership firms and their partners to income-tax in India resulting in considerable uncertainties in this regard both for the firms and for the partners.

Depending upon the form of business organisation chosen, the assessee could also shift the place of control and management of the affairs of that organisation to India or outside, whether wholly or partly, to secure that the assessee in question is a resident or non-resident in India for the relevant period depending upon what is beneficial from the income-tax angle.

Since each year is a separate and self contained period, it is permissible for the assessee to be resident in one year and to become non-resident in another and such a change can, however, be contemplated or brought about only if the form of organisation is properly thought out. The tax base and consequently the burden of tax, particularly in India would, therefore, be dependent upon the choice made in this regard not only at the beginning but also from year to year.

17.6 Taxability of different kinds of income

17.6.1 Interest income: Under section 2(28A), 'interest' means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilised. The definition of interest also includes any service fee or other charges in respect of loans, debts, deposits, etc. as well as commitment charges on non-utilised portion of credit facilities.

Section 9(1)(v) provides that income by way of interest payable by the Government, or by a person who is resident or by a person who is a non-resident, shall be income deemed to accrue or arise in India. However, the following exceptions have been provided:

- (i) interest payable by a resident in respect of any debt incurred or any moneys borrowed and used for the purposes of a business or profession carried on by him outside India;
- (ii) interest payable by a resident in respect of any debt incurred or any moneys borrowed and used for the purpose of making or earning any income from any source outside India;
- (iii) interest payable by a non-resident in respect of any debt incurred or money borrowed and used for the purpose of a business or profession carried on by him outside India.

17.6.2 Royalty : Royalty has been defined in *Explanation 2* to section 9(1)(vi) to mean the consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head 'capital gains') for –

- (i) the transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;
- (ii) the imparting of any information concerning the working of or the use of patent, invention, model, design, secret formula or process or trade mark or similar property;
- (iii) the use of any patent, invention, model, secret formula or process or trade mark or similar property;
- (iv) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB;
- (v) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;
- (vi) the transfer of all or any rights including the granting of a licence in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting but not including consideration for the sale, distribution or exhibition of cinematographic films; or
- (vii) the rendering of any service in connection with the activities referred to in (i) to (v) above.

Further, *CBDT Circular No. 202 dated 5.7.1976* has clarified that 'royalty' would include both industrial royalties and copyright royalties.

Section 9(1)(vi) deems income by way of royalty as accruing or arising in India in the following

three cases:

- (i) Royalty payable by the Central Government or any State Government must be deemed to accrue in India regardless of who is the payee and what is the amount of royalty and also irrespective of the purpose of the payment;
- (ii) Royalty payable by any resident taxpayer to any person, whether resident or non-resident, would be deemed to accrue in India in every case except where the payment is relatable to a business or profession carried on by the resident outside India or for the purpose of making or earning any income from any other source outside India; and
- (iii) Royalty payable even by a non-resident would be deemed to accrue in India in cases where the payment is relatable to any business or profession carried on by the non-resident in India or to any other sources of the non-resident's income in India.

However, the definition excludes any income which might otherwise be chargeable as capital gains. Thus, a receipt of a capital nature for the total change in ownership of the patents, invention, model, design, drawings, specifications, trade mark, secret formula or process, data, documentation, etc. representing technical know-how provided by foreign collaborators to Indian taxpayers would not give rise to income by way of royalty while the authority given under the collaboration agreement to the Indian taxpayer to use for the purpose of his business the drawings, designs, patents, etc., representing technical know-how which would continue to belong to the foreign collaborator would come within the purview of royalty for purposes of deeming the same accruing in India, thus, making the non-resident liable to tax under this provision. For this purpose, it is immaterial whether the royalty is paid as a lump sum or as a recurring payment; it is also immaterial whether the royalty is described as such under the collaboration agreement or is known as licence fees, copyright charges or by any other name.

Consideration for use or right to use of computer software is royalty within the meaning of section 9(1)(vi)

As per section 9(1)(vi), any income payable by way of royalty in respect of any right, property or information is deemed to accrue or arise in India. The term "royalty" means consideration for transfer of all or any right in respect of certain rights, property or information. There have been conflicting court rulings on the interpretation of the definition of royalty, on account of which there was a need to resolve the following issues –

Does consideration for use of computer software constitute royalty?

- (i) Is it necessary that the right, property or information has to be used directly by the payer?
- (ii) Is it necessary that the right, property or information has to be located in India or control or possession of it has to be with the payer?
- (iii) What is the meaning of the term "process"?

In order to resolve the above issues arising on account of conflicting judicial decisions and to clarify the true legislative intent, Explanations 4, 5 & 6 have been inserted with retrospective effect from 1st June, 1976.

Explanation 4 clarifies that the consideration for use or right to use of computer software is royalty by clarifying that, transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

Consequently, the provisions of tax deduction at source under section 194J and section 195 would be attracted in respect of consideration for use or right to use computer software since the same falls within the definition of royalty.

Note - The Central Government has, vide *Notification No.21/2012 dated 13.6.2012* to be effective from 1st July, 2012, exempted certain software payments from the applicability of tax deduction under section 194J. Accordingly, where payment is made by the transferee for acquisition of software from a resident-transferor, the provisions of section 194J would not be attracted if –

- (1) the software is acquired in a subsequent transfer without any modification by the transferor;
- (2) tax has been deducted either under section 194J or under section 195 on payment for any previous transfer of such software; and
- (3) the transferee obtains a declaration from the transferor that tax has been so deducted along with the PAN of the transferor.

Explanation 5 clarifies that royalty includes and has always included consideration in respect of any right, property or information, whether or not,

- (a) the possession or control of such right, property or information is with the payer;
- (b) such right, property or information is used directly by the payer;
- (c) the location of such right, property or information is in India.

Explanation 6 clarifies that the term “process” includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret.

Under section 115A, royalty income is taxable at the rate of 25% if it is received in pursuance of an agreement made after 31st March, 1976. The conditions attached to this provision are as follows:

- (i) The recipient of the royalty should be a foreign company or a non-corporate non-resident.
- (ii) The royalty may be received from the Government or an Indian concern.
- (iii) The royalty should be received in pursuance of an agreement made by the foreign company with the Government or the Indian concern after 31st March, 1976.
- (iv) Where the agreement is with an Indian concern, it should be approved by the Central Government.
- (v) Where the agreement relates to a matter included in the industrial policy (prevailing at

that time) of the Central Government, the agreement should be in accordance with that policy.

- (vi) The conditions (iv) and (v) shall not apply where the royalty is received in consideration for the transfer to an Indian concern, all or any rights in respect of copyright in any book, or for the transfer to a person resident in India, any computer software.
- (vii) In computing the royalty income, no deduction shall be allowed under sections 28 to 44C and section 57.

It is to be noted that section 115A is not applicable in respect of royalty income covered under section 44DA (1).

17.6.3 Fees for technical services: For the purpose of taxation, technical services fees are treated similarly as royalty income.

Explanation 2 to section 9(1)(vii) defines 'fees for technical services' as any consideration (including lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient.

Further, any income of the recipient chargeable under the head "salaries" will also not form part of fees for technical services.

The taxability of fees received for technical services is on similar lines as royalty income. *Under section 115A, fees for technical services received by a non-corporate non-resident or foreign company is taxable @25%, if the agreement is entered into on or after 31st March, 1976.* No deduction shall be allowed under sections 28 to 44C and section 57 in respect of any expenditure or allowance, for the purpose of computing the aforesaid income. In this regard, the following issues are relevant.

Section 115A, however, does not apply in respect of fees for technical services covered under section 44DA(1).

Note: Income deemed to accrue or arise in India to a non-resident by way of interest, royalty and fee for technical services to be taxed irrespective of territorial nexus (*Explanation to section 9*): Income by way of interest, royalty or fee for technical services which is deemed to accrue or arise in India by virtue of clauses (v), (vi) and (vii) of section 9(1), shall be included in the total income of the non-resident, whether or not –

- (i) the non-resident has a residence or place of business or business connection in India; or
- (ii) the non-resident has rendered services in India.

In effect, the income by way of fee for technical services, interest or royalty, from services utilized in India would be deemed to accrue or arise in India in case of a non-resident and be included in his total income, whether or not such services were rendered in India.

17.6.4 Transfer of know-how: Royalty payments may be in exchange for something in addition to the mere use of the invention. Usually the licence contracts include "know-how" provisions. In other words, the licensor not only grants the right to use the invention but also

undertakes to supply the licensee with technical 'know-how'. The Madras High Court in *Fenner Woodroffe & Co., vs. CIT* (1976) 102 ITR 665 (Mad.) has explained that know-how may be taken as comprehending within it the fund of knowledge or experience gained by a manufacturer during the long number of years in which they had been manufacturing on the formulae, the engineering drawings and specifications, mechanical details or processes and general knowledge that is associated with the production and development which is in the exclusive knowledge of the trade.

Know-how is also referred to as a manufacturing technique. It is an intangible asset. The House of Lords in *Moriarty vs. Evans Medical Supply Ltd.* (1959) 35 ITR 707 laid down the criteria to be applied to determine whether the transaction involving dealings in know-how would constitute a receipt of payment of a capital or revenue nature. If the assessee sells its know-how and realizes the price for the same, the money realized for providing the know-how would be a receipt of a capital nature. On the other hand, in a case where the assessee who owns the know-how continues to own it and allows the other person only the right of use of such know-how the payments received towards the use of the know-how by another person would be a revenue receipt liable to tax. The question whether the transaction involved is one of purchase or sale of know-how or is that of allowing the other person the right to use it will have to be determined with reference to the facts and circumstances of the case. Where the receipt is of a capital nature, it would be wholly outside the purview of tax under section 9(1)(vi) as royalty. Further, receipts of a capital nature which would otherwise have been liable to tax under the head "capital gains" (e.g. on transfer of patents, designs, drawings, secret formula, etc. forming part of the know-how) would not be liable to tax in the hands of the collaborator in India particularly when the transfer does not take place in India. Therefore, only if the transfer takes place in India, the non-resident collaborator would attract liability to capital gains tax in respect of the transfer of know-how, but not otherwise.

17.6.5 Export of goods from India by non-residents: Clause (b) of the *Explanation* to section 9(1)(i) provides that in the case of every non-resident, no income should be regarded as being deemed to accrue or arise to him in India through or from operations which are confined to the purchase of goods in India for the purpose of export. Thus, even in cases where the non-resident has an agency or office in India but the agent or branch office in India does nothing more than the purchase of the goods for their export, there would be no question of income accruing to the non-resident under the deeming provisions although in effect the non-resident may derive income outside India from the goods so exported ultimately on their sale outside India and the profits arising from such export are traceable to the business connection in India through the agency, branch or office. The exemption is, however, subject to the non-resident taking precaution to ensure that even a negligible part of the goods purchased are not sold in India and the whole of the goods purchased are only exported. The country to which the export is made is immaterial for the purpose. Of course, care should be taken in every case to secure that no part of the sale proceeds for the goods exported is received directly or indirectly, in cash or in kind in India by or on behalf of the non-resident. In view of this benefit of total exemption from income-tax without any monetary or other limits and conditions, every possible export should be made by foreign collaborators and their Indian counterparts to secure that the benefit of exemption under clause (b) of the *Explanation* to section 9(1)(i) is obtained, wherever practicable.

17.7 Tax treatment of payments made for expenses, etc.

The carrying on of a business in India by different categories of taxpayers involves a variety of expenses being incurred by them both in India and outside. The nature and amount of the expenses would, however, depend on the nature of the business, the purpose of incurring the expenditure and the stage at which it is incurred. Of these, a substantial portion of the expenditure is incurred after the business of the taxpayer in India is actually set up. The expenses incurred prior to the setting up of the business do not qualify for any allowance or deduction in computing the taxable profits of the business in India since the previous year of the business cannot be regarded as having commenced until the business is actually set up. Therefore, expenses which are incurred prior to the setting up of business and which are directly related to the acquisition of capital assets including their installation, whichever necessary, have to be capitalised and the assessee would become entitled to claim depreciation allowance and investment allowance in respect thereof from the time the business commences its normal operations by virtue of the commercial production being started. An important guiding factor for deciding in favour of or against the foreign collaboration agreement would be the admissibility or otherwise of the expenses incurred in the form of payments made to the foreign collaborator in computing the business profits of the taxpayer in India.

Wherever the expenditure is disallowable because of the restrictions under section 37(1) read with section 28 of the Income-tax Act, 1961, the Indian taxpayers will have to be extremely careful to examine, before entering into the foreign collaboration agreement whether the scheme of foreign collaboration could be modified suitably to secure that such a disallowance is not attracted. This is because of the fact that the incurring of any expenditure which is disallowable would effectively mean that the Indian taxpayers' financial position would be substantially weakened by virtue of the agreement under which the disallowable expenditure becomes liable to be incurred. The reason for this is not far to seek. Under the scheme of the Income-tax law in India, any expenditure which is incurred by a taxpayer carrying on business and which is disallowed in computing the taxable profits would result in an addition to the real income of the assessee to the extent of the disallowed expenditure. Consequently, the taxpayer in India will not only be having the commitment of paying the amount of expenditure but also be faced with the problem of having to pay a sizeable amount towards income-tax with interest on the amount of notional income attributable to the disallowed expenditure in his income-tax assessment.

Section 37(1) would be the primary guiding provision for the purpose of determining the admissibility or otherwise of the expenditure incurred by the Indian taxpayer. Under this section, it is obligatory for the assessee to establish, for the purpose of obtaining an allowance in respect of the expenditure incurred by him, that the expenditure is of a revenue nature and has been incurred wholly and exclusively for the purpose of the business or profession carried on during the previous year, the income of which is assessable to tax in India.

The criteria for deciding the nature of the expenditure to ascertain whether it is capital or revenue is not one of universal application and the decision in each case will have to depend on the facts and circumstances of the case. The question whether a particular expenditure is

capital or revenue in nature and is accordingly deductible or not for purpose of computing the taxable profits is essentially a mixed question of law and fact.

The broad principles for making a distinction between capital and revenue expenditure were outlined by the Andhra Pradesh High Court in *Hylam Ltd. v. CIT (1973) 87 ITR 310* after a perusal of a number of judicial pronouncements of the courts in India and abroad on this issue. These are quoted below:

1. If the expenditure is for the initial outlay or for acquiring or bringing into existence an asset or advantage of an enduring benefit to the business that is being carried on or for the extension of the business that is going on or for substantial replacement of an existing business asset, it would be capital expenditure.
2. If, on the other hand, the expenditure, although for the purpose of acquiring an asset or advantage is for running the business or for working out that asset with a view to producing profit, it would be revenue expenditure.
3. If the outgoing is related to the carrying on or the conduct of the business that it may be regarded as an integral part of the profit earning process or operations and not for acquisition of an asset of a permanent character, possession of which is a condition precedent for the running of the business, then it would be expenditure of a revenue nature.
4. Special knowledge or technical knowledge or a patent or a trademark is an asset and if it is acquired for payment for use and exploitation for a limited period and what is acquired is not an asset or advantage of an enduring nature and at the end of the agreed period that advantage or asset reverts back intact to the giver of the special knowledge or the owner of the patents or trademarks, it would be expenditure of a revenue nature.
5. If it is intrinsically a capital asset, it is immaterial whether the price of it is paid once and for all or periodically or whether it is paid out of the capital or income or linked up with net sales; the outgoing in such a case would be of the nature of capital expenditure.
6. If the amount paid for the acquisition of an asset of an enduring nature is settled for the mere fact that the amount so settled is chalked out into various small amounts or periodic installments, the capital nature of the expenditure would not cease to be so or be altered it into the nature of a revenue expenditure.
7. A lump sum amount for liquidating recurring claims would not cease to be revenue expenditure or get converted into capital expenditure merely because its payment is spread over a number of years. It is the intention and object with which the asset is acquired that determines the nature of the expenditure incurred over it and not the method or the manner in which the payment is made or the source of such payment.
8. If the expenditure is recurring and is incurred during the course of business or manufacture, it would be revenue expenditure.
9. An asset or advantage of an enduring nature does not mean that it should last for ever. If the capital asset is in its nature a short-lived one, the expenditure incurred over it does not for that reason cease to be a capital expenditure.
10. It is not the law that if an enduring advantage is obtained the expenditure for securing it must always be treated as capital expenditure. If the advantage acquired is to get any

stock-in-trade of the business then it would be revenue expenditure. However, if what is acquired is not the advantage of getting any stock-in-trade directly but of something which has to be dressed up or processed before it is converted into stock-in-trade, the expenditure incurred over it would be capital expenditure”.

17.8 Other Factors

17.8.1 Drafting of agreement: Special care is required in regard to the terms of the agreement. Since the facts and circumstances of each case differ from one another, it would be difficult to lay down a uniform guideline or principle by which the nature of the expenditure could be indicated as being capital or revenue in nature much in advance of incurring the expenditure itself. Therefore, having regard to the broad principles laid down by the Supreme Court case and also the High Courts in various cases one should, as far as practicable, plan the terms of the agreement in such a manner as to ensure that the amount payable to the foreign collaborator qualifies for deduction either as a revenue expenditure under section 37(1) when it is incurred or as capital expenditure qualifying for amortisation by way of depreciation admissible thereon.

In many cases, the problem of allocation of expenditure between capital and revenue and also the determination of the amount of royalties or fees for technical services or other consideration for the transfer of patents, copyrights, etc. outside India poses a considerable advantage both for the taxpayers and for the tax authorities. The solution to this problem lies in proper planning whereby under the terms of the agreement it is expressly indicated as to what is the amount of payment attributable to each type of service provided or asset given by the collaborator to the Indian taxpayer. To prescribe one composite amount of consideration for covering all the different types of services is to the disadvantage of both the Indian taxpayer and the foreign collaborator. It would be most advisable to have separate agreements for collaboration between the Indian company and the foreign collaborator for each of the technical services besides ensuring that the transfer of capital assets, wherever contemplated, is made by the collaborator to the Indian assessee outside India in every case. The agreement should also provide the amount of consideration for each type of service rendered or asset given, indicating also the manner in which the payment to the collaborator should be calculated. In other words, every care should be taken to secure that there is no ambiguity in terms of the agreement as a result of which the tax authorities might interpret the same to the disadvantage of the assessee. If it is not convenient to have separate agreements for different types of technical services because of the difficulties involved in obtaining the approval of the Central Government/CBDT to the agreements individually in each case coupled also with the formalities involved in obtaining the permission required under the Foreign Exchange Management Act from the different authorities, the Indian company may enter into one single collaboration agreement but the agreement should spell out in clear terms the different types of technical services and the amount of consideration payable for each one of them. By doing so, the Indian assessee and the foreign collaborator would be in a position to secure that the tax authorities do not have any authority to ignore the consideration specified under the agreement and substitute/allocate or even apportion the amount of consideration to the different items in the manner they find to be beneficial to the revenue.

Expenditure incurred towards professional fees for drafting of agreement in connection with

the investments, collaboration, etc. would be expenditure of a revenue nature [*CIT v. Century Spg. & Mfg. Co. Ltd. (1994) 210 ITR 783 (Bom)*]

17.8.2 Termination of Agreement : The Bombay High Court in *Dorr-Oliver India Ltd. v. CIT (1998) 234 ITR 723* has held that in the case of a collaboration agreement, the liability of the Indian company to make payment under the agreement to the non-resident would continue only so long as the agreement remains operative. When once the Government of India and the Reserve Bank do not approve the agreement or direct the assessee to terminate the Agreement by a specified period, the moneys paid/payable after the date of termination of the agreement would not qualify for deduction as a business expenditure. This is because a termination of the agreement brings about cession of the liability and hence the question of deduction for a non-existing liability does not arise; for this purpose it is immaterial that the collaboration agreement initially entered into had stipulated that it would be operative for specified period and came to be terminated as per the orders of the Government or the Reserve Bank earlier than the duration of the agreement.

17.9 Assessment of Foreign Collaborators

The Income-tax Act, 1961, contains special provision for making assessments on representative assessee of non-resident foreign collaborators. Sections 160(1)(i), 161, 162 and 163 read with sections 166 and 167 govern the scheme of assessment of non-residents through their agents.

17.9.1 Meaning of 'representative assessee': Section 160(1)(i) defines the expression 'representative assessee' for all purposes of assessment to income-tax to mean the agent of a non-resident in respect of the income of the non-resident which is deemed to accrue or arise to him in India under section 9(1) of the Income-tax Act, 1961. The expression 'agent', in this context, must also be taken to include a person who is treated or deemed to be an agent by the Assessing Officer for the purposes of making assessment on him under section 163 of the Income-tax Act, 1961.

The term 'assessee' under section 2(7) include a representative assessee within its scope. The Assessing Officer is statutorily empowered to issue notice under section 163 to any person to deem him as the agent of the non-resident foreign collaborator. The term 'agent' should, for this purpose, be taken to include:

- (i) any person in India who is employed by or on behalf of the non-resident; or
- (ii) any person in India who has any business connection with the non-resident within the meaning of *Explanation 2* to section 9(1)(i); or
- (iii) any person in India from or through whom the non-resident is in receipt of any income, whether directly or indirectly; or
- (iv) any person in India who is the trustee of the non-resident; or
- (v) any person in India who, whether resident or non-resident, has acquired by means of a transfer, a capital asset in India.

However, a broker in India who in respect of any transaction does not deal directly with or on

behalf of a non-resident principal but deals with or through a non-resident broker should not be deemed to be an agent under section 163(1) in respect of the income attributable to those transactions provided both the following conditions are fulfilled:

- (a) the transactions must be carried on in the ordinary course of business through the first mentioned broker; and
- (b) the non-resident broker must be one who carries on such transactions in the ordinary course of his business and not as a principal.

17.9.2 Liabilities of a representative assessee: It is essential that a person who is sought to be assessed as the agent of the non-resident must be given an opportunity of being heard before the assessing officer treats him as the agent and imposes on him the vicarious liability to income-tax on behalf of the non-resident.

In order to be assessed as the agent of a non-resident it is not essential that the agent, who is regarded as the representative assessee under section 160(1)(i), must be actually in receipt of or is entitled to receive the income of the non-resident.

The representative assessee is not liable to be assessed under section 161 in his own name in respect of that income but the assessment made on him must, for all purposes be deemed to have been made upon him only in his representative capacity. The tax determined on assessment shall be levied upon and recovered from the representative assessee in the like manner and to the same extent as it would be leviable upon and recoverable from the non-resident for whom he is the representative assessee. It may so happen that a person who is in India may have business connections with different non-residents and may also be a trustee in a number of trusts besides being a director of a number of companies. In such cases, there can be a large number of assessments on the very person as the representative assessee of each one of the non-residents with whom he has business connections, (as the representative assessee of the trusts) of which he is a trustee and these assessments in the representative capacity shall be made over and above his own assessment to income-tax and wealth-tax as an individual. Even if the representative assessee so desires, the income assessable in his hands in his representative capacity cannot be added to determine his total income assessable under the Income-tax Act, 1961 in his individual capacity or in any other representative capacity.

17.9.3 Protective assessment : The Supreme Court has also pointed out in *Lalji Haridas v. ITO (1961) 43 ITR 387 (SC)* that "in cases where it appears to the income-tax authorities that certain income has been received during the relevant assessment year but it is not clear who has received that income and prima facie it appears that the income may have been received either by A or by B or by both together, it would be open to the relevant income-tax authorities to determine the said question by taking appropriate proceedings both against A and B." It is also expressly provided by section 161(2) that in every case where assessment has to be made on any person as representative assessee he should not be in respect of that income be assessed under any other provision of the Income-tax Act, 1961 in other words, the status of the assessee in his representative capacity for the non-resident cannot be ignored and the income of the non-resident cannot just be added to the other income of the representative assessee which may be made on him in his individual or other representative capacity.

17.9.4 Rights of a representative assessee

Right to recover tax: Section 162 grants to every representative assessee the right to recover the tax paid by him as a result of such assessments. Accordingly, every representative assessee who pays any sum (which would include not only the tax but also the interest, fine and/or penalty, if any,) is statutorily entitled to recover the amount paid by him from the person/s on whose behalf the payment is made by him in his representative capacity. He is also entitled, if it is necessary to do so, to retain out of any moneys that may be in his possession or may come to him in his representative capacity the amount equal to the payment of tax or other sum made by him. In the event of any disagreement between the principal and the representative assessee in regard to the amount to be so retained, the representative assessee is entitled to apply to the Assessing Officer to secure a certificate from him specifying the amount to be so retained pending the final settlement of his liability to tax.

Right to agitate assessment as agent: The question whether, in any particular case, the taxpayer in India could be assessed as the agent of a non-resident or not is essentially a question of law. Thus, the liability to be assessed arbitrarily or unreasonably, could be challenged in the court through a writ or other appellate proceedings.

Quite often the Indian company is treated as the representative assessee for the foreign technicians of the collaborators who visit India and such a situation becomes necessary by the fact that before the technicians leave India they have to discharge the liability to tax in India and obtain tax clearance certificate from the income-tax authorities. Often it becomes difficult for them to fulfil all the obligations and the tax authorities also find it difficult to quantify the liability which has to be discharged by the technicians before they leave India. In such cases the Indian enterprise executes a guarantee bond in favour of the income-tax department undertaking to discharge the liability to tax which may be found to become due from the employee leaving India. While executing such a guarantee the Indian company also refunds in certain cases the amount of tax which might have been already deducted at source to the foreign technicians in the assessment of the technicians. Consequently, if the Assessing Officer takes a view that the exemption was not assessable and he in turn passes an order of assessment raising a demand against the foreign technician by treating the Indian company as the representative assessee of the foreign technician, the Indian enterprise becomes liable to pay the tax demanded from it.

Criteria for assessment as agent: The assessment can be made either on the representative assessee or the non-resident principal to him. The CBDT, in its *Circular No.157 dated 26.12.1974*, has clarified that "once the choice is made by the department to tax either the trustee or the beneficiary, it is no more open to the department to go behind it and assess the other at the same time."

17.10 Deduction of tax at source from non-resident's income

The provision of sections 192 to 206B contained in Part B of Chapter XVII of the Income-tax Act, 1961 regulate the manner in which and the extent to which the tax on the income liable to income-tax in India should be recovered by way of deduction of the tax at source by the person who makes the payment or from whom the non-resident collaborator becomes entitled to receive the same.

17.10.1 Salaries: If the non-resident renders technical services in the capacity of an employee to the Indian enterprise and the payment for such technical services becomes liable to be taxed in India under the head 'salaries', the tax payable thereon should be deducted at source by the Indian enterprise before making the payment of remuneration or crediting the amount thereof to the account of the non-resident under section 192.

Failure on the part of the Indian enterprise to deduct the tax at source would disentitle it to claim the remuneration paid or payable to the non-resident employee as an expenditure in computing its taxable income because of the mandatory provisions for disallowance contained in section 40(a)(iii) of the Income-tax Act, 1961. Further, the Indian enterprise would also attract liability for prosecution besides the liability to penalty and fine over and above the obligation to pay the amount of tax which ought to have been deducted, with interest, to the government. For this purpose all the provisions for collection and recovery of tax would be applicable since the employer in India would be deemed in such a case to be the assessee in default.

17.10.2 Other payments to non-residents : According to section 195(1) any person who is responsible for paying to a non-resident any interest or any other sum (not being salaries) chargeable to income-tax under the Income-tax Act, 1961, must, at the time of credit of such income to the account of the payee or at the time of making the payment thereof in cash or by the issue of a cheque or draft or any mode, whichever is earlier, deduct income-tax payable thereon at the rates in force.

Sub-section (2) to section 195 provides that in cases where the person is responsible for paying any sum chargeable to income-tax in India to a non-resident and he considers that the whole of the amount of payment may not be income assessable to tax in the hands of the recipient, he may make an application to the Assessing Officer to determine, by a general or special order, the appropriate proportion of the sum payable as being chargeable to tax and thereby obtain an advance ruling from the Assessing Officer with regard to the income assessable and the tax payable thereon. If that is done, the tax shall be deducted under section 195(1) only in that proportion in which the payment to the non-resident becomes taxable in India.

In this context, it may be noted that section 40(a)(i) provides for disallowance of any interest, royalty, fees for technical services or other sum chargeable under this Act, which is payable, -

(a) outside India;

(b) in India to a non-resident, not being a company or to a foreign company,

on which tax is deductible at source under Chapter XVIIIB and such tax has not been deducted or, after deduction, has not been paid during the previous year, or in the subsequent year before the expiry of the time prescribed under section 200(1). It is also provided that where in respect of any such sum, where tax has been deducted in any subsequent year, or has been deducted in the previous year but paid in any subsequent year after the expiry of the time prescribed under section 200(1), such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

18.1 Introduction

One of the dictionary meanings of the word “restructuring” is “rearrangement”. Thus, business restructuring refers to a rearrangement of the corporate structure. In today's world, along with increasing focus on globalisation and liberalization, there is free competition amongst businesses. As a result, corporates are trying to identify opportunities so that they can command a presence in the market. They are redefining their strategies, looking at core competency and trying to create a value for the shareholder in a competitive business environment. This has given rise to business restructuring.

18.2 Forms of Business Restructuring

Business restructuring can be done through mergers, acquisitions, strategic alliances, etc. The following are the methods by which businesses are redefining their affairs:

1. Amalgamation/merger
2. Demerger and spin off
3. Conversion of sole proprietary business into a company
4. Conversion of partnership firm into a company
5. Conversion of a private company or an unlisted public company into a Limited Liability Partnership (LLP)
6. Slump sale of business
7. Buy back of shares
8. Capital reduction
9. Redemption of preference shares
10. Conversion of debentures into shares
11. Conversion of an Indian branch of foreign company into an Indian subsidiary company.

These are discussed in the subsequent paragraphs.

18.3 Amalgamation

18.3.1 Definition: In the context of taxation, amalgamation includes not only the merger of one existing company with another existing company but also the merger of two or more existing companies to form a third company.

The Income-tax Act, 1961 defines amalgamation in section 2(1B) as a merger of one or more companies with another company, or the merger of two or more companies to form one company, in such a manner that:

- a. all the properties of the amalgamating company or companies immediately before the amalgamation, become the properties of the amalgamated company by virtue of the amalgamation;
- b. all the liabilities of the amalgamating company or companies immediately before the amalgamation, become the liabilities of the amalgamated company by virtue of the amalgamation; and
- c. shareholders holding not less than 75% in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by, or by a nominee, for the amalgamated company or its subsidiary) become shareholders of the amalgamated company.

18.3.2 Effective date: Amalgamation is assumed to take effect on the date on which it is approved by the High Court. Once amalgamation is approved, it should be treated as relating back to the appointed date with reference to which the accounts of both the amalgamating and amalgamated companies are made up.

18.3.3 Exemptions available under the Income-tax Act, 1961:

- ◆ **Exemption from capital gains in the hands of the amalgamating companies:** Under section 47(vi), capital gains arising from the transfer of assets by the amalgamating companies to the Indian amalgamated company is exempt from tax.
- ◆ **Exemption from capital gains for the shareholders of the amalgamating companies:** Under section 47(vii), capital gains arising from the transfer of shares by a shareholder of the amalgamating companies are exempt from tax, if:
 - (a) the transfer is made in consideration of the allotment to him of shares in the amalgamated company except where the shareholder itself is an amalgamated company; and
 - (b) the amalgamated company is an Indian company.

The issue of exemption from capital gains is not free from doubt where the transaction is not structured as a share for share exchange and the consideration is paid in other forms. There are two contrary High Court judgments in this regard.

In the case of *CIT vs. Gautam Sarabhai Trust* [1988] 173 ITR 216, the Gujarat High Court held that to qualify for exemption under section 47(vii), the shareholder should receive the entire

consideration in the form of shares of the amalgamated company alone. In other words, if besides the share or shares in the amalgamated company, the shareholders of the amalgamating company is allotted something more, namely, bonds or debentures in consideration of the transfer of his share or shares in the amalgamating company, he cannot get the benefit of section 47(vii).

The other view is based on the judgment in the case of *CIT vs. M.Ct.M Corporation Private Ltd.* [1996] 221 ITR 524. In this case, the Madras High Court held that in as much as shares and debentures are allotted to the assessee on account of the amalgamation of the two companies and in view of the fact that the identity of the transferor company got lost in the amalgamation, there was no transfer or extinguishment of any right in allotting the shares and debentures in favour of the assessee under the provisions of section 2(47). Even if there was a transfer, the gains arising therefrom, were entitled to exemption under section 47(vii).

- ◆ **Exemption from capital gains in case of international restructuring :** Under section 47(via), in case of amalgamation of foreign companies, transfer of shares held in Indian company by amalgamating foreign company to amalgamated foreign company is exempt from tax, if the following two conditions are satisfied:
 - a. At least 25% of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company; and
 - b. The amalgamation is tax-free in the foreign company.

18.3.4 Carry forward and set-off of accumulated loss and unabsorbed depreciation in certain cases of amalgamation [Section 72A]: Sub-section (1) of section 72A provides that where there is an amalgamation of a company, owning an industrial undertaking or a ship or a hotel with another company or the amalgamation of a banking company with a specified bank, then the accumulated loss and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or allowance for depreciation of the amalgamated company for the previous year in which the amalgamation was effected and other provisions of the Act shall apply accordingly.

The “specified bank” means the State Bank of India constituted under the State Bank of India Act, 1955 or a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 or a corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980.

Conditions: However, sub-section (2) lays down the following conditions for admissibility of set-off and carry forward in hands of the amalgamated company:

Conditions to be fulfilled by the amalgamating company

- (i) The amalgamating company should have been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for three or more years.
- (ii) The amalgamating company has held continuously as on the date of amalgamation at least three-fourths of the book value of the fixed assets held by it, two years prior to the date of amalgamation.

Conditions to be fulfilled by the amalgamated company

- (i) the amalgamated company holds continuously for a minimum period of 5 years from the date of amalgamation at least 75% in the book value of fixed assets of the amalgamating company acquired in a scheme of amalgamation;
 - (ii) the amalgamated company continues the business of the amalgamating company for a minimum period of 5 years from the date of amalgamation;
 - (iii) the amalgamated company fulfills such other conditions as may be prescribed to ensure the revival of the business of the amalgamated company or to ensure that the amalgamation is for genuine business interest.
- ◆ **Withdrawal of deduction or allowance:** Sub-section (3) provides that where any of the conditions laid down in sub-section (2) are not complied with, the set off or allowance for depreciation made in any previous year in the hands of the amalgamated company shall be deemed to be the income of the amalgamating company chargeable to tax for the year in which such conditions are not complied with.
 - ◆ **Meaning of “Industrial undertaking”:** “Industrial undertaking” means any undertaking which is engaged in:
 - (i) the manufacture or processing of goods; or
 - (ii) the manufacture a computer software; or
 - (iii) the business of generation or distribution of electricity or any other form of power; or
 - (iv) the business of providing telecommunication services, whether basic or cellular, including radio paging, domestic satellite service, network of trunking, broadband network and internet services; or
 - (v) mining; or
 - (vi) the construction of ships, aircrafts or rail systems.”

18.3.5 Power of Central Government to prescribe other conditions: Section 72A(2)(iii) empowers the Central Government to prescribe other conditions to ensure that the amalgamation is for “genuine business purpose” or for the purpose of revival of the business of amalgamating company.

Rule 9C prescribes that the amalgamated company should achieve the level of production of at least 50% of the installed capacity of the said undertaking before the end of 4 years from the date of amalgamation and maintain the said minimum level till the end of 5 years from the date of amalgamation. The assessee is required to obtain a report in the prescribed form as given in the Rules.

An issue arises that the above condition prescribed vide the above notification cannot be satisfied in case where the installed capacity is not there. Examples could be software companies, units engaged in assembly/processing activities etc.

18.3.6 Other benefits: Apart from carrying forward unabsorbed business loss and unabsorbed depreciation, the amalgamated company shall also be entitled to carry forward and set off the following unabsorbed expenditures of the amalgamating company:

- (a) Capital expenditure on Scientific Research u/s 35;
- (b) Expenditure in connection with amalgamation u/s 35DD;
- (c) Expenditure for obtaining licence to operate telecommunication services u/s 35ABB;
- (d) Preliminary expenses u/s 35D;
- (e) Deduction for expenditure on prospecting etc. for minerals u/s 35E.

18.4 Demerger

The concept of demerger was introduced in the context of taxation by Finance Act, 1999. The objective was to enable corporate undertakings to undertake business restructuring in a tax neutral form.

18.4.1 Definition: Section 2(19AA) defines demerger in relation to companies, as the transfer, pursuant to a scheme of arrangement under section 391 to 394 of the Companies Act, 1956¹, by the demerged company of one or more of its undertakings to any resulting company in such manner that:

- (a) all the property and liabilities of the undertaking which is being transferred by the demerged company become the property and liabilities of the resulting company by virtue of the demerger;
- (b) the property and liabilities of the undertakings being transferred by the demerged company are transferred at their book values immediately before the demerger;
- (c) in consideration of the demerger, the resulting company issues shares to the shareholders of the demerged company on a proportionate basis except where the resulting company itself is a shareholder of the demerged company;
- (d) shareholders holding not less than 75% in value of the shares in the demerged company (other than shares already held therein immediately before the demerger by the resulting company or by a nominee of the resulting company or its subsidiary) becomes shareholders of the resulting company by virtue of the demerger;
- (e) the transfer of the undertaking is on a going concern basis;
- (f) the demerger is in accordance with the conditions, if any, notified by the Central Government under section 72A(5).

For this purpose, the following points need to be noted:

¹ Sections 230 to 232 of the Companies Act, 2013

- (i) An 'undertaking' shall include any part of an undertaking, or a unit or division of an undertaking or a business activity taken as a whole, but does not include individual assets or liabilities or any combination thereof not constituting a business activity.
- (ii) 'Liabilities' shall mean the following:
 - (a) those which arise out of the activities or operations of the undertaking;
 - (b) the specific loans or borrowings (including debentures) raised, incurred and utilized solely for the activities or operations of the undertaking;
 - (c) so much of the general or multipurpose borrowings of the demerged company as stand in the same proportion which the value of the assets transferred in a demerger bears to the total value of the assets of the demerged company immediately before the demerger.
- (iii) For determining the value of the property, any change in the value of assets consequent to their revaluation shall be ignored.
- (iv) Demerged company means the company whose undertaking is transferred pursuant to demerger, to the resulting company.
- (v) The splitting up or the reconstruction of any authority or a body constituted or established under a Central, State or Provincial Act, or a local authority or a public sector company, into separate authorities or bodies or local authorities or companies, as the case may be, shall be deemed to be a demerger if such split up or reconstruction fulfils the conditions specified by the Central Government.

'Resulting company' means one or more companies (including a wholly owned subsidiary thereof) to which the undertaking of the demerged company is transferred in a demerger and against which the resulting company issues shares to the shareholders of the demerged company and includes any authority or body or local authority or public sector company or a company established, constituted or formed as a result of demerger.

18.4.2 Exemption and benefits: A demerger transaction fulfilling the conditions of section 2(19AA) is free from capital gains tax, both with respect to the transfer of assets as well with respect to issue of shares to the shareholders.

Section 2(22) provides that the issue of shares directly to the shareholder pursuant to the demerger of an undertaking will not constitute deemed dividend.

Further, in respect of international demergers, provisions similar to amalgamation of foreign companies have been made. Transfer of shares of an Indian company pursuant to the demerger of a foreign company is exempt provided the following two conditions are satisfied.

- ◆ At least 75% of the shareholders in the demerged foreign company continue to be shareholders in the resulting company;
- ◆ Such transfer should not attract capital gains tax in the foreign company.

18.4.3 Accumulated losses and depreciation: Accumulated losses and depreciation relating to the undertaking being transferred in a scheme of demerger is allowed to be carried forward and set off in the hands of the resulting company.

In case such past losses cannot be directly attributed to the undertaking being transferred, the Act provides for the apportionment of the same between the demerged company and the resulting company in the same proportion in which the value of the assets have been transferred.

Depreciation in the hands of the resulting company: The depreciable assets base for tax purposes in the hands of the resulting company would be tax written down value in the hands of the demerged company.

Reduction from book value of assets in the hands of the demerged company: The tax depreciable assets base for the demerged company will be reduced by the tax written down value of the assets transferred in the demerger process.

Cost of acquisition of shares in the resulting company: In a demerger transaction, the shareholders of the demerged company are allotted shares in the resulting company by virtue of the demerger.

The cost of acquisition of the shares of the demerged company in the hands of the shareholders will be calculated by apportioning the cost of acquisition of the shares of the demerged company in the ratio of net assets transferred (to the resulting company) to the net worth of the demerged company.

18.5 Conversion of sole proprietary business into company

Where a sole proprietary concern is converted into a company and as a result of such conversion, the sole proprietary concern transfers any capital asset (whether tangible or intangible) to the company, such transfer will not be charged to capital gains tax if the following conditions are complied with:

- (i) all the assets and liabilities of the sole proprietary concern immediately before its succession should become the assets and liabilities of the company;
- (ii) the shareholding of the sole proprietor in the company is not less than 50% of the total voting power in the company and his shareholding continues to remain so for a period of 5 years from the date of succession;
- (iii) the sole proprietor does not receive any consideration or benefit (whether directly or indirectly) other than the shares allotted to him by the company section 47(xiv).

18.6 Conversion of Partnership Firm into Company

Where a firm is converted into a company and as a result of such conversion, the firm transfers any capital asset (whether tangible or intangible) to the company, such transfer will not be charged to capital gains tax if the following conditions are complied with:

- (i) all the assets and liabilities of the firm immediately before its succession should become the assets and liabilities of the company;
- (ii) all the partners of the firm immediately before its succession become the shareholders of the company in the same proportion in which their capital accounts stood before such succession;

- (iii) the partners of the firm do not receive any consideration or benefit (whether direct or indirect) other than the shares allotted to them by the company;
- (iv) the partners' aggregate shareholding in the company is not less than 50% of the total voting power in the company and their shareholding should continue to remain so for a period of 5 years from the date of succession [Section 47(xiii)].

Carry forward of loss and unabsorbed depreciation in case of re-organisation of business: If a firm or a proprietary concern is succeeded by a company fulfilling the conditions laid down in sections 47(xiii) and 47(xiv), then the accumulated loss and the unabsorbed depreciation of the predecessor firm or the proprietary concern shall be allowed to be carried forward and set off by the successor company.

If any of the conditions laid down in clause (xiii) or clause (xiv) are not complied with in any subsequent year, the set-off of loss or allowance for depreciation made in any previous year in the hands of the successor company shall be deemed to be the income of the company chargeable to tax in the year in which such conditions are not complied with.

Will the firm be liable to pay tax on depreciable assets?

If the transfer is on a going concern basis, even though no specific exemption is spelt out, the firm shall not be taxable since there can be no inference of a sale of any specific item comprised therein.

18.7 Conversion of a private company or an unlisted public company into a Limited Liability Partnership (LLP)

- (i) Consequent to the Limited Liability Partnership Act, 2008 coming into effect in 2009 and notification of the Limited Liability Partnership Rules w.e.f. 1st April, 2009, the Finance (No.2) Act, 2009 had incorporated the taxation scheme of LLPs in the Income-tax Act, 1961, on the same lines as applicable for general partnerships, i.e. tax liability would be attracted in the hands of the LLP and tax exemption would be available to the partners. Therefore, the same tax treatment would be applicable for both general partnerships and LLPs.
- (ii) Under section 56 and section 57 of the Limited Liability Partnership Act, 2008, conversion of a private company or an unlisted public company into an LLP is permitted. However, under the Income-tax Act, 1961, no exemption is available on conversion of a company into an LLP. As a result, transfer of assets on conversion would attract capital gains tax. Further, there is no specific provision enabling the LLP to carry forward the unabsorbed losses and unabsorbed depreciation of the predecessor company.
- (iii) Therefore, section 47(xiiib) provides that -
 - (1) any transfer of a capital asset or intangible asset by a private company or unlisted public company to a LLP; or
 - (2) any transfer of a share or shares held in a company by a shareholder

on conversion of a company into a LLP in accordance with section 56 and section 57 of the Limited Liability Partnership Act, 2008, shall not be regarded as a transfer for the purposes of levy of capital gains tax under section 45, subject to fulfillment of certain

conditions. This section facilitates conversion of small private and unlisted public companies into LLPs. These conditions are as follows:

- (1) the total sales, turnover or gross receipts in business of the company should not exceed ₹ 60 lakh in any of the three preceding previous years;
 - (2) the shareholders of the company become partners of the LLP in the same proportion as their shareholding in the company;
 - (3) no consideration other than share in profit and capital contribution in the LLP arises to the shareholders;
 - (4) the erstwhile shareholders of the company continue to be entitled to receive at least 50% of the profits of the LLP for a period of 5 years from the date of conversion;
 - (5) all assets and liabilities of the company become the assets and liabilities of the LLP; and
 - (6) no amount is paid, either directly or indirectly, to any partner out of the accumulated profit of the company for a period of 3 years from the date of conversion.
- (iv) However, if subsequent to the transfer, any of the above conditions are not complied with, the capital gains not charged under section 45 would be deemed to be chargeable to tax in the previous year in which the conditions are not complied with, in the hands of the LLP or the shareholder of the predecessor company, as the case may be [Section 47A(4)].
- (v) Further, the successor LLP would be allowed to carry forward and set-off the business loss and unabsorbed depreciation of the predecessor company [Sub-section (6A) of section 72A].
- (vi) However, if the entity fails to fulfill any of the conditions mentioned in (iii) above, the benefit of set-off of business loss/unabsorbed depreciation availed by the LLP would be deemed to be the profits and gains of the LLP chargeable to tax in the previous year in which the LLP fails to fulfill any of the conditions listed above.

18.8 Slump Sale

18.8.1 Definition: 'Slump sale' means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales. If value of an asset or liability is determined for the sole purpose of payment of stamp duty, registration fees or other similar taxes or fees, that should not be regarded as assignment of values to individual assets and liabilities.

One question that arises in this context is whether in a situation where an undertaking is transferred against the allotment of shares in the acquiring company, the transaction would qualify as "slump sale" under the Income-tax Act, 1961. One view in this regard is that the transfer must necessarily be effected against a monetary consideration and a transfer against allotment of share is merely an "exchange" which will not qualify as a "sale". However, a more reasonable view seems to be that the allotment of shares is merely a manner of discharge of consideration and the transaction would still qualify as a slump sale if other conditions are satisfied.

18.8.2 Chargeability: Any profits arising from the slump sale effected in the previous year shall be chargeable to tax as capital gains and shall be deemed to be the income of the previous year which the transfer took place. In relation to a capital asset being an undertaking or division transferred by way of such sale, the 'net worth' of the undertaking or the division shall be deemed to be the cost of acquisition and cost of improvement for the purposes of sections 48 and 49. The benefit of indexation shall not be allowed. If the undertaking is owned and held by the assessee for not more than 36 months, it shall be taken as short-term capital asset.

- ◆ The Supreme Court in the case of *R.C. Cooper vs. UOI: AIR 1970 SC 564 (610)* held that the undertaking is distinct from the various assets which comprise the undertaking. The aforesaid principle has now been statutorily recognised.
- ◆ "Undertaking" is defined to include any part of an undertaking or a unit or division of an undertaking or a business activity as a whole, but does not include individual assets or liabilities or any combination thereof not constituting business activity [Section 2(42C)].

In case of a slump sale, every assessee shall furnish in the prescribed form along with the return of income, a report of a Chartered Accountant indicating the computation of net worth of the undertaking or division, as the case may be, and certifying that the net worth of the undertaking or division has been correctly arrived at in accordance with the provisions of this section.

'Net worth' shall be the aggregate value of total assets of the undertaking or division as reduced by the value of liabilities of such undertaking or division as appearing in its books of account. Change in value of assets on account of revaluation shall be ignored. The value of depreciable assets shall be the written down value of block of assets determined in accordance with section 43(6)(c). The value of capital assets in respect of which the whole of the expenditure has been allowed or is allowable as a deduction under section 35AD would be Nil. The value of all other assets would be the book value.

The auditor of the company is required to give a certificate in Form No.3CEA (Rule 6H) relating to the computation of capital gains in case of slump sale. This certificate should be filed along with the return of income duly accompanied by copies of the profit and loss account and Balance Sheet in accordance with the provisions of section 139.

18.9 Buy Back of Shares

Section 77A of the Companies Act, 1956² allows a company to purchase its own shares subject to certain conditions. Section 2(22) of the Income-tax Act, 1961 provides that dividend does not include any payment made by a company on purchase of its own shares in accordance with the provisions of the Companies Act, 1956. Further, section 46A provides that the difference between any consideration received by a shareholder or a holder of other specified securities

² Section 68 of the Companies Act, 2013

from any company on purchase of its own shares or other specified securities and the cost of the shares/securities shall be deemed to be capital gains arising to such shareholder or the holder of other specified securities in the year in which such shares or other specified securities were purchased by the company.

Buyback of unlisted shares by domestic companies

In order to discourage the practice of domestic companies resorting to buy back of unlisted shares instead of payment of dividends in order to avoid payment of tax by way of DDT, especially if the capital gains arising to the shareholders are either not chargeable to tax or are taxable at a lower rate, a new Chapter XII-DA, comprising of sections 115QA, 115QB and 115QC, has been inserted with effect from 1st June, 2013 to levy additional income-tax on buy back of such shares by domestic companies. The income arising to the shareholders in respect of such buy back of unlisted shares by the domestic company would be exempt under section 10(34A) w.e.f. A.Y.2014-15, where the company is liable to pay the additional income-tax on the buy-back of shares.

Section 115QA provides that the distributed income (i.e., consideration paid by the company for buyback of its own unlisted shares which is in excess of the sum received by the company at the time of issue of such shares) would be subject to additional income-tax@20% (plus surcharge@10% and education cess@2% and secondary and higher education cess@1%) in the hands of the domestic company. The company is liable to pay such additional income-tax even though no income-tax may be payable by it in respect of its total income computed under the provisions of the Act.

18.10 Capital Reduction

Sale of a capital asset is not a pre-condition for capital gains. As a result of reduction in the face value of the shares, the share capital balance is reduced. It also extinguishes the right of the preference shareholder to receive dividend on the shares held and the right to share in the distribution of the net assets on liquidation in proportion to the extent of reduction in the capital. Such reduction in shareholder's right would amount to a transfer within the meaning of section 2(47) of the Act [*Kartikeya V. Sarabhai vs. CIT (1997) 228 ITR 163 (SC)*].

18.11 Redemption of Preference Shares

When a preference share is redeemed by a company, what the shareholder does in effect is to sell the share to the company. The company redeems its preference shares only by paying the preference shareholders the value of the shares and taking back the preference shares. In effect, the company buys back the preference shares from the shareholders. The redemption of preference shares by the company, therefore, is a sale and squarely comes within the phrase 'sale, exchange or relinquishment' of an asset [*Anarkali Sarabhai vs. CIT (1997) 224 ITR 422*].

Acquisition of irredeemable preference shares of a company in exchange of equity shares consequent to capital restructuring scheme of the company cannot be exchange of one kind of shares against another kind of shares having different rights and liabilities. Where the assessee sells the preference shares within 6 months of their acquisition, the capital gain/loss shall be short-term in nature [*CIT vs. Santosh L. Chowgule (1998) 234 ITR 787 (Bombay)*].

18.12 Conversion of Debentures into Shares

Any transfer by way of conversion of bonds or debentures, debenture stock or deposit certificates in any form, of a company into shares or debentures of that company is not regarded as transfer under section 47(x). Hence, if any amount is paid in cash etc., the entire transaction will attract capital gains tax.

Section 49(2A) states that where the capital asset, being a share or debenture in a company became the property of the assessee in consideration of a transfer referred to in section 47(x), the cost of acquisition of the asset to the assessee shall be deemed to be that part of the cost of debenture, debenture-stock or deposit certificates in relation to which such asset is acquired by the assessee.

18.13 Conversion of an Indian branch of foreign company into an Indian subsidiary company [Chapter XII-BB - Section 115JG]

- (i) The provisions of this section apply to a foreign company engaged in banking business in India through its branch situated in India, which is converted into an Indian subsidiary company in accordance with the scheme framed by RBI.
- (ii) If the conditions notified by the Central Government in this behalf are satisfied, then capital gains arising from such conversion would not be chargeable to tax in the assessment year relevant to the previous year in which such conversion takes place.
- (iii) Also, the provisions of the Act relating to computation of income of foreign company and Indian subsidiary company would apply with such exceptions, modifications and adaptations as specified in the notification.
- (iv) Further, the benefit of set-off of unabsorbed depreciation, set-off and carry forward of losses, tax credit in respect of tax paid on deemed income relating to certain companies available under the Act shall apply with such exceptions, modifications and adaptations as specified in the notification.
- (v) If the conditions specified in the scheme of RBI or notification issued by the Central Government are not complied with, then, all the provisions of the Act would apply to the foreign company and Indian subsidiary company without any benefit, exemption or relief under this section.
- (vi) If the benefit, exemption or relief has been granted to the foreign company or Indian subsidiary company in any previous year and thereafter, there is a failure to comply with any of the conditions specified in the scheme or notification, then, such benefit, exemption or relief shall be deemed to have been wrongly allowed.
- (vii) In such a case, the Assessing Officer is empowered to re-compute the total income of the assessee for the said previous year and make the necessary amendment. This power is notwithstanding anything contained in the Income-tax Act, 1961.
- (viii) The provisions of rectification under section 154, would, accordingly, apply and the four year period within which such rectification should be made has to be reckoned from the end of the previous year in which the failure to comply with such conditions has taken place.
- (ix) Every notification under issued under this section shall be laid before each House of Parliament.

Taxation of E-Commerce Transactions

19.1 What is E-Commerce?

E-commerce or electronic commerce, in its widest sense, means consumer and business transactions conducted over a network, using computers and telecommunications. In other words, e-commerce refers to the exchange of goods or services for value on the internet. It includes, *inter alia*, on-line shopping, on-line trading of goods and services, electronic fund transfers, electronic data exchanges and on-line trading of financial instruments.

The OECD defines e-commerce in a somewhat more restricted manner as commercial transactions between individuals and organisations, based on the processing or transmission of digitised data units, sound, and visual images, which are carried out over open networks (like internet) or over closed networks (like minitel) with a gateway to open networks. This more specific definition would therefore exclude electronic data interchange (EDI), carried out over closed networks, if such EDIs are being used by themselves, without access to an open network (e.g. credit cards used over a closed network, connecting specified merchants with a card organisation).

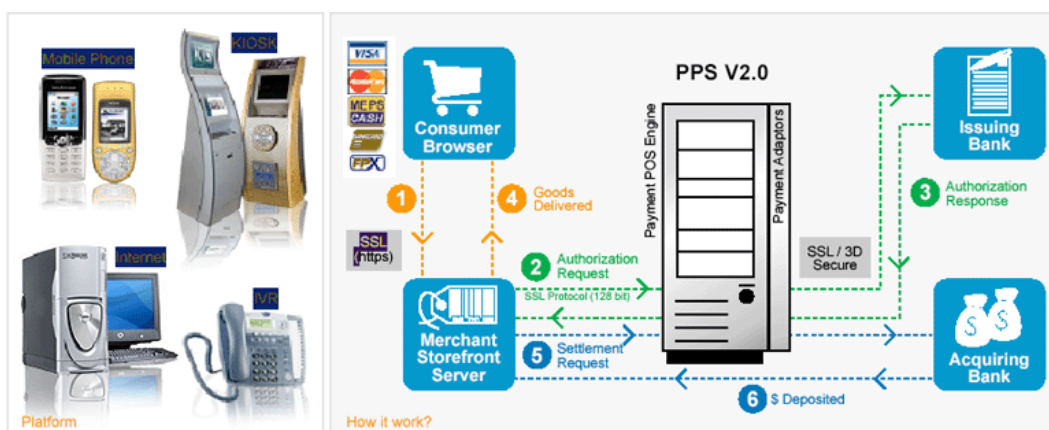


Figure 19.1.1 Illustrates an e-commerce transaction. Source: www.ocsb.com.my/ePayment.htm

Whatever be the definition, this method of carrying on a business is widely different from the traditional practice of business. Whereas traditional businesses have rested squarely on the physical presence and delivery of goods, in doing business via the internet, as is the case in e-commerce transactions, physical presence of goods is not required at all. Consequently, geographical boundaries between nations hold no significance. Secondly, in such type of transactions, physical delivery of goods is not necessary. Where the goods and services are

available in digital form, e.g. computer software, music, magazines, drawings etc. physical transactions are replaced by transfer of bytes. Thirdly, e-commerce transactions can be completed almost instantaneously across the world and irrespective of the time of the day.

19.2 Issues and Problems in taxing E-Commerce transactions

Due to absence of national boundaries, physical presence of goods and non-requirement of physical delivery, taxation of e-commerce transactions raises several issues. They have to be understood in the light of international taxation. International taxation arises from cross border transactions for the reason that the author of the transactions arises in one country (called the Home State) and the sites of the transactions is in the other country (Host State).

Income arising out of such transaction is subject to tax in both countries by virtue of 'personal attachment' to the transfer (in the Home State) and again by virtue of 'economic attachment' to the income itself (in the Host State). Thus, this gives rise to double taxation of the same income. This problem is generally solved by a Double Taxation Avoidance Agreement (DTAA) between the two countries concerned. The problematic issues arising in respect of e-commerce transactions are as follows:

19.2.1 How to determine 'economic attachment': In order to determine economic attachment, the *situs* of the transactions should be clearly determined. In a traditional commerce transaction, the *situs* of the transaction is clearly known, because of the physical presence and the physical delivery. Therefore the Source Rule as laid down in section 9 of the Income-tax Act, 1961 can be clearly applied to effect Host State taxation. Section 9 provides that income is deemed to accrue or arise in Indian taxable territory if there is a business connection. In E-commerce situations, with transactions being completed in cyberspace, it is often not clear as to the place where the transaction is effected, giving rise thereby to difficulties in implementing Source Rule taxation.

19.2.2 How to determine existence of a permanent establishment : Under most bilateral double tax treaties, a country will seek to tax corporate business profits if they can be applied to a 'permanent establishment' in that country. The basic requirement is, therefore, that there must be a place of business and it must have some permanence.

The major taxation problem of e-commerce is that no establishment is necessary across the border to carry on business. With regard to tangible property, the source can be traced, as the delivery has to cross the other territory through the customs or postal barrier. The destination also will be known from the shipping address. Where the seller is located in a tax-haven country, it becomes difficult to enforce tax laws on the non-resident business. In such cases, the natural option should be to tax the resident as the agent, especially where the non-resident cannot be reached. The difficulty is not so much in taxing those who are assessed and who maintain accounts but in taxing others who do business and there is no record of their transactions, like the persons liable to pay the 'use tax' in US. With the development of WAP (Wireless Application Protocol) which integrates mobile telephony with the Internet, e-commerce will be taken over by M-commerce (Mobile Commerce). This makes the place of origin of business invisible thus adding complication to the existing scenario and is a real challenge to domestic jurisprudence.

Further, how such income is to be attributed to the permanent establishment is also a significant matter. This is relevant to determine whether income from sales can be taxed on host country soil. For instance, if a particular income is classified as royalties or fees for technical services, or dividends or interests, then irrespective of the existence of a permanent establishment, the income will be liable to host country taxation under section 115A of the Income-tax Act, 1961. On the other hand, if the income is classified as income from sales, then unless there is a permanent establishment, there can be no taxation in the host country. And if there is a permanent establishment, how much income is to be taxable will be determined by how much of the income is to be attributed to the permanent establishment.

19.2.3 Legal difficulty: Till now all cross-border commercial transactions have to cross the customs barrier or the postal barrier. All trade and commerce are operated in a physical world and in terms of tangible goods. Hence, there is a check on these transactions, though smuggling remains outside the scope of any control. Even in the present situation, the tax authorities are unable to fully grapple with the problem of myriad ways of tax evasion. In e-commerce transactions, the contracting parties are in two different states and, therefore, the question would arise as to which state law would be applied.

19.2.4 Nature of contract: A contract need not necessarily be in writing unless, the statute requires it to be so. It can be oral. This will create problems relating to the law that will be applicable in case of dispute. In a contract, generally the parties are free to choose the law applicable to the contract and the same can be expressed or implied in the terms of the contract. In some cases, the principal place of business is relevant in deciding the law applicable. In some other case, the place where the buyer normally resides decides the law to be applied. Where there is a clause for retention of title until the buyer performs some act, then the matter of which *lex situs* will govern the validity clause is open to question. In answering this, the Rome Convention says that if the contract accords with the rules of anyone of the States, its validity cannot be questioned. This would be the most satisfactory solution and can be followed. All these problems arise mostly regarding transactions relating to movables and those relating to immovable properties are less difficult. There are many areas where the present domestic laws including international laws would be inadequate to deal with the emerging new field of e-commerce.

19.2.5 Taxable jurisdiction: The taxable jurisdiction of any country covers its national boundary. Besides this the territorial jurisdiction includes territorial sea and airspace above as per the territorial waters, continental shelf, exclusive economic zone and other Maritime Zones Act, 1976. Each one extends to specified nautical miles from the base line. The following are the limits indicated therein:

- (i) Territorial Water - 12 nautical miles from the nearest point of appropriate base line.
- (ii) Contiguous Zone - 24 nautical miles beyond and adjacent to the territorial waters from the base line.
- (iii) Continental Shelf - 200 nautical miles from the base line.
- (iv) Exclusive Economic Zone is an area beyond and adjacent to the territorial waters extending to 200 nautical miles from the base line.

But electronic commerce takes place through satellite and the server can be in any part of the globe. It can in all probability be in a tax-haven country. Another condition for taxing the income arising or accruing beyond the taxable territories in the physical residence of the taxpayer for 182 days or more. This becomes meaningless with the Internet access. The information highway provides numerous visits to another jurisdiction outside the control of border mechanism.

19.3 How business is transacted through E-Commerce

E-commerce is but a method of conducting business transactions and not a business transaction by itself. Therefore, the contents of a business transaction done through e-commerce are no different from that of a business transaction carried out through traditional means.

Divergence however arises in two dimensions - the business methods and the business concepts. The first area, which is very different, viz. the means of doing business, is analysed. In e-commerce there are three distinct means of doing business: electronic advertising, electronic sales and electronic delivery. The presence of anyone or more of these is sufficient to characterise the business as e-commerce.

These are separately discussed below :

19.3.1 Electronic advertising: Advertising is done on the open networks, through websites. Potential customers access the websites and obtain the information they need which enables them thereafter to proceed with the transaction in suitable cases. If the e-commerce business is restricted to putting up a website alone, then the rest of the transaction is completed through traditional means; i.e. the placing of orders by telephone or mail, the making of payment by cheque and credit card and the delivery of goods through a carrier, the telephone etc. being referred to as intermediaries.

19.3.2 Electronic sales: This is done through 'smart' resources which enable the potential customer to place an order on the internet. The payment is effected through a closed network by means of credit cards.

19.3.3 Electronic delivery: This is of course possible only for goods and services that can be fully digitised, but this range is quite wide and ever expanding. Texts, visual materials, audio materials and computer software are digitised. Therefore products like journals, books, music, plans, designs, drawings and games to mention a few, would be goods available in digitised form. Besides goods, services like diagnostic services, could also be available in digitised form. Therefore a whole host of goods and services could be delivered electronically.

One way of classifying E-commerce is based on parties involved in transactions. Major types are mentioned below:

1. Business to Customers (B2C)
2. Business to Business (B2B)
3. Government to Customers (G2C)
4. Government to Business (G2B)
5. Customer to Customer (C2C)

The name of a type indicates the parties involved in that type of E-commerce transaction.

19.3.4 The Committee of Fiscal Affairs of the OECD has been actively working on taxation issues relating to e-commerce. The committee has developed the taxation framework conditions setting forth the governing principles in relation to e-commerce. The key conclusion was that the taxation principles that guide Governments in relation to conventional commerce, should also guide them in relation to e-commerce. It was postulated that this would be possible only by adapting and adopting the existing principles to e-commerce situations.

For adapting and adopting the existing principles, the following key areas in the context of international tax were identified:

- (1) the extent to which a website or a server can constitute a permanent establishment and how income may be attributed to it; and
- (2) the manner in which payments for digitised products are to be characterised.

19.4 Permanent Establishment In E-Commerce Situations

We now discuss different situations which arise in an e-commerce environment and consider whether these situations would constitute a permanent establishment.

19.4.1 Situation 1 - Existence of a website on host country soil: A website may be defined as a set of web documents belonging to a particular organisation. It consists of data and programmes in digitised form which is stored on a server of the internet service provider. On the other hand, a permanent establishment, as the name itself suggests, is a fixed place of some permanence from where a business is carried on. Therefore, the existence of a website, by itself, would not constitute a permanent establishment.

19.4.2 Situation 2 - Server on host country soil: A server is a system which carries out activities initiated by an end-user's computer. The question whether a server can be considered as a permanent establishment is more complicated. It is possible that the enterprise that operates the server may be different from the enterprise that carries on business through the website. The use of a particular internet service provider (ISP) does not give website owner the right of control over the server's operation. The server's location is not at that enterprise's disposal. The server could easily be removed to other locations.

In such a situation, the server's location cannot be considered to be the place of business.

On the other hand, if the enterprise itself owns or leases and operates the server, and the computer equipment is fixed, and business is carried on through the server, it could be construed to be a permanent establishment. Therefore what is essential to be considered in this issue, is not merely whether a server exists or host country soil, but also what the values as well as extent of its operations are. As the permanent establishment concept deals not only with permanence and a geographical link with the host soil, but also with the actual carrying on of the business, the values and extent of the operations carried out by the server becomes important. We now consider separately the above points.

Nature of operation - The nature of operations could have a very wide range. The range could profess from being a mere provider of information, to being a forwarding address to acting as a warehouse for digitised goods, to contributing directly to productivity and value creation, thereby realising profits. In a situation where the server acts as a mere provider of

information it cannot be considered to be a permanent establishment. At the other end, where it contributes to productivity, the server will become a permanent establishment for distinctions which falls in between these two entrances, it would be necessary to go to the next step of examining the extent of operations.

Extent of operations- In the extent of operations, as well, there could be a wide range of activities. A server could be simply located on host country soil with skeletal support services, or it could be a server with multiple services, or it could be a server which carries on the complete set of operations. In the last situation, there would clearly be a permanent establishment.

19.4.3 Situation 3 - Server functioning as agent: It is possible that a server on host country soil could be construed to be a dependent agent of the foreign enterprise. Such a situation will apply in the case of 'Smart' servers. 'Smart' servers are programmed to not only provide information but also to take and process orders from persons who make a 'hit' on the website. Such a server has the power to contract on behalf of the foreign enterprise and habitually exercises this power. It is possible to argue that since such a server is a dependent agent of the foreign enterprise, it may be considered to be a permanent establishment. However, a contrary and more logical view would be that the website together with the server that hosts it can only constitute the medium through which orders are placed. The time acceptance of the order is not done by the machine itself but by the person or corporation which inserted into the machine a programme capable of performing these tasks. Therefore, the website and the server would not constitute a permanent establishment.

According to the principles of international taxation, business income cannot be taxed on Host State soil, unless there is a permanent establishment in the Host State. If there is such a permanent establishment, then the only income which the Host State is entitled to tax is the income attributable to the permanent establishment. Such attributable income is determined by imagining the permanent establishment to be an entity independent of the foreign enterprise, and dealing with the foreign enterprise at arm's length price. The issue therefore translates to one of determining the transfer price between the foreign enterprise and permanent establishment, and rewriting the transaction between the two, at arm's length.

19.5 Determination of the Nature of Income

The manner of taxation in income arising from e-commerce transactions, as it also the case in conventional commercial transactions, depends on the characterisation of the income. The characterisation of income is relevant because different types of income are taxed differently. Once this is identified, the existing rules may be adopted and adapted to the e-commerce transactions.

In conventional commerce, when all rights in a property are transferred it would amount to a sale giving rise therefore to business income. On the other hand, when only limited rights in a property are transferred, the transferor retaining substantial rights therein, the income therefrom would be classified either as a royalty in the case of intellectual properties, or a lease rent in the case of tangible properties. Thirdly, if the ultimate results of the transaction is the rendering of services, the income would have to be characterised either as fees for professional services.

Similarly, in an e-commerce situation, if licensing of a know-how is done, the payment for this would clearly be characterised as a royalty income in terms of most double taxation avoidance agreements and this would be so irrespective of whether this is done by physical transfer of information or by transfer of digitised information. If on the other hand, practically all rights in a design are transferred, whether physically or through electronic transfer of digitised information, with no rights being retained by the transferor, under most double taxation avoidance agreements, the transaction would be considered to be one which is more in the nature of outright sale of the design rather than a licence thereof. The payment for this would then be characterised as a sale consideration rather than as a royalty.

The principles of adopting and adapting postulated by the OECD and the US treasury unable a proper determination of the character of income in most cases. However, the problem arises in the case of transactions involving software. This is discussed below:

Transactions involving software: The process of adopting and adapting existing rules to e-commerce transactions becomes complicated in the case of transactions involving software. For instance, where a packaged product like Windows 98 is sold, we normally refer to it as buying a product. Moreover, this sale in reality is not a sale but an agreement or a license to use the software. The product comes in a transparent shrink wrap packaging through which the license agreement can be read.

When the buyer tears open the packaging, this act is tantamount to his signing the agreement or license. By doing so, the buyer (licensee) accepts the terms of the license, i.e. he agrees to use the software only at that one work station, to not make copies except for archival purposes, to not alter the contents, etc.. When it comes to taxation of such transactions the characterisation of the income would become extremely relevant. If the transactions were to be treated as one of licensing, irrespective of the fact that there might be no permanent establishment in the buyer's State, the amount paid by the buyer would, (according to most double taxation avoidance agreements and most domestic tax laws), be considered not as a sale consideration, but as a licence fee constituting a royalty and this would therefore be subject to Host State taxation on the basis of the Source Rule, the payer of the consideration being a resident of the Host State.

Let us now examine this issue in the context of Indian law.

Section 14 of the Copyright Act, 1957, as amended by the Copyright (Amendment) Act, 1999, defines "copyright" to mean the exclusive right to do or authorise the doing of any of the following acts, in respect of a work or any substantial part thereof

- (a) in the case of a literary, dramatic or musical work, not being a computer programme,-
 - (i) to reproduce the work in any material form, including the storing of it in any medium by electronic means;
 - (ii) to issue copies of the work to the public not being copies already in circulation;
 - (iii) to perform the work in public; or communicate it to the public;
 - (iv) to make any cinematograph film or sound recording in respect of the work;
 - (v) to make any translation of the work;

- (vi) to make any adaptation of the work;
- (vii) to do, in relation to a translation or an adaptation of the work, any of the acts specified in relation to the work in sub-clause (i) to (vi);
- (b) in the case of a computer programme, -
 - (i) to do any of the acts specified in clause (a);
 - (ii) to sell or give on commercial rental or offer for sale or for commercial rental any copy of the computer programme.

However, such commercial rental does not apply in respect of computer programme where the programme itself is not the essential object of the rental.

Therefore, most of the computer programmes, including software would clearly be considered to be covered by copyright. If software is licensed or its use is permitted in any manner, in accordance with Explanation 2 to section 9(1)(vi) of the Income-tax Act, the income would be royalty in nature. The income would therefore be deemed to arise in India in accordance with section 9(1)(vi)(b) when the payer of the same is an Indian resident, unless it could be established that the software is used in a business outside India. When therefore purchase consideration in respect of any software to be used in India is paid to a non-resident who has exported software, the payment will be construed as income deemed to arise or accrue within India, in terms of section 9(1)(vi); it would become income of the non resident subject to Indian tax in terms of section 5(2); and consequently tax would require to be deducted by the buyer of the software in terms of section 195. In terms of most double taxation agreements entered into by India with other countries, again the amount would be considered royalty income accruing or arising within India, and therefore subject to Indian withholding tax.

19.6 Conclusion

Despite the divergence of method between traditional commercial transaction and e-commerce transactions, it is essential to conform to the tenets of neutrality of taxation.

On account of the characteristics of e-commerce namely that transactions are completed in cyberspace, thereby making national boundaries meaningless, and considering the level of dis-intermediation and non-traceability of the path of the transactions, traditional Source Rules of taxation become increasingly difficult to apply.

As techniques of e-commerce progress, the situations become more complex with increasing dis-intermediation. Instances of these could be where traditional transfer pricing rules cannot be applied to multiple servers which switch signals depending on their work loads. This could give rise to increasing emphasis on Residence Rule taxation whenever Source Rule taxation becomes difficult to apply. Such a situation could spell diminishing revenues for developing countries, particularly in situations of technology transfers, where Host States are generally developing countries.

20.1 Appointment and Control [Sections 116 to 119]

The following are the classes of income-tax authorities:

- (i) The Central Board of Direct Taxes.
- (ii) Directors-General of Income-tax or Chief Commissioners of Income-tax.
- (iii) Directors of Income-tax or Commissioners of Income-tax or Commissioners of Income-tax (Appeals).
- (iv) Additional Directors of Income-tax or Additional Commissioners of Income-tax or Additional Commissioners of Income-tax (Appeals).
- (v) Joint Directors or Joint Commissioners of Income-tax
- (vi) Deputy Directors of Income-tax or Deputy Commissioners of Income-tax.
- (vii) Assistant Directors of Income-tax or Assistant Commissioners of Income-tax.
- (viii) Income-tax Officers.
- (ix) Tax Recovery Officers.
- (x) Inspectors of Income-tax.

20.1.1 Assessing Officer: In this connection, it may be noted that under section 2(7A), the term 'Assessing Officer' means –

- (a) the Assistant Commissioner or Deputy Commissioner or Assistant Director or Deputy Director; or
- (b) the Income-tax Officer who is vested with the relevant jurisdiction by virtue of directions or orders issued under section 120(1) or (2) or any other provision of the Act; and
- (c) the Additional Commissioner or Additional Director or Joint Commissioner or Joint Director who is directed under section 120(4)(b) to exercise or perform all or any of the powers and functions conferred on, or assigned to, an Assessing Officer.

20.1.2 Central Board of Direct Taxes (CBDT): The Central Board of Direct Taxes is a statutory body constituted under the Central Board of Revenue Act, 1963. It consists of a number of members appointed by the Central Government for the performance of such duties, as may be entrusted to the Board from time to time. It is functioning under the jurisdiction of the Ministry of Finance. The Central Board of Direct Taxes, besides being the highest

executive authority, exercises control and supervision over all officers of the Income-tax Department and is authorised to exercise certain powers conferred upon it by the Income-tax Act, 1961. In particular, it has the powers, subject to the control and approval of the Central Government to make any rules, from time to time for the proper administration of the provisions of the Income-tax Act, 1961.

All the rules under the Act are framed by the Board under section 295 and placed before the Parliament. In addition to the general power of making rules and of superintendence, the Board has been given specific powers on several matters.

The Board has been empowered under section 119 to issue instructions and circulars to its subordinates for the proper administration of the Act. It is obligatory for the various authorities and all other persons employed in the execution of the Act to observe and follow such orders, instructions and directions of the Board. However, the Board is not empowered to issue orders, instructions or directions in such a way as to (i) require any income-tax authority to make the assessment of a particular case in a particular manner or (ii) interfere with the discretion of the Commissioner (Appeals) in the exercise of his appellate functions. Further, the Board may, if it considers necessary or expedient to do so, for the purpose of proper and effective management of the work of assessment and collection of revenue, issue general or special orders from time to time in respect of any class of incomes or class of cases setting forth directions and instructions not being prejudicial to the assessee. In appropriate cases, the Board may relax the provisions of sections 115P, 115S, 139, 143, 144, 147, 148, 154, 155, 234A, 234B, 271 and 273. The Board can exercise its powers to remove difficulties in the matter of sections 201(1A), 210, 211 and 234C. The following table gives a brief glimpse of what these sections relate to –

Section	Particulars of section
115P	Interest payable for non-payment of tax by domestic companies
115S	Interest payable for non-payment of tax on distributed income to unit-holders
139	Return of income
143	Assessment of income
144	Best Judgment Assessment of income
147	Income escaping assessment
148	Issue of notice where income has escaped assessment
154	Rectification of mistake apparent on record
155	Other amendments relating to assessment of income
201(1A)	Interest for non-deduction of tax or non-payment of tax after deduction by such person/principal officer/company, as the case may be.
210	Payment of advance tax by the assessee of his own accord or in pursuance of order of Assessing Officer.
211	Installments of advance tax and due dates
234A	Interest for default in furnishing return of income
234B	Interest for default in payment of advance tax

20.3 Income tax

234C	Interest for deferment of advance tax
271	Penalty for failure to furnish returns, comply with notices, concealment of income etc.
273	Penalty for false estimate of, or failure to pay, advance tax

The Central Government may appoint such persons as it thinks fit to be income-tax authorities. It may also authorise the Board or a Director General, a Chief Commissioner or a Director or a Commissioner to appoint income-tax authorities below the rank of an Assistant Commissioner or Deputy Commissioner. An income-tax authority authorised by the Board may appoint such executive or ministerial staff as may be necessary to assist it in the execution of its functions. The Board may also direct, by way of notification, that any Income-tax authority or authorities shall be subordinate to such other income-tax authority as may be specified.

20.2 Jurisdiction of Income-tax Authorities

The income-tax authorities shall exercise all or any of the powers and perform all or any of the functions conferred on, or assigned to, such authorities in accordance with the directions issued by the CBDT for the exercise of such powers and performance of the functions by all or any of those authorities [Section 120(1)].

Any income-tax authority, being an authority higher in rank, may exercise the powers and perform the functions of the income-tax authority lower in rank, if so directed by the CBDT. Such direction issued by the CBDT shall be deemed to be a direction issued under the said section 120(1).

In issuing such directions the Board may have regard to the following criteria:

- (a) Territorial area.
- (b) Persons or classes of persons.
- (c) Incomes or classes of incomes.
- (d) Cases or classes of cases.

The CBDT can authorise any Director General or Director of Income-tax to perform such functions of any other income-tax authority.

The CBDT can empower the Director General or Chief Commissioner or Commissioner to issue orders in writing to the effect that the powers and functions conferred on or assigned to the Assessing Officer under this act in respect of any specified area or person or class of person or persons or incomes or classes of income or cases or classes of cases shall be exercised or performed by a Joint Commissioner or Joint Director.

Further, the powers and functions conferred on or assigned to the Assessing Officer may also be exercised or performed by an Additional Commissioner and Additional Director, on issue of order in writing to that effect by the Director General, Chief Commissioner or Commissioner.

The CBDT or any other authority authorised in this behalf can confer jurisdiction with more than one income-tax authority in relation to any case.

20.2.1 Jurisdiction of Assessing Officers [Section 124]

- (i) Where the Assessing Officer has been vested with jurisdiction over any area within the limits of such area he shall have jurisdiction in respect of any person carrying on business or profession within that area or in respect of a person whose business or profession is carried on in more than 1 places, if his principal place of business is in that area and in respect of any other person residing within the area.
- (ii) Where a question arises under this section as to whether an Assessing Officer has jurisdiction to assess any person the question shall be determined by the Director General or the Chief Commissioners or Commissioner.

In case the question relates to an area within the jurisdiction of different Director General or Chief Commissioners or Commissioner then the question shall be determined by the Director General or Chief Commissioners or Commissioners concerned or if they are not in agreement, then the same shall be determined by the Board or by such Director General or Chief Commissioner or Commissioner as the Board may specify by way of notification in the Official Gazette.

- (iii) Section 124(3)(a) provides that no person shall be entitled to call in question the jurisdiction of an Assessing Officer where such person has made a return of income under section 139(1), after the expiry of one month from the date on which he was served with a notice under section 142(1) or section 143(2) or after the completion of the assessment, whichever is earlier.
- (iv) Section 124(3)(b) provides that the jurisdiction of the Assessing Officer shall not be called in question where no return has been made, after the expiry of the time allowed by the notice under section 142(1) or under section 148 for the making of the return or by the notice under section 144, whichever is earlier.
- (v) Where the assessee questions the jurisdiction of an Assessing Officer, then, the Assessing Officer shall, if not satisfied with the correctness of the claim refer the matter for determination under (ii) above before the assessment is made.
- (vi) Every Assessing Officer shall have all the powers conferred by or under this Act on an Assessing Officer in respect of the income accruing or arising or received within the area, if any, over which he has been vested with jurisdiction by virtue of the direction or order issued under section 120(1) and 120(2).

20.2.2 Power to transfer cases [Section 127]

- (i) The power to transfer a case from one Assessing Officer to another subordinate Assessing Officer or Officers is vested with the Director General or Chief Commissioner or Commissioner of Income-tax. However, this power can be exercised only after giving the assessee a reasonable opportunity of being heard and after recording reasons for doing so, wherever possible.
- (ii) There may be situations where the Assessing Officer from whom the case is transferred and the Assessing Officer to whom the case is transferred do not fall under the control of

the same Director General or Chief Commissioner or Commissioner of Income-tax. In such cases, the Director General or Chief Commissioner or Commissioner of Income-tax from whose jurisdiction the case is transferred shall pass an order, if such concerned higher authorities mutually agree for such transfer.

- (iii) If the higher authorities are not in agreement about the transfer, then, the Board or any such authority authorized by the Board may pass the order.
- (iv) If the case is transferred between Assessing Officers within the same city or locality or place, then, it is not necessary to give the assessee an opportunity of being heard.
- (v) The transfer of a case may be made at any stage of the proceedings and it is not necessary to reissue any notice already issued.
- (vi) For the purpose of section 120 and section 127, case in relation to any person whose name is specified in any order or direction issued thereunder, means all proceedings under this act in respect of any year which may be pending on the date of such order or direction or which may have been completed on or before such date, and includes also all proceedings under this act which may be commenced after the date of such order or direction in respect of any year.

20.2.3 Change of Income-tax Authority [Section 129]

- (i) In cases where an income-tax authority succeeds another income-tax authority, who ceases to exercise jurisdiction, then, the succeeding income-tax authority may continue the proceedings from the stage at which the proceedings was left by his predecessor.
- (ii) The assessee concerned can demand that before continuance of proceedings as in (i) above, the previous proceedings or any part thereof be reopened or be reheard before passing of any assessment order.

20.3 Powers of Income-tax Authorities [Sections 131 to 136]

20.3.1 Discovery, production of evidence etc. [Section 131]: The Assessing Officer, Deputy Commissioner (Appeals), Joint Commissioner, Commissioner (Appeals), the Chief Commissioner and the Dispute Resolution Panel referred to in section 144C have the powers vested in a Civil Court under the Code of Civil Procedure, 1908 while dealing with the following matters:

- (i) discovery and inspection;
- (ii) enforcing the attendance of any person, including any officer of a banking company and examining him on oath;
- (iii) compelling the production of books of account and documents; and
- (iv) issuing commissions [Section 131(1)]

The powers aforementioned are normally those exercisable by a Court when it is trying a suit. While exercising these powers, the authorities act in a quasi-judicial capacity and ought to conform to the principles of judicial procedure.

If the Director General or Director or Joint Director or Assistant Director or Deputy Director or the authorized officer referred to in section 132(1), before he takes action under the said sub-section, has reason to suspect that any income has been concealed, or is likely to be concealed, by any person or class of persons, within his jurisdiction, then for the purposes of making an enquiry or investigation relating thereto, it shall be competent for him to exercise the powers conferred in section 131(1) on the income-tax authorities referred to therein, even if no proceedings with respect to such person or class of persons are pending before him or any other income-tax authority [Section 131(1A)].

For facilitating quick collection of information on request from tax authorities outside India, notified income-tax authorities (not below the rank of Assistant Commissioner of Income-tax), as may be notified by the Board, to now have powers under section 131(1) for making an inquiry or investigation in respect of any person or class of persons relating to an agreement for exchange of information under section 90 or 90A, even if no proceeding is pending before it or any other income-tax authority with respect to the concerned person or class of persons [Section 131(2)].

Further, the said income-tax authority is vested with the power to impound or retain in its custody for such period as it may think fit, any books of account or other documents produced before it in any proceeding under this Act. The powers are unrestricted in the case of all the authorities except the Assessing Officer or an Assistant Director or Deputy Director whose powers are subjected to two restrictions; (i) he must record his reasons for impounding books of account or other documents; and (ii) if he desires to retain in his custody any such books or documents for a period exceeding fifteen days (excluding holidays), he must obtain the prior approval of the Chief Commissioner or Director General or Commissioner or Director, as the case may be, for the purpose [Section 131(3)].

20.3.2 Search and Seizure [Section 132]: Under this section, wide powers of search and seizure are conferred on the income-tax authorities. The important points relating to this provision have been briefly summarised below:

The provisions of the Criminal Procedure Code relating to searches and seizure would, as far as possible, apply to the searches and seizures under this Act. Contravention of the orders issued under this section would be punishable with imprisonment and fine under section 275A.

(i) Search and seizure can be authorised by Director General or Director or the Chief Commissioner or Commissioner or Additional Director or Additional Commissioner or any such Joint Director or Joint Commissioner as may be empowered by the Board. A Director General or Director or the Chief Commissioner or Commissioner may authorise any Joint Director, Joint Commissioner, Additional Director or Additional Commissioner, Assistant Director, or Deputy Director, Assistant Commissioner or Deputy Commissioner or Income-tax Officer. A Additional Director or Additional Commissioner, Joint Director or Joint Commissioner can authorise Assistant Director or Deputy Director or Assistant Commissioner or Deputy Commissioner or Income-tax Officer.

Thus, under section 132(1), the income-tax authorities listed above are empowered to authorise other income-tax authorities to conduct search and seizure operations.

The authorities empowered to issue authorization are:

- (1) Director General or Chief Commissioner;
 - (2) Director or Commissioner; and
 - (3) such Additional Director or Additional Commissioner, Joint Director or Joint Commissioner as are empowered by the CBDT to do so.
- (ii) Such authorisation could take place if the authority believes, on the basis of information in his possession:
- (a) that the person to whom a summons under section 131(1) or notice under section 142(1) was issued to produce or cause to produce books of account or other documents has omitted or failed to do so; or
 - (b) that a person to whom a summons or a notice has been or might be issued, does not or would not produce any books of account or other documents called for or which will be useful or relevant to any proceeding under the Income-tax Act, 1961 or
 - (c) that a person who is in possession of any valuable articles or things, including money, bullion or jewellery etc. (which has not been disclosed or would not be disclosed by the person concerned for income-tax purposes).
- (iii) Such an authorisation can empower the authorised officer to enter any building or place or vehicle, vessel or aircraft where he has reasons to suspect that such books of account, documents, articles including money, jewellery, valuables etc. are kept and in case they are found, he may seize them, place marks of identification on them or make a note or inventory thereof for the purpose. However, any bullion, jewellery or other valuable article or thing, which is in the nature of stock-in-trade of the business, found as a result of search shall not be seized but the authorised officer shall make a note or inventory of such stock-in-trade of the business. The person who is in possession or control of books of account or other documents maintained in the form of electronic records, shall be required to afford the necessary facility to authorised officer to inspect all such books of account or other documents.
- Electronic record as defined in section 2(1)(t) of the Information Technology Act, 2000 means data, record or data generated, image or sound stored, received or sent in an electronic form or microfilm or computer generated microfile.
- In the discharge of such a duty, he is authorised to break open the locks in case keys are not readily available. However, the books of account and other documents seized should be returned within a period of 30 days from the date of the order of assessment under section 153A or section 158BC(c), unless the reasons for retaining the same are recorded and approved by the Chief Commissioner or Commissioner or Director General or Director. The books or other records cannot be retained for a period exceeding 30 days after the assessment proceedings for the relevant year are over. The persons from whose custody any books of account or other documents have been seized may make copies thereof or take extracts therefrom.
- (iv) The Authorised Officer is empowered to search any person in or about the building or place in respect of which a search has been authorised, if he has reason to suspect that any article for which the search is being made is concealed about his person. This Authorised

Officer is also entitled to search any person who has got out of or is able to get into or is in the building, place, vessel, vehicle or aircraft in respect of which a search has been authorised, if he has reason to suspect that such person has secreted about his person any books of account or other documents, money, bullion, jewellery or other valuable articles for which the search is being made.

(v) The Commissioner of Income-tax has the power to authorise the search of any building, place, vessel, vehicle, aircraft etc., within his territorial jurisdiction and also in cases where he has no jurisdiction over the persons concerned, if he has reason to believe that any delay in obtaining authorisation from the Commissioner having jurisdiction over the person would be prejudicial to the interests of revenue.

(vi) Where a search for any books of account or other documents or assets has been authorised by any authority who is competent to do so, and the Commissioner has reason to suspect that such books of account or the documents of the assessee are kept in any building, place, vessel, vehicle or aircraft not specified in the search warrant, he may authorise the authorised officer to search such other building, place, vessel, vehicle or aircraft. Accordingly, if a search warrant is issued by the Commissioner of Income-tax, authorising the search of a premises in a particular place specified in the search warrant and the Authorised Officer finds that the books of account or other documents and/or assets have been secreted in a building or place not specified in the search warrant, he could request the local Commissioner to authorise him to search that building or place.

(vii) Now there is a rebuttable presumption to the effect that the books of account or other documents and assets found in the possession of any person in the course of a search belong to such person and also that the contents of such books of account and other documents are true and that the signature and every other part of such books of account and other documents are in hand-writing of the persons who can reasonably be assumed to have signed or written the books of account or other documents.

(viii) Where it is not possible or practicable to take physical possession of any valuable article or thing and remove it to a safe place due to its volume, weight or other physical characteristics or due to its being of a dangerous nature, the authorised Officer may serve an order on the owner or the person who is in immediate possession thereof that he shall not remove, part with or otherwise deal with it except with the previous permission of such authorised officer and such action of the Authorised Officer shall be deemed to be seizure of such valuable article or thing. This is called a restraint order. However, such a deeming seizure would not apply to stock-in-trade of the business.

(ix) The authorised officer may, where it is not practicable to seize any such books of account, other documents, money, bullion, jewellery or other valuable article or thing (for reasons other than those mentioned in (viii) above] serve an order on the owner or the person who is in immediate possession or control thereof that he shall not remove, part with or otherwise deal with it except with the previous permission of such officer and such officer may take such steps as may be necessary for ensuring compliance with this sub-section. However, serving of such an order shall not be deemed to be seizure of such valuable article or thing.

(x) The examination of any person may be not merely in respect of any books of account,

other documents or assets found as a result of the search but also in respect of all matters relevant for the purposes of any investigation under the Act.

(xi) An order as mention under point (ix), shall not be in force for a period exceeding 60 days from the date of the order [Section 132(8A)].

(xii) The person from whose custody any books of account or other documents are seized under sub-section (1) or sub-section (1A) may make copies thereof, or take extracts therefrom, in the presence of the authorized officer or any other person empowered by him in this behalf, at such place and time as the authorized officer may appoint in this behalf [Section 132(9)].

(xiii) Where the authorized officer has no jurisdiction over the person referred to in clause (a) or clause (b) or clause (c) of point (ii) above, the books of account or other documents, or any money, bullion, jewellery or other valuable article or thing seized under that sub-section shall be handed over by the authorized officer to the Assessing Officer having jurisdiction over such person within a period of 60 days from the date of which the last of the authorizations for search was executed and thereupon the powers exercisable by the authorized officer under sub-section (8) or sub-section (9) shall be exercisable by such Assessing Officer [Section 132(9A)].

(xiv) If a person, legally entitled to the books of account or other documents seized, objects for any reason to the approval given by the Chief Commissioner, Commissioner, Director General or Director to extend the period of retention of the same by the Assessing Officer beyond 30days, he may make an application to the Board stating therein the reasons for such objection and requesting for the return of the books of account or other documents and the Board may, after giving the applicant an opportunity of being heard, pass such orders as it thinks fit. [Section 132(10)].

(xv) The Board may make rules in relation to any search or seizure under this section; in particular, and without prejudice to the generality of the foregoing power, such rules may provide for the procedure to be followed by the Authorised Officer—

- (a) for obtaining ingress into any building, place, vessel, vehicle or aircraft to be searched where free ingress thereto is not available ;
- (b) for ensuring safe custody of any books of account or other documents or assets seized. [Section 132(14)].

(xvi) For the purpose of this section, the word "proceeding" means any proceeding in respect of any year under this Act, which may be pending on the date on which a search is authorised under this section or which may have been completed on or before such date and includes also all proceedings under this Act which may be commenced after such date in respect of any year.

20.3.3 Power to requisition books of account etc. [Section 132A]

(i) Where the Director General or Director or the Chief Commissioner or Commissioner on the basis of information in his possession, has reason to believe that-

- (a) any person to whom a summons under section 131(1) or a notice under section 142(1) was issued to produce, or cause to be produced, any books of account or other documents has omitted or failed to produce, or cause to be produced, such books of

account or other documents, as required by such summons or notice and the said books of account or other documents have been taken into custody by any officer or authority under any other law for the time being in force, such as, by the Collector of Customs, the Sales-tax Commissioner etc. or

- (b) any books of account or other documents will be useful for, or relevant to, any proceeding under this Act and any person to whom a summons or notice as aforesaid has been or might be issued will not, or would not, produce or cause to be produced, such books of account or other documents on the return of such books of account or other documents by any officer or authority by whom or which such books of account or other documents have been taken into custody under any other law for the time being in force, such as, by the Collector of Customs, the Sales-tax Commissioner etc. or
- (c) any assets represent either wholly or partly income or property which has not been, or would not have been, disclosed for the purposes of this Act by any person from whose possession or control such assets have been taken into custody by any officer or authority under any other law for the time being in force, such as, by the Collector of Customs, the Sales-tax Commissioner etc.

then, the Director General or Director or the Chief Commissioner or Commissioner may authorise any Additional Director, Additional Commissioner, Joint Director Joint Commissioner, Assistant Director or Deputy Director, Assistant Commissioner, Deputy Commissioner or Income-tax Officer (referred to as the requisitioning officer) to require the officer or authority under any other law referred above, as the case may be, to deliver such books of account, other documents or assets to the requisitioning officer.

(ii) On a requisition being made under (i), the officer or authority under any other law referred above, as the case may be, shall deliver the books of account, other documents or assets to the requisitioning officer either forthwith or when such officer or authority is of the opinion that it is no longer necessary to retain the same in his or its custody.

(iii) Where any books of account, other documents or assets have been delivered to the requisitioning officer, the provisions of sections 132(4A) to 132(14) and section 132B shall, so far as may be, apply as if such books of account, other documents or assets had been seized under section 132(1) by the requisitioning officer from the custody of the concerned person and for the words "the Authorised Officer" occurring in any of the above mentioned sections, the words "the requisitioning officer" were substituted.]

20.3.4 Application of retained assets [Section 132B]

Section 132B(1), *inter alia*, provides that the assets seized under section 132 or requisitioned under section 132A may be adjusted against -

- (1) any "existing liability" under the Income-tax Act, 1961 Wealth-tax Act, 1957 etc.,; and
- (2) the amount of liability determined on completion of assessments pursuant to search, including any penalty levied or interest payable in connection with such assessment and in respect of which such person is in default or deemed to be in default.

“Existing liability” does not include advance tax payable in accordance with the provisions of Part C of Chapter XVII of the Income-tax Act, 1961.

If the assets consist solely or money or partly or money and partly of other assets, the Assessing Officer may apply the money in discharge of the liabilities mentioned above. The assessee shall be discharged to the extent of the money so applied.

The assets other than money may also be applied for the discharge of such liabilities which still remains undischarged. For this purpose, such assets shall be deemed to be under distraint, as if such distraint was effected by the Assessing Officer or, as the case may be, the Tax Recovery Officer under authorization from the Chief Commissioner or Commissioner under section 226(5). The Assessing Officer or the Tax Recovery Officer, as the case may be, may recover the amount of such liabilities by the sale of such assets in the manner laid down in the Third Schedule.

Where the person concerned makes an application to the Assessing Officer within 30 days from the end of the month in which the asset was seized, for release of the asset and explains the nature and source of acquisition of seized assets is explained satisfactorily, then, such assets are required to be released within a period of 120 days from the date on which last of the authorisations for search under section 132 is executed after meeting any existing liabilities. The assessee shall be entitled to simple interest at $\frac{1}{2}\%$ per month or part of a month, if the amount of assets seized exceeds the liabilities eventually, for the period immediately following the expiry of 120 days from the date on which the last of the authorisations for search under section 132 or requisition under section 132A was executed to the date of completion of the assessment under section 153A or under Chapter XIV-B.

20.3.5 Power to call for information [Sections 133]

The Assessing Officer, the Deputy Commissioner (Appeals), the Joint Commissioner or the Commissioner (Appeals)] may call for following information for the purposes of this Act-

- (1) require any firm to furnish him with a return of the names and addresses of the partners of the firm and their respective shares;
- (2) require any Hindu undivided family to furnish him with a return of the names and addresses of the manager and the members of the family;
- (3) require any person whom he has reason to believe to be a trustee, guardian or agent, to furnish him with a return of the names of the persons for or of whom he is trustee, guardian or agent, and of their addresses;
- (4) require any assessee to furnish a statement of the names and addresses of all persons to whom he has paid in any previous year rent, interest, commission, royalty or brokerage, or any annuity, not being any annuity taxable under the head "Salaries" amounting to more than one thousand rupees, or such higher amount as may be prescribed], together with particulars of all such payments made;
- (5) require any dealer, broker or agent or any person concerned in the management of a stock or commodity exchange to furnish a statement of the names and addresses of all persons to whom he or the exchange has paid any sum in connection with the transfer,

whether by way of sale, exchange or otherwise, of assets, or on whose behalf or from whom he or the exchange has received any such sum, together with particulars of all such payments and receipts;

- (6) require any person, including a banking company or any officer thereof, to furnish information in relation to such points or matters, or to furnish statements of accounts and affairs verified in the manner specified by the Assessing Officer, the Deputy Commissioner (Appeals), the Joint Commissioner or the Commissioner (Appeals), giving information in relation to such points or matters as, in the opinion of the Assessing Officer, the Deputy Commissioner (Appeals)], the Joint Commissioner or the Commissioner (Appeals)], will be useful for, or relevant to, any enquiry or proceeding under this Act :

Under the existing provisions of section 133(6), the prescribed authorities have the power to call for any information from any person which will be useful for or relevant to any proceedings under the Act. Such powers may also be exercised by the Director-General, the Chief Commissioner, the Director and the Commissioner. Further, the power in respect of an inquiry, in a case where no proceeding is pending, shall not be exercised by any income-tax authority below the rank of Director or Commissioner without the prior approval of the Director or as the case may be, the Commissioner.

For facilitating quick collection of information on request from tax authorities outside India, notified income-tax authorities (not below the rank of Assistant Commissioner of Income-tax) to have powers under section 131(1) for making an inquiry or investigation in respect of any person or class of persons relating to an agreement for exchange of information under section 90 or 90A, even if no proceeding is pending before it or any other income-tax authority with respect to the concerned person or class of persons. Such notified authorities are also empowered, for the purposes of an agreement referred to in section 90 or section 90A, to exercise the powers conferred under section 133 to call for information, irrespective of whether any proceedings are pending before it or any other income-tax authority.

20.3.6 Power of Survey [Section 133A]: An income-tax authority may enter any place:

- (i) within the limits of the area assigned to him, or
- (ii) any place occupied by any person in respect of whom he exercises jurisdiction, or
- (iii) any place in respect of which he is authorised for the purposes of this section by such income-tax authority, who is assigned the area within which such place is situated or who exercises jurisdiction in respect of any person occupying such place

at which a business or profession is carried on and require any proprietor, employee or any other person/s, who may at that time/place be attending in any manner to or helping him to carry on any such business or profession. This power may be exercised:

- (i) to afford him the necessary facility to inspect such books of account or other documents as he may require and which may be available at such place;
- (ii) to afford him the necessary facility to check or verify the cash, stock or other valuable articles or things which may be found therein; and
- (iii) to furnish such information as he may require as to any matter which may be useful for or relevant to any proceeding under the Income-tax Act, 1961.

This power may be exercised in respect of any place with which the assessee is connected, whether or not such place is the principal place of business or profession. It will also include any other place, whether any business or profession is carried on therein or not, in which the person carrying on the business or profession states that any of his books of account or other valuable article or thing relating to his business or profession is kept. The income-tax authority may enter any place of business or profession mentioned above only during the hours at which such place is open for the conduct of business or profession and in the case of any other place, only after sunrise and before sunset.

The income-tax authority exercising this power of survey may:

- (i) place marks of identification, if he finds it necessary, on the books of account or other documents inspected by him and make or cause to be made extracts or copies therefrom;
- (ii) impound and retain in his custody for such period as he thinks fit any book of account or other documents inspected by him after recording reasons for doing so.

However, the income tax authority cannot retain in his custody such books of account etc. for a period exceeding 10 days (excluding holidays) without obtaining the approval of the Chief Commissioner or Director General therefor, as the case may be.

- (iii) make an inventory of any cash, stock or valuable article or thing checked or verified by him; and
- (iv) record the statements of any person which may be useful for or relevant to any proceedings under the Income-tax Act, 1961.

However, the income-tax authority cannot remove or cause to be removed from the place where he has entered, any cash, stock or other valuable article or thing.

The income-tax authorities would also have the power to collect information and record the statements of any of the persons concerned at any time after any function, ceremony or event even before the stage of commencement of assessment proceedings for the following year for which the information may be relevant, if they are of the opinion that having due regard to the nature, scale and extent of the expenditure incurred, it is necessary to do so. This provision is intended to help in collecting evidence about ostentatious expenditure immediately after the event to be used at the time of the assessment.

If any person who is required to provide facility to the income-tax authority to inspect the books of account or the other documents or to check or verify any cash, stock or other valuable articles or to furnish any information or to have his statement recorded, either refuses or evades to do so, the income-tax authority would be entitled to use all the powers vested in it under section 131(1) for enforcing proper compliance with the requirements. However, no action under sub-section (1) shall be taken by the Assistant Director or a Deputy Director or an Assessing Officer or a Tax Recovery Officer or an Inspector of Income-tax except with the prior approval of the Joint Director or the Joint Commissioner, as the case may be.

For the purpose of this section, "proceeding" means any proceeding under this Act in respect of any year which may be pending on the date on which the powers under this section are

exercised or which may have been completed on or before such date and includes also all proceedings under this Act which may be commenced after such date in respect of any year.

20.3.7 Power to collect certain information [Section 133B]

(i) Under this section, an income-tax authority may enter any building or place (at which a business or profession is carried on) within its jurisdiction or any building or place (at which a business or profession is carried on) which is occupied by any person in respect of whom the said authority exercises jurisdiction for the purpose of collecting any information which may be useful for or relevant for the purposes of the Act. It is not necessary that such a place should be the principal place of the business or profession.

(ii) The authority may require any proprietor, employee or any other person who may at the time and place be attending in any manner to or helping in carrying on such business or profession to furnish such information as may be prescribed.

(iii) An income-tax authority may enter any place of business or profession referred to above only during the hours at which such place is open for business.

(iv) Such authority shall on no account remove or cause to be removed from the building or place wherein he has entered any books of account or other valuable articles or things.

(v) In this section, income-tax authority means a Joint Commissioner, an Assistant Director or Deputy Director or an Assessing Officer, and includes an Inspector of Income-tax who has been authorised by the Assessing Officer to exercise the power conferred under this section in relation to the area in respect of which the Assessing Officer exercises jurisdiction or any part thereof.

20.3.8 Power to inspect registers of companies [Section 134] : The Assessing Officer, the Joint Commissioner or the Commissioner (Appeals), or any person subordinate to him authorised in writing in this behalf by the Assessing Officer, the Joint Commissioner or the Commissioner (Appeals), as the case may be, may inspect and if necessary, take copies, or cause copies to be taken, of any register of the members, debenture holders or mortgagees of any company or of any entry in such register.

20.3.9 Other powers [Sections 135 and 136] : The Director General or Director, the Chief Commissioner or Commissioner and the Joint Commissioner are competent to make any enquiry under this act and for all purposes they shall have the powers vested in an Assessing Officer in relation to the making of enquiries.

If the Investigating officer is denied entry into the premises, the Assessing Officer shall have all the powers vested in him under sections 131(1) and (2). All the proceedings before Income-tax authorities are judicial proceedings for purposes of section 196 of the Indian Penal Code, 1860, and fall within the meaning of sections 193 and 228 of the Code.

An income-tax authority shall be deemed to be a Civil Court for the purposes of section 195 of the Criminal Procedure Code, 1973.

20.3.10 Disclosure of information regarding assessee [Section 138]: If a person makes an application in accordance with Rule 113 of the Income-tax Rules, 1962 to the Chief

Commissioner or the Commissioner of Income-tax in the prescribed form for obtaining any information relating to any assessee in respect of any assessment year, the Commissioner may, if he is satisfied that it is in the public interest, furnish the information. His decision in this regard cannot be called into question. Nevertheless, the Government may, having regard to practice and usage customary or otherwise, and any other relevant factors, direct that no information or documents shall be furnished or produced by a public servant in respect of such matters relating to a particular class or classes of assessee except to certain authorities which may be specified. It would be observed that, under section 138, the Commissioner can make a disclosure on the basis of an application made to him; he cannot volunteer to give the information.

Further, the Board has been empowered to furnish or cause to be furnished any information relating to any assessee in respect of assessment under the Income-tax Act, 1961, to any office or authority or body performing any function under any law relating to the imposition of any tax, duty or cess or dealings in foreign exchange in all cases where the Board considers such information necessary for the purpose of enabling the officer, authority or body to perform his or its functions under that law. This power of disclosure of information can as well be exercised by any other Income-tax authority specified by the Board by general or special order in this behalf. It will also be open to the Central Government to notify any officer, authority or body performing functions under any other law and on such notification, the Board or any other income-tax authority may furnish or cause to be furnished similar information relating to any assessee to the officer, authority or body concerned.

21.1 Return of Income

The Income-tax Act, 1961 contains provisions for filing of return of income. Return of income is the format in which the assessee furnishes information as to his total income and tax payable. The format for filing of returns by different assesseees is notified by the CBDT. The particulars of income earned under different heads, gross total income, deductions from gross total income, total income and tax payable by the assessee are generally required to be furnished in a return of income. In short, a return of income is the declaration of income by the assessee in the prescribed format.

21.2 Compulsory filing of return of income [Section 139(1)]

(1) As per section 139(1), it is compulsory for companies and firms to file a return of income or loss for every previous year on or before the due date in the prescribed form.

(2) In case of a person other than a company or a firm, filing of return of income on or before the due date is mandatory, if his total income or the total income of any other person in respect of which he is assessable under this Act during the previous year exceeds the basic exemption limit.

(3) Every resident and ordinarily resident having –

- (i) any asset (including financial interest in any entity) located outside India or
- (ii) signing authority in any account located outside India

is required to file a return of income in the prescribed form compulsorily, whether or not he has income chargeable to tax.

(4) All such persons mentioned in (1), (2) & (3) above should, on or before the due date, furnish a return of his income or the income of such other person during the previous year in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed.

(5) Further, every person, being an individual or a HUF or an AOP or BOI or an artificial juridical person -

- whose total income or the total income of any other person in respect of which he is assessable under this Act during the previous year
- without giving effect to the provisions of Chapter VI-A
- exceeded the basic exemption limit.

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is required to file a return of his income or income of such other person on or before the due date in the prescribed form and manner and setting forth the prescribed particulars.

For the A.Y.2014-15, the basic exemption limit is ₹ 2,00,000 for individuals/HUFs/AOPs/BOIs and artificial juridical persons, ₹ 2,50,000 for resident individuals of the age of 60 years but less than 80 years and ₹ 5,00,000 for resident individuals of the age of 80 years or more at any time during the previous year. These amounts denote the level of total income, which is arrived at after claiming the admissible deductions under Chapter VI-A. However, the level of total income to be considered for the purpose of filing return of income is the income before claiming the admissible deductions under Chapter VI-A.

(6) 'Due date' means -

(i) 30th September of the assessment year, where the assessee, other than an assessee referred to in clause (ii), is -

(a) a company,

(b) a person (other than a company) whose accounts are required to be audited under the Income-tax Act, 1961 or any other law in force; or

(c) a working partner of a firm whose accounts are required to be audited under the Income-tax Act, 1961 or any other law for the time being in force.

(ii) 30th November of the assessment year, in the case of an assessee who is required to furnish a report referred to in section 92E.

(iii) 31st July of the assessment year, in the case of any other assessee.

21.3 Interest for default in furnishing return of income [Section 234A]

(1) Interest under section 234A is attracted for failure to file a return of income on or before the due date mentioned above i.e. interest is payable where an assessee furnishes the return of income after the due date or does not furnish the return of income.

(2) Simple interest @1% per month or part of the month is payable for the period commencing from the date immediately following the due date and ending on the following dates -

Circumstances	Ending on the following dates
Where the return is furnished after due date	the date of furnishing of the return
Where no return is furnished	the date of completion of assessment

(3) The interest has to be calculated on the amount of tax on total income as determined under section 143(1) or on regular assessment as reduced by the advance tax paid and any tax deducted or collected at source.

Note – Section 143(1) provides that if any tax or interest is found due on the basis of a return of income after adjustment of advance tax, tax deducted at source and self-assessment tax, an intimation would be sent to the assessee and such intimation is deemed to be a notice of demand issued under section 156. If any refund is due on the basis of the return, it shall be granted to the assessee and an intimation to this effect would be sent to the assessee. Where no tax or refund is due, the acknowledgement of the return is deemed to be an intimation under section 156.

21.4 Option to furnish Return of Income to Employer [Section 139(1A)]

(1) This section gives an option to a person, being an individual who is in receipt of income chargeable under the head "Salaries", to furnish a return of his income for any previous year to his employer, in accordance with such scheme as may be notified by the CBDT and subject to such conditions as may be specified therein.

(2) Such employer shall furnish all returns of income received by him on or before the due date, in such form (including on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media) and manner as may be specified in that scheme.

(3) In such a case, any employee who has filed a return of his income to his employer shall be deemed to have furnished a return of income under sub-section (1).

21.5 Income-tax Return through computer readable media [Section 139(1B)]

(1) This sub-section enables the taxpayer to file his return of income in computer readable media, without interface with the department.

(2) It provides an option to a person (both corporate and non-corporate) required to furnish a return of his income.

(3) Such person may, on or before the due date, furnish a return of income in accordance with such scheme as may be notified by the CBDT, in such form (including on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media) and manner as may be specified in that scheme.

(4) Such return shall be deemed to be a return furnished under section 139(1).

21.6 Specified class or classes of persons to be exempted from filing Return of Income [Section 139(1C)]

(1) Under section 139(1), every person has to furnish a return of his income on or before the due date, if his total income exceeds the basic exemption limit.

(2) For reducing the compliance burden of small taxpayers, the Central Government has been empowered to notify the class or classes of persons who will be exempted from the requirement of filing of return of income, subject to satisfying the prescribed conditions.

(3) Every notification issued under section 139(1C) shall, as soon as may be after its issue, be laid before each House of Parliament while it is in session, for a total period of thirty days. If both Houses agree in making any modification in the notification, the notification will thereafter have effect only in such modified form. If both Houses agree that the notification should not be issued, the notification shall thereafter have no effect.

21.7 Return of Loss [Section 139(3)]

(1) This section requires the assessee to file a return of loss in the same manner as in the case of return of income within the time allowed under section 139(1).

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(2) Under section 80, an assessee cannot carry forward or set off his loss against income in the same or subsequent year unless he has filed a return of loss in accordance with the provisions of section 139(3).

(3) A return of loss has to be filed by the assessee in his own interest and the non-receipt of a notice from the Assessing Officer requiring him to file the return cannot be a valid excuse under any circumstances for the non-filing of such return.

(4) In particular, a return of loss must be filed by an assessee who has incurred a loss under the heads "Profits and gains from business or profession", "Capital gains", and income from the activity of owning and maintaining race horses taxable under the head "Income from other sources".

(5) However, loss under the head "Income from house property" under section 71B and unabsorbed depreciation under section 32 can be carried forward for set-off even though return of loss has not been filed before the due date.

21.8 Belated Return [Section 139(4)]

(1) Any person who has not furnished a return within the time allowed to him under section 139(1) or within the time allowed under a notice issued under section 142(1) may furnish the return for any previous year at any time -

- (i) before the expiry of one year from the end of the relevant assessment year; or
 - (ii) before the completion of the assessment,
- whichever is earlier.

(2) A belated return cannot be revised. It has been held in *Kumar Jagdish Chandra Sinha v. CIT [1996] 86 Taxman 122 (SC)* that only a return furnished under section 139(1) or in pursuance of a notice under section 142(1) can be revised. A belated return under section 139(4) cannot be revised.

Note – Notice under section 142(1) is served by the Assessing Officer for the purpose of making an assessment -

- (i) on any person who has filed a return under section 139(1) to -
 - (a) produce or cause to be produced such accounts or documents as may be required by the Assessing Officer; or
 - (b) to furnish in writing information in the prescribed form on such points or matters as required by the Assessing Officer.
- (ii) on a person who has not filed his return within the time allowed under section 139(1) or before the end of the relevant assessment year to -
 - (a) furnish a return of his income or the income of any other person in respect of which he is assessable under the Act, in the prescribed form containing the prescribed particulars;
 - (b) produce or cause to be produced such accounts or documents as may be required by the Assessing Officer; or
 - (c) to furnish in writing information in the prescribed form on such points or matters as required by the Assessing Officer.

21.9 Return of Income of Charitable Trusts and Institutions [Section 139(4A)]

- (1) Every person in receipt of income -
 - (i) derived from property held under a trust or any other legal obligation wholly or partly for charitable or religious purpose; or
 - (ii) by way of voluntary contributions on behalf of such trust or institution

must furnish a return of income if the total income in respect of which he is assessable as a representative assessee (computed before allowing any exemption under sections 11 and 12) exceeds the basic exemption limit.

(2) Such persons should furnish the return in the prescribed form and verified in the prescribed manner containing all the particulars prescribed for this purpose.

(3) This return must be filed by the representative-assessee voluntarily within the time limit. Any failure on the part of the assessee would attract liability to pay interest and penalty.

21.10 Return of Income of Political Parties [Section 139(4B)]

(1) Under this section, a political party is required to file a return of income if, before claiming exemption under section 13A, the party has taxable income.

(2) The grant of exemption from income-tax to any political party under section 13A is subject to the condition that the political party submits a return of its total income within the time limit prescribed under section 139(1).

(3) The chief executive officer of the political party is statutorily required to furnish a return of income of the party for the relevant assessment year, if the amount of total income of the previous year exceeds the basic exemption limit before claiming exemption under section 13A.

(4) The return must be filed in the prescribed form and verified in the prescribed manner setting forth such other particulars as may be prescribed by the CBDT.

(5) The provisions of the Act would apply as if it were a return required to be furnished under section 139(1).

21.11 Mandatory filing of returns by Scientific Research Associations, News Agency, Trade Unions, etc. [Section 139(4C)]

(1) It will be mandatory for the following institutions/associations etc. to file the return of income if their total income without giving effect to exemption under section 10, exceeds the basic exemption limit –

	Institution/Association etc.	Applicable section
(a)	Research association	10(21)
(b)	News agency	10(22B)
(c)	Association or institution	10(23A)

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(d)	Institution	10(23B)
(e)	Fund or institution	10(23C)(iv)
(f)	Trust or institution	10(23C)(v)
(g)	University or other educational institution	10(23C)(vi)/(iiiad)
(h)	Hospital or other medical institution	10(23C)(via)/(iii ae)
(i)	Trade union	10(24)(b)
(j)	Body or Authority or Board or Trust	10(46)
(k)	Infrastructure Debt Fund	10(47)

(2) Such return of income should be in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed.

(3) Then, the provisions of the Act would apply as if it were a return required to be furnished under section 139(1).

21.12 Mandatory filing of returns by Universities, Colleges etc. [Section 139(4D)]

(1) It will be mandatory for every university, college or other institution referred to in clause (ii) and clause (iii) of section 35(1), which is not required to furnish its return of income or loss under any other provision of section 139, to furnish its return in respect of its income or loss in every previous year.

(2) All the provisions of the Income-tax Act, 1961 shall apply to such return as if it were a return under section 139(1).

21.13 Revised Return [Section 139(5)]

(1) If any person having furnished a return under section 139(1) or in pursuance of a notice issued under section 142(1), discovers any omission or any wrong statement therein, he may furnish a revised return at any time before the expiry of one year from the end of the relevant assessment year or before completion of assessment, whichever is earlier.

(2) It may be noted that a belated return cannot be revised. It has been held in *Kumar Jagdish Chandra Sinha v. CIT [1996] 86 Taxman 122 (SC)* that only a return furnished under section 139(1) or in pursuance of a notice under section 142(1) can be revised. A belated return furnished under section 139(4), therefore, cannot be revised.

21.14 Particulars to be furnished with the return [Section 139(6)]

The prescribed form of the return shall, in certain specified cases, require the assessee to furnish the particulars of -

- (i) income exempt from tax
- (ii) assets of the prescribed nature and value and belonging to him
- (iii) his bank account and credit card held by him
- (iv) expenditure exceeding the prescribed limits incurred by him under prescribed heads
- (v) such other outgoings as may be prescribed.

21.15 Particulars to be furnished with return of income in the case of an assessee engaged in business or profession [Section 139(6A)]

The prescribed form of the return shall, in the case of an assessee engaged in any business or profession also require him to furnish -

- (i) the report of any audit referred to in section 44AB.
- (ii) the particulars of the location and style of the principal place where he carries on the business or profession and all the branches thereof.
- (iii) the names and addresses of his partners, if any, in such business or profession.
- (iv) if he is a member of an association or body of individuals,
 - (a) the names of the other members of the association or the body of individuals; and
 - (b) the extent of the share of the assessee and the shares of all such partners or members, as the case may be, in the profits of the business or profession.

21.16 Defective Return [Section 139(9)]

(1) Under this sub-section, the Assessing Officer has the power to call upon the assessee to rectify a defective return.

(2) Where the Assessing Officer considers that the return of income furnished by the assessee is defective, he may intimate the defect to the assessee and give him an opportunity to rectify the defect within a period of 15 days from the date of such intimation. The Assessing Officer has the discretion to extend the time period beyond 15 days, on an application made by the assessee.

(3) If the defect is not rectified within the period of 15 days or such further extended period, then the return would be treated as an invalid return. The consequential effect would be the same as if the assessee had failed to furnish the return.

(4) Where, however, the assessee rectifies the defect after the expiry of the period of 15 days or the further extended period, but before assessment is made, the Assessing Officer can condone the delay and treat the return as a valid return.

(5) A return of income shall be regarded as defective unless all the following conditions are fulfilled, namely:

- (i) The annexures, statements and columns in the return of income relating to computation of income chargeable under each head of income, computations of gross total income and total income have been duly filled in.
- (ii) *The tax together with interest, if any, payable in accordance with the provisions of section 140A, has been paid on or before the date of furnishing the return.*
- (iii) The return of income is accompanied by the following, namely:
 - (a) a statement showing the computation of the tax payable on the basis of the return.
 - (b) the report of the audit obtained under section 44AB (If such report has been furnished

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prior to furnishing the return of income, a copy of such report and the proof of furnishing the report should be attached).

- (c) the proof regarding the tax, if any, claimed to have been deducted or collected at source and the advance tax and tax on self-assessment, if any, claimed to have been paid. (However, the return will not be regarded as defective if (a) a certificate for tax deducted or collected was not furnished under section 203 or section 206C to the person furnishing his return of income, (b) such certificate is produced within a period of 2 years).
- (d) the proof of the amount of compulsory deposit, if any, claimed to have been paid under the Compulsory Deposit Scheme (Income-tax Payers) Act, 1974;
- (iv) Where regular books of account are maintained by an assessee, the return of income is accompanied by the following -
 - (a) copies of manufacturing account, trading account, profit and loss account or income and expenditure account, or any other similar account and balance sheet;
 - (b) the personal accounts as detailed below -

(1)	Proprietary business or profession	The personal account of the proprietor
(2)	Firm, association of persons or body of individuals	personal accounts of partners or members
(3)	Partner or member of a firm, association of persons or body of individuals	partner's personal account in firm member's personal account in the association of persons or body of individuals

- (v) Where the accounts of the assessee have been audited, the return should be accompanied by copies of the audited profit and loss account and balance sheet and the auditor's report.
- (vi) Where the cost accounts of an assessee have been audited under section 233B¹ of Companies Act, 1956, the return should be accompanied by such report.
- (vii) Where regular books of account are not maintained by the assessee, the return should be accompanied by -
 - (a) a statement indicating -the amount of turnover or gross receipts, gross profit, expenses and net profit of the business or profession;
 - (b) the basis on which such amounts mentioned in (1) above have been computed,
 - (c) the amounts of total sundry debtors, sundry creditors, stock-in-trade and cash balance as at the end of the previous year.

¹ Section 148 of the Companies Act, 2013

21.17 Permanent Account Number (PAN) [Section 139A]

(1) Sub-section (1) requires the following persons, who have not been allotted a permanent account number (PAN), to apply to the Assessing Officer within the prescribed time for the allotment of a PAN -

- (i) Every person whose total income or the total income of any other person in respect of which he is assessable under this Act during any previous year exceeded the basic exemption limit; or
- (ii) Every person carrying on any business or profession whose total sales, turnover or gross receipts exceeds or is likely to exceed ₹ 5 lakh in any previous year; or
- (iii) Every person who is required to furnish a return of income under section 139(4A). [Sub-section (1)].

(2) A person who has already been allotted a PAN under sub-clauses (i), (ii) or (iii) of sub-section (1), is not required to obtain another PAN under sub-clause (iv). The PAN already allotted to him shall be deemed to be the PAN in relation to fringe benefit tax.

(3) The Central Government is empowered to specify, by notification in the Official Gazette, any class or classes of persons by whom tax is payable under the Act or any tax or duty is payable under any other law for the time being in force. Such persons are required to apply within such time as may be mentioned in that notification to the Assessing Officer for the allotment of a PAN [Sub-section (1A)].

(4) For the purpose of collecting any information which may be useful for or relevant to the purposes of the Act, the Central Government may notify any class or classes of persons, and such persons shall within the prescribed time, apply to the Assessing Officer for allotment of a PAN [Sub-section (1B)].

(5) The Assessing Officer, having regard to the nature of transactions as may be prescribed, may also allot a PAN to any other person (whether any tax is payable by him or not) in the manner and in accordance with the procedure as may be prescribed [Sub-section (2)].

(6) Any person, other than the persons mentioned in (1) to (5) above, may apply to the Assessing Officer for the allotment of a PAN and the Assessing Officer shall allot a PAN to such person immediately.

(7) The CBDT had introduced a new scheme of allotment of computerized 10 digit PAN. Such PAN comprises of 10 alphanumeric characters and is issued in the form of a laminated card.

(8) All persons who were allotted PAN (Old PAN) earlier and all those persons who were not so allotted but were required to apply for PAN, shall apply to the Assessing Officer for a new series PAN within specified time.

(9) Once the new series PAN is allotted to any person, the old PAN shall cease to have effect. No person who has obtained the new series PAN shall apply, obtain or process another PAN.

(10) Quoting of PAN is mandatory in all documents pertaining to the following prescribed transactions :

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- (a) in all returns to, or correspondence with, any income-tax authority ;
 - (b) in all challans for the payment of any sum due under the Act;
 - (c) in all documents pertaining to such transactions entered into by him, as may be prescribed by the CBDT in the interests of revenue. In this connection, CBDT has notified the following transactions, namely:
 - (i) sale or purchase of any immovable property valued at ₹ 5 lakh or more;
 - (ii) sale or purchase of motor vehicle or other vehicle (other than two wheeled motor vehicle) which requires registration under section 2(28) of the Motor Vehicle Act, 1988;
 - (iii) a time deposit exceeding ₹ 50,000 with a banking company;
 - (iv) a deposit exceeding ₹ 50,000 in any account with Post Office Savings Bank;
 - (v) a contract for sale or purchase of securities exceeding value of ₹ 1 lakh;
 - (vi) opening a bank account;
- However, in case the person making the application is a minor who does not have any income chargeable to tax, he is required to quote the PAN of his father or mother or guardian, as the case may be.
- (vii) making an application for installation of telephone connection (including cellular telephone connection);
 - (viii) bill payments to hotels and restaurants exceeding ₹ 25,000 at any one time;
 - (ix) payment in cash for purchase of bank drafts/pay orders/banker's cheque from a banking company for an amount aggregating ₹ 50,000 or more during any one day;
 - (x) cash deposit aggregating ₹ 50,000 or more with a banking company during any one day;
 - (xi) cash payment in excess of ₹ 25,000 in connection with travel to any foreign country at any one time. Such payment includes cash payment made towards fare, or to a travel agent or a tour operator, or for the purchase of foreign currency. However, travel to any foreign country does not include travel to the neighbouring countries or to such places of pilgrimage as may be specified by the CBDT under *Explanation 3* to section 139(1);
 - (xii) making an application to any bank or banking institution or company or any institution for issue of a credit card;
 - (xiii) making an application for the following purposes involving payment of an amount exceeding ₹ 50,000 -
 - (a) for purchase of units of a mutual fund;
 - (b) for acquiring shares of a company through public issue;
 - (c) for acquiring debentures of a company or institution;
 - (d) for acquiring bonds of Reserve Bank of India.
- (11) Every person who receives any document relating to any transaction cited above shall ensure that the PAN is duly quoted in the document.

(12) If there is a change in the address or in the name and nature of the business of a person, on the basis of which PAN was allotted to him, he should intimate such change to the Assessing Officer.

(13) Every person who receives any amount from which tax has been deducted at source shall intimate his PAN to the person responsible for deducting such tax.

(14) Where any amount has been paid after deducting tax at source, the person deducting tax shall quote the PAN of the person to whom the amount was paid in the following documents:

- (i) in the statement furnished under section 192(2C) giving particulars of perquisites or profits in lieu of salary provided to any employee;
- (ii) in all certificates for tax deducted issued to the person to whom payment is made;
- (iii) in all returns made to the prescribed income-tax authority under section 206;
- (iv) in all statements prepared and delivered or caused to be delivered in accordance with the provisions of section 200(3)[Sub-section (5B)].

(15) The above sub-sections (5A) and (5B) shall not apply to a person who –

- (i) does not have taxable income or
- (ii) who is not required to obtain PAN

if such person furnishes a declaration under section 197A in the prescribed form and manner that the tax on his estimated total income for that previous year will be nil.

(16) The CBDT is empowered to make rules with regard to the following:

- (a) the form and manner in which an application for PAN may be made and the particulars to be given there;
- (b) the categories of transactions in relation to which PAN is required to be quoted on the related documents;
- (c) the categories of documents pertaining to business or profession in which PAN shall be quoted by every person;
- (d) the class or classes of persons to whom the provisions of this section shall not apply;
The following classes of persons are exempt from the provisions of section 139A:
 - (i) persons who have agricultural income and are not in receipt of any other taxable income;
 - (ii) non-residents under the Act, provided that any non-resident entering into any of the prescribed transactions shall furnish a copy of his passport.
- (e) the form and manner in which a person who has not been allotted a PAN shall make a declaration;
- (f) the manner in which PAN shall be quoted for transactions cited in (b) above;
- (g) the time and manner in which such transactions shall be intimated to the prescribed authority.

21.18 Scheme for submission of returns through Tax Return Preparers [Section 139B]

(1) This section provides that, for the purpose of enabling any specified class or classes of persons to prepare and furnish their returns of income, the CBDT may notify a Scheme to provide that such persons may furnish their returns of income through a Tax Return Preparer authorised to act as such under the Scheme.

(2) The Tax Return Preparer shall assist the persons furnishing the return in a manner that will be specified in the Scheme, and shall also affix his signature on such return.

(3) A Tax Return Preparer can be an individual, other than

- (i) any officer of a scheduled bank with which the assessee maintains a current account or has other regular dealings.
- (ii) any legal practitioner who is entitled to practice in any civil court in India.
- (iii) a chartered accountant.
- (iv) an employee of the 'specified class or classes of persons'.

(4) The "specified class or classes of persons" for this purpose means any person other than a company or a person whose accounts are required to be audited under section 44AB (tax audit) or under any other existing law, who is required to furnish a return of income under the Act.

(5) The Scheme notified under the said section may provide for the following -

- (i) the manner in which and the period for which the Tax Return Preparers shall be authorised,
- (ii) the educational and other qualifications to be possessed, and the training and other conditions required to be fulfilled, by a person to act as a Tax Return Preparer,
- (iii) the code of conduct for the Tax Return Preparers,
- (iv) the duties and obligations of the Tax Return Preparers,
- (v) the circumstances under which the authorisation given to a Tax Return Preparer may be withdrawn, and
- (vi) any other relevant matter as may be specified by the Scheme.

(6) Every Scheme framed by the CBDT under this section shall be laid before each House of Parliament while it is in session to make the same effective.

(7) If both the houses decide in making any modification of Scheme, then the Scheme will have effect only in such modified form.

(8) Similarly, if both the Houses decide that any Scheme should not be framed, then such Scheme will thereafter be of no effect.

(9) However, such modification or annulment should be without prejudice to the validity of anything previously done under that scheme.

(10) Accordingly, the CBDT has, in exercise of the powers conferred by this section, framed the Tax Return Preparer Scheme, 2006, which came into force from 1.12.2006.

As per this scheme, Tax Return Preparer means any individual who has been issued a Tax Return Preparer Certificate and a Unique Identification Number by the Partner Organisation to carry on the profession of preparing the returns of income in accordance with the provisions of this Scheme. However, persons referred to in clause (ii) or clause (iii) or clause (iv) of section 288(2), namely, any officer of a Scheduled Bank with which the assessee maintains a current account or has other regular dealings, any legal practitioner who is entitled to practice in any civil court in India and an accountant are not eligible to act as Tax Return Preparers.

It may be noted that as per section 139B(3), an employee of the "specified class or classes of persons" is not authorized to act as a Tax Return Preparer. Therefore, it follows that employees of companies and persons whose accounts are required to be audited under section 44AB or any other law for the time being in force, are eligible to act as Tax Return Preparers.

21.19 Power of CBDT to dispense with furnishing documents etc. with the return and filing of return in electronic form [Sections 139C & 139D]

- (i) Section 139C provides that the CBDT may make rules providing for a class or classes of persons who may not be required to furnish documents, statements, receipts, certificate, reports of audit or any other documents, which are otherwise required to be furnished along with the return under any other provisions of this Act.
- (ii) However, on demand, the said documents, statements, receipts, certificate, reports of audit or any other documents have to be produced before the Assessing Officer.
- (iii) Section 139D empowers the CBDT to make rules providing for –
 - (a) the class or classes of persons who shall be required to furnish the return of income in electronic form;
 - (b) the form and the manner in which the return of income in electronic form may be furnished;
 - (c) the documents, statements, receipts, certificates or audited reports which may not be furnished along with the return of income in electronic form but have to be produced before the Assessing Officer on demand;
 - (d) the computer resource or the electronic record to which the return of income in electronic form may be transmitted.

21.20 Authorised Signatories to the Return of Income [Section 140]

This section specifies the persons who are authorized to sign and verify the return of income under section 139 of the Act.

	Assessee	Circumstance	Authorised signatory
1.	Individual	(i) In circumstances not covered under (ii), (iii) & (iv) below	- the individual himself
		(ii) where he is absent from India	- the individual himself; or - any person duly authorised by him in this behalf holding a valid power of attorney from

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			the individual (Such power of attorney should be attached to the return of income)
		(iii) where he is mentally incapacitated from attending to his affairs	- his guardian; or - any other person competent to act on his behalf
		(iv) where, for any other reason, it is not possible for the individual to sign the return	- any person duly authorised by him in this behalf holding a valid power of attorney from the individual (Such power of attorney should be attached to the return of income)
2.	Hindu Undivided Family	(i) in circumstances not covered under (ii) and (iii) below	- the karta
		(ii) where the karta is absent from India	- any other adult member of the HUF
		(iii) where the karta is mentally incapacitated from attending to his affairs	- any other adult member of the HUF
3.	Company	(i) in circumstances not covered under (ii) to (v) below	- the managing director of the company
		(ii) (a) where for any unavoidable reason such managing director is not able to sign and verify the return; or (b) where there is no managing director	- any director of the company - any director of the company
		(iii) where the company is not resident in India	- a person who holds a valid power of attorney from such company to do so (such power of attorney should be attached to the return).
		(iv) (a) Where the company is being wound up (whether under the orders of a court or otherwise); or (b) where any person has been appointed as the receiver of any assets of the company	- Liquidator - Liquidator

		(v) Where the management of the company has been taken over by the Central Government or any State Government under any law	- the principal officer of the company
4.	Firm	(i) in circumstances not covered under (ii) below	- the managing partner of the firm
		(ii) (a) where for any unavoidable reason such managing partner is not able to sign and verify the return; or (b) where there is no managing partner.	- any partner of the firm, not being a minor - any partner of the firm, not being a minor
5.	LLP	(i) in circumstances not covered under (ii) below	Designated partner
		(ii) (a) where for any unavoidable reason such designated partner is not able to sign and verify the return; or (b) where there is no designated partner.	- any partner of the LLP - any partner of the LLP
6.	Local authority	-	- the principal officer
7.	Political party [referred to in section 139(4B)]	-	- the chief executive officer of such party (whether he is known as secretary or by any other designation)
8.	Any other association	-	- any member of the association or the principal officer of such association
9.	Any other person	-	- that person or some other person competent to act on his behalf.

21.21 Self-Assessment [Section 140A]

- (i) Where any tax is payable on the basis of any return required to be furnished under section 139 or section 142 or section 148 or section 153A, after taking into account -
- (1) the amount of tax, already paid,
 - (2) the tax deducted or collected at source

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- (3) relief of tax claimed under section 90 or 90A
- (4) deduction of tax claimed under section 91
- (5) any tax credit claimed to be set-off in accordance with the provisions of section 115JAA or section 115JD.

the assessee shall be liable to pay such tax together with interest payable under any provision of this Act for any delay in furnishing the return or any default or delay in payment of advance tax before furnishing the return and the return shall be accompanied by the proof of payment of such tax and interest.

- (ii) Where the amount paid by the assessee under section 140A(1) falls short of the aggregate of the tax and interest as aforesaid, the amount so paid shall first be adjusted towards the interest payable and the balance shall be adjusted towards the tax payable.
- (iii) For the above purpose, interest payable under section 234A shall be computed on the amount of tax on the total income as declared in the return, as reduced by the amount of -
 - (1) advance tax paid, if any;
 - (2) any tax deducted or collected at source;
 - (3) relief of tax claimed under section 90 or 90A;
 - (4) deduction of tax claimed under section 91;
 - (5) any tax credit claimed to be set-off in accordance with the provisions of section 115JAA or section 115JD.
- (iv) Interest payable under section 234B shall be computed on the assessed tax or on the amount by which the advance tax paid falls short of the assessed tax. For this purpose "assessed tax" means the tax on total income declared in the return as reduced by the amount of -
 - (1) tax deducted or collected at source on any income which forms part of the total income;
 - (2) relief of tax claimed under section 90 or 90A
 - (3) deduction of tax claimed under section 91
 - (4) any tax credit claimed to be set-off in accordance with the provisions of section 115JAA or section 115JD [Sub-section (1B)].
- (v) After the regular assessment under section 143 or section 144 or an assessment under section 153A has been made, any amount paid under sub-section (1) shall be deemed to have been paid towards such regular assessment or assessment, as the case may be.
- (vi) If any assessee fails to pay the whole of tax and interest he shall be deemed to be an assessee in default in respect of the tax and interest and all the provisions of this Act shall apply accordingly.

21.22 Inquiry before Assessment [Section 142]

For the purpose of making an assessment, the Assessing Officer may serve on any person who has made a return under section 139 or in whose case the time allowed under section 139(1) for furnishing the return has expired, a notice requiring him:

(i) To furnish a return of his income or the income of such other person in respect of which he is assessable, in the prescribed form and verified in the prescribed manner and setting-forth such other particulars as may be prescribed [This is in a case where such person has not made a return within the time allowed under section 139(1) or before the end of the relevant assessment year]

Further, where any notice has been served under the aforesaid provision after the end of the relevant assessment year to any person who has not made a return of his income within the time allowed under section 139(1) or before the end of the relevant assessment year, such notice shall be deemed to be a notice served in accordance with the provisions of section 142(1).

Now, the department can issue notice either under section 142(1) or under section 148. Notice under section 142(1) saves the department from the requirement of having to record reasons for the belief that income chargeable to tax has escaped assessment.

It may be noted that the time-limit for completion of assessment under section 153(1) is 2 years from the end of the assessment year in which the income was first assessable. Therefore, since assessment has to be completed within the said period of 2 years, it appears that notice under section 142(1) should also be issued within that period.

(ii) To produce, or cause to be produced, such accounts or documents as the Assessing Officer may require.

(iii) To furnish in writing and verified in the prescribed manner information in such form and on such points or matters (including a statement of all assets and liabilities of the assessee, whether included in the accounts or not) as the Assessing Officer may require.

However, the previous approval of the Joint Commissioner has to be obtained before requiring the assessee to furnish the statement of all assets and liabilities not included in the accounts.

Further, the Assessing Officer shall not require the production of any accounts relating to a period more than 3 years prior to the previous year.

Where the business is carried on in several places the assessment of the total profits must be made by the Assessing Officer having jurisdiction at the principal place of business. He can call for the accounts pertaining to any Branch office even if independent inquiries have already been made and the accounts have been examined by the Assessment Officer exercising jurisdiction at the Branch. Similarly the Assessing Officer has power to call for the account books of a foreign business carried on abroad provided that such books are in the possession or control of the assessee.

21.23 Audit under section 142

Sub-sections (2A), (2B), (2C), and (2D), of section 142 contain the statutory provisions relating to the conduct of audit. Students may note that the audit envisaged under this provision is different from the compulsory tax audit under section 44AB.

1. If at any stage of the proceedings before him, the Assessing Officer, having regard to the nature and complexity of the accounts, *volume of the accounts, doubts about the correctness of the accounts, multiplicity of transactions in the accounts or specialized nature of business activity of the assessee*, and the interests of the revenue, is of the

opinion that it is necessary so to do, he may, with the previous approval of the Chief Commissioner or the Commissioner, direct the assessee to get his accounts audited by an accountant and to furnish a report of such audit.

The expression 'accountant' for this purpose means a 'chartered accountant' within the meaning of the Chartered Accountants Act, 1949.

2. The auditor by whom the audit should be carried out would be nominated by the Commissioner of Income-tax specifically for the purpose and the auditor is required to furnish the report of his audit in the prescribed form duly signed and verified by him and setting forth such other particulars as may be prescribed and also giving details in regard to such additional particulars as the Assessing Officer may require in respect of each individual case. The report of the auditor should be furnished in Form No.6B prescribed under Rule 14A of the Income-tax Rules, 1962. The auditor appointed for carrying out the audit becomes liable to carry out the requirements of audit as directed by Assessing Officer and it is the Commissioner and not the assessee who would be his client for this purpose.

3. The Supreme Court in *Rajesh Kumar & Ors. v. DCIT (2006) 287 ITR 91* observed that the order under section 142(2A) is a quasi judicial order. Therefore, the principles of natural justice have to be applied and the assessee has to be given an opportunity of being heard before directing the special audit. The principles of natural justice are based on two principles, namely, (i) nobody shall be condemned unheard; (ii) nobody shall be a judge of his own cause. Once it is held that the assessee suffers civil consequences and any order passed would be prejudicial to him, the principles of natural justice must be held to be implicit. If the principles of natural justice were to be excluded, the Parliament could have said so expressly.

Accordingly, to give effect to the observation of the Supreme Court, it has been provided that the Assessing Officer is required to give the assessee an opportunity of being heard before issuing directions for special audit under section 142(2A).

4. The Assessing Officer is empowered to direct the audit to be carried out in the case of any particular assessee even if the accounts of the assessee have already been audited under any other law for the time being in force or otherwise.

5. The report of the auditor after conducting the audit must be furnished to Assessing Officer by the assessee within the period specified by the Assessing Officer in his order. The Assessing Officer is, however, entitled, *suo motu* on receipt of an application made in this behalf by the assessee for any good and sufficient reason to extend the time-limit by such further period or periods as he deems fit. Further, the aggregate of the period originally fixed and the period or periods so extended should not exceed 180 days in any case. This time of 180 days must be reckoned from the date on which the Assessing Officer's direction to get the accounts audited is received by the assessee.

6. Where the direction for special audit is issued by the Assessing Officer, the expenses of, and incidental to, such special audit, including remuneration of the Accountant, shall be determined by the Chief Commissioner or Commissioner in accordance with the prescribed guidelines. The expenses so determined shall be paid by the Central Government.

Rule 14B lays down the guidelines for the purposes of determining expenses for audit under section 142(2A). The said Rule is applicable when the audit under section 142(2A) is directed

by an Assessing Officer on or after 1st June, 2007. The expenses of, and incidental to, audit (including the remuneration of the accountant, qualified assistants, semi-qualified and other assistants who may be engaged by such Accountant) should not be less than ₹ 3750 and not more than ₹ 7500 for every hour of the period as specified by the Assessing Officer under section 142(2C). Such period shall be specified in terms of the number of hours required for completing the report.

7. The assessee should, however, be given an opportunity of being heard in respect of any material gathered on the basis of –

- (i) any inquiry under section 142(2); or
- (ii) any audit under section 142(2A)

which is proposed to be utilized for the purposes of the assessment. If, however, the assessment is in nature of a best judgment assessment under section 144, it is not obligatory for the Assessing Officer to give the assessee an opportunity to be heard, before passing the assessment order on the basis of the report of the auditor.

8. In any case, where the assessee is directed to get audit done and the assessee fails to do so, the Assessing Officer is entitled to make a best judgment assessment under section 144 in addition to imposing penalty or taking such steps as may be necessary under the law.

21.24 Power of Assessing Officer to make a reference to the Valuation Officer [Section 142A]

- (i) For determining the cost of construction of properties, an Assessing Officer has been taking the assistance of a Valuation Officer by exercising the power vested in him under section 131 of the Income-tax Act, 1961.
- (ii) Section 131 provides that the Assessing Officer shall have the same powers as are vested in a Court under the Code of Civil Procedure, 1908, when trying a suit.
- (iii) One such power is that of an “issuing commission” provided under section 131(1)(d) which, *inter-alia*, empowers the court “to make a local investigation” and also “to hold a scientific, technical or expert investigation”.
- (iv) The authority of Valuation Officer was created under the Wealth-tax Act by Taxation Laws (Amendment) Act, 1972 with effect from 15.11.1972.
- (v) The scope of power under section 131 vested in an Assessing Officer to make a reference to the Valuation Officer for estimating the cost of construction of properties has been a matter attracting different legal interpretations.
- (vi) Therefore, with a view to remove any doubt in this regard, section 142A clarifies that Assessing Officer has and always had the power to make a reference to the Valuation Officer.
- (vii) Sub-section (1) provides that where an estimate of the value of any – (1) investment referred to in section 69 or section 69B or (2) bullion, jewellery or other valuable article referred to in section 69A or section 69B or (3) fair market value of any property referred to in section 56(2) is required for the purposes of making any assessment or re-

assessment, the Assessing Officer may require the Valuation Officer to make an estimate of the same and report to the Assessing Officer.

- (viii) Sub-section (2) provides that the Valuation Officer to whom such a reference is made under sub-section (1) shall, for the purpose of dealing with such reference, have all the powers that he has under section 38A of the Wealth-tax Act, 1957.
- (ix) Sub-section (3) provides that on receipt of the report from the Valuation Officer, the Assessing Officer may after giving the assessee an opportunity of being heard, take into account such report in making such assessment or reassessment.
- (x) The *Explanation* to the section provides that the definition of the expression "Valuation Officer" will have the same meaning as in section 2(r) of the Wealth-tax Act, 1957 i.e. a person appointed as a Valuation Officer under section 12A, and includes a Regional Valuation Officer, a District Valuation Officer, and an Assistant Valuation Officer.

21.25 Assessment [Section 143]

Where a return has been made under section 139 or in response to a notice under section 142(1), if any tax or interest is found due an intimation should be sent to the assessee which will be deemed to be a demand notice. If any refund is due to the assessee it shall be granted.

21.25.1 Summary assessment [Section 143(1)/(1A)/(1B)/(1C)]:

- (i) Section 143(1) provides for computation of the total income of an assessee after making the following adjustments to the returned income:-
 - (a) any arithmetical error in the return; or
 - (b) an incorrect claim, if such incorrect claim is apparent from any information in the return.
- (ii) The term "an incorrect claim apparent from any information in the return" shall mean such claim on the basis of an entry, in the return, –
 - (a) of an item, which is inconsistent with another entry of the same or some other item in such return;
 - (b) in respect of which, information required to be furnished to substantiate such entry, has not been furnished under this Act; or
 - (c) in respect of a deduction, where such deduction exceeds specified statutory limit which may have been expressed as monetary amount or percentage or ratio or fraction.
- (iii) Tax and interest should be computed on the basis of the total income computed after making the adjustments in (i) above.
- (iv) The sum payable by, or the amount of refund due to, the assessee shall be determined after adjustment of such tax and interest, if any, so computed by any tax deducted at source, any tax collected at source, any advance tax paid, any relief allowable under an agreement under section 90 or section 90A, or any relief allowable under section 91 any tax paid on self-assessment and any amount paid otherwise by way of tax or interest.
- (v) Based on the above adjustments, an intimation shall be prepared or generated and sent

to the assessee within a period of one year from the end of the financial year in which the return was made. The intimation shall specify the sum determined to be payable by, or the amount of refund due to, the assessee.

- (vi) If any amount of refund is due to the assessee, the same shall be granted to the assessee.
- (vii) An intimation shall also be sent to the assessee in a case where the loss declared in the return by the assessee is adjusted but no tax or interest is payable by, or no refund is due to, him.
- (viii) On the other hand, where there is neither any adjustment nor any tax due from or refund payable to the assessee, the acknowledgement of the return shall be deemed to be the intimation under section 143(1).
- (ix) The scheme contemplates avoiding human interface and therefore, provides for computerised processing of returns for making the above adjustments i.e., the software will be designed to detect arithmetical inaccuracies and internal inconsistencies and make appropriate adjustments in the computation of the total income/fringe benefits.
- (x) For this purpose, the Department is in the process of establishing a system for Centralised Processing of Returns. To facilitate the Department in establishing this system –
 - (a) the Board may formulate a scheme with a view to expeditiously determine the tax payable by, or refund due to, the assessee;
 - (b) the Central Government may issue a notification in the Official Gazette, directing that any of the provisions of this Act relating to processing of returns shall not apply or shall apply with such exceptions, modifications and adaptations as may be specified in the notification. However, such direction shall not be issued after 31st March, 2012.
 - (c) every notification shall be laid before each House of Parliament as soon as such notification is issued. Along with the notification, the scheme referred above is also required to be laid before each House of Parliament.

21.25.2 Processing of return of income under section 143(1) not necessary in a case where notice has been issued under section 143(2) to the assessee for scrutiny of return [Section 143(1D)]

- (i) As per section 143(1), every return of income is to be processed and refund, if any, due is to be issued to the tax payer. There are cases where demand for taxes is raised after scrutiny of return of income under section 143(3) although the refund may have been issued earlier at the time of processing under section 143(1).
- (ii) Section 143(1D) provides that, notwithstanding anything contained in section 143(1), the processing of a return under section 143(1) shall not be necessary, where a notice of assessment has been issued to the assessee under section 143(2) for scrutiny of the return.
- (iii) However, this provision cannot be applied if the processing of return under section 143(1) is completed and intimation has already been issued.

21.25.3 Regular assessment/Scrutiny assessment: If the Assessing Officer considers it necessary or expedient to ensure that the assessee has not understated his income or has not computed excessive loss or has not underpaid his tax in any manner he can issue a notice for

making the assessment in the normal manner as at present. This will be a scrutiny assessment. It may be noted that notice for detailed scrutiny under section 143(2) cannot be issued after the expiry of 6 months from the end of the financial year in which the return of income is furnished.

It is also obligatory for research associations and other institutions exempt under clauses (21),(22B),(23A),(23B), sub-clauses (iv),(v),(vi) and (via) of clause (23C) of section 10 to file their returns of income. In these cases, the Assessing Officer cannot make an assessment denying exemption under section 10 without intimating the Central Government or the prescribed authority of the contravention of the provisions of the relevant sections and till the approval granted to these funds, trusts, institutions, universities, educational institutions or hospitals or medical institutions has been withdrawn or notification rescinded.

The time period for completing the assessment in such cases will exclude the period between the date on which the Assessing Officer gives the intimation of the default and date on which copy of the order withdrawing the approval is received by the Assessing Officer.

Section 2(15) provides that in case of a trust or institution, whose main object is the “advancement of object of general public utility”, the purpose does not remain charitable in a previous year, if its commercial receipts exceed the specified threshold of ₹ 25 lakhs. However, this temporary excess in one year may not be treated as altering the very nature of the trust or institution so as to lead to cancellation of registration or withdrawal of approval or rescinding of notification issued in respect of trust or institution. Accordingly, such trust and institution does not get benefit of tax exemption under section 10(23C) or 11 or 12 in the year in which its receipts from commercial activities exceed the specified threshold of ₹ 25 lakhs, whether or not the registration or approval granted or notification issued is cancelled, withdrawn or rescinded in respect of such trust or institution. Consequently, in such a circumstance, no effect shall be given by the Assessing Officer to the exemption provisions under section 10(23C) while making an assessment of the total income or loss of the trust or institution for the previous year under section 143(3).

Assessing Officer empowered to send a proposal to the Central Government recommending withdrawal of approval of research association, university, college or other institution approved under section 35(1)(ii) and (iii)

- (i) The guidelines, the manner and the conditions in accordance with which an application made by a research association, university, college or other institution shall be approved under section 35(1)(ii)/(iii) have been provided by the Taxation Laws (Amendment) Act, 2006. Also, the amendment provides for grant of one time approval, which means the approval is to remain in force unless it is withdrawn.
- (ii) Therefore, the Assessing Officer is now required to satisfy himself as to the activities of the university, college or other institution referred to in clause (ii) or clause (iii) of section 35(1).
- (iii) If the activities are not being carried out in accordance with all or any of the conditions subject to which any of the said entities had been approved, the Assessing Officer may, after giving a reasonable opportunity of showing cause to the concerned entity, send a proposal to the Central Government recommending withdrawal of approval.
- (iv) The Central Government may, by order, withdraw the approval and forward a copy of the order to the concerned university, college or other institution and to the Assessing Officer.

21.25.4 Best judgment assessment [Section 144]: If any person:

- (a) fails to make the return required under section 139(1) and has not made a return or a revised return under sub-section (4) or sub-section (5) of section 139 or
- (b) fails to comply with all the terms of a notice issued under section 142(1) or fails to comply with the direction issued under section 142(2A) or
- (c) having made a return, fails to comply with all the terms of a notice issued under section 143(2) the Assessing Officer shall make a best judgment assessment.

Before making such assessment the Assessing Officer can take into account all relevant material which he has gathered. The assessee must be given an opportunity of being heard. Such opportunity shall be given by an Assessing Officer by serving a notice calling upon the assessee to show cause on a date and time to be specified in the notice, why the assessment should not be completed to the best of his judgment. Thereafter, the Assessing Officer shall make the assessment of total income or loss to the best of his judgment and determine the sum payable on the basis of such assessment. It may be noted that no refund can be granted under section 144.

However, where a notice under section 142(1) has been issued prior to the making of an assessment under this section, it is not necessary to give such opportunity.

In all the three cases stated above it is mandatory for the Assessing Officer to make a best judgment assessment and he has no discretion to make or not to make such assessment. These three cases are alternative and not cumulative for the purpose of making an ex parte assessment.

In a case where a Chief Commissioner or Commissioner issued instructions under section 142(2A) nominated a Chartered Accountant for auditing the assessee's accounts and though the concerned assessee was willing to produce the records the concerned Chartered Accountant refused to audit the accounts, the question arose as to whether there was a failure on the assessee's part to comply with the directions under section 142(2A) and consequently the best judgement assessment could be made under section 144(b).

The Supreme Court held that if for a frivolous reason the Chartered Accountant declined to undertake the audit of the assessee's accounts the assessee could not be held responsible. In such a case there was no default or failure to comply with the direction issued under section 142(2A) on the assessee's part so as to attract the provisions of section 144(b). The best judgement made by the assessing officer was set aside with the directions to appoint another Chartered Accountant within one month to get the accounts audited. [*Swadesh Polytex Ltd. v. ITO* [1983] 15 Taxman 19 (SC)].

21.26 Power of Joint Commissioner to issue directions in certain cases [Section 144A]

- (i) A Joint Commissioner may on his own motion or on a reference being made to him by the Assessing Officer or on the application of an assessee, call for and examine the record of any proceeding in which an assessment is pending and if he considers that,

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having regard to the nature of the case or the amount involved or for any other reason it is necessary so to do, he may issue such direction as he thinks fit for the guidance of the Assessing Officer to enable him to complete the assessment. Such directions shall be binding on the Assessing Officer.

- (ii) No directions which are prejudicial to the assessee shall be issued before an opportunity is given to the assessee to be heard.

21.27 Provision for constitution of Alternate Dispute Resolution Mechanism [Section 144C]

An alternate dispute resolution mechanism which will aid speedy resolution of disputes on a fast track basis has now been provided for under the Income-tax Act, 1961. The significant features of the alternate dispute resolution mechanism are briefed hereunder –

- (1) The Assessing Officer shall, forward a draft order of assessment to the eligible assessee if he proposes to make, on or after 1st October, 2009, any variation in the income or loss returned which is prejudicial to the interest of such assessee.

“Eligible assessee” means,-

- (i) any person in whose case such variation arises as a consequence of the order of the Transfer Pricing Officer passed under sub-section (3) of section 92CA; and
 - (ii) any foreign company.
- (2) The eligible assessee shall, within thirty days of the receipt by him of the draft order,-
 - (a) file his acceptance of the variations to the Assessing Officer; or
 - (b) file his objections, if any, to such variation with,—
 - (i) The Dispute Resolution Panel; and
 - (ii) The Assessing Officer.

“Dispute Resolution Panel” means a collegium comprising of three commissioners of Income-tax constituted by the CBDT for this purpose.

- (3) The Assessing Officer has to complete the assessment on the basis of the draft order, if—
 - (a) the assessee intimates the acceptance of the variation to the Assessing Officer; or
 - (b) no objections are received within the period of 30 days specified in (2) above.
- (4) The Assessing Officer shall, notwithstanding anything contained in section 153 or section 153B, pass the assessment order within one month from the end of the month in which,—
 - (a) the acceptance is received; or
 - (b) the period of filing of objections expires.
- (5) The Dispute Resolution Panel shall, in a case where any objections are received, issue

such directions, as it thinks fit, for the guidance of the Assessing Officer to enable him to complete the assessment.

- (6) The Dispute Resolution Panel shall issue such directions, after considering the following, namely:—
 - (a) Draft order;
 - (b) Objections filed by the assessee;
 - (c) Evidence furnished by the assessee;
 - (d) Report, if any, of the Assessing Officer, Valuation Officer or Transfer Pricing Officer or any other authority;
 - (e) Records relating to the draft order;
 - (f) Evidence collected by, or caused to be collected by, it; and
 - (g) Result of any enquiry made by, or caused to be made by it.
- (7) The Dispute Resolution Panel may, before issuing any such directions -
 - (a) make such further enquiry, as it thinks fit; or
 - (b) cause any further enquiry to be made by any income tax authority and report the result of the same to it.
- (8) The Dispute Resolution Panel may confirm, reduce or enhance the variations proposed in the draft order. However, it cannot set aside any proposed variation or issue any direction as mentioned in (5) above, for further enquiry and passing of the assessment order.

The power of the DRP to enhance the variation as mentioned in section 144C(8) shall include and shall be deemed to have always included the power to consider any matter arising out of the assessment proceedings relating to the draft order. This power to consider any issue shall be irrespective of whether the matter was raised by the eligible assessee or not.

While exercising the aforesaid power for considering any matter arising out of the assessment proceedings relating to the draft order, the DRP can only enhance the variation. The power of reducing the variation is not accorded to DRP in respect of such matters.
- (9) If the members of the Dispute Resolution Panel differ in opinion on any point, the point shall be decided according to the opinion of the majority of the members.
- (10) Every direction issued by the Dispute Resolution Panel shall be binding on the Assessing Officer.
- (11) If any direction is prejudicial to the interest of the assessee or the interest of the revenue, then, the same can be issued only after an opportunity of being heard is given to the assessee or the Assessing Officer, as the case may be.
- (12) Such direction has to be issued within nine months from the end of the month in which the draft order is forwarded to the eligible assessee.

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- (13) Upon receipt of such direction, the Assessing Officer has to complete the assessment in accordance with the same, within one month from the end of the month in which the direction is received. This is notwithstanding anything contained in section 153 or section 153B. There is no requirement of providing any further opportunity of being heard to the assessee.
- (14) The CBDT is empowered to make rules for the efficient functioning of the Dispute Resolution Panel and speedy resolution of the objections filed by the eligible assessee.

21.28 Valuation of Inventory [Section 145A]

The valuation of purchase and sale of goods and inventory for the purpose of determining the income chargeable under the head 'Profits and gains of business or profession' shall be in accordance with the method of accounting regularly followed by the assessee. Such value will be arrived at after being adjusted to include the amount of any tax, duty, cess or fee (by whatever name called), actually paid or incurred by the assessee to bring the goods to their present location and condition.

Further, for the purpose of valuation, any entitlement to rebate or set-off, etc. therefrom should not be considered. In this context, the following points may be noted:

- This section applies irrespective of section 145 laying down method of accounting to be followed, to determine business income.
- It applies only in respect of valuation of purchase and sale of goods and inventory (opening as well as closing stock).
- Otherwise, business income should be computed in accordance with method of accounting regularly employed.
- In valuation of sale and purchase of goods as well as inventory, any amount actually paid or incurred on any tax, duty, cess or fees, ("duty etc." in relation to purchase and sale of goods) shall be included.
- Duty, etc., must have been actually paid or incurred to bring the goods to the place of its location and condition, as on the date of valuation.
- The amount of duty, etc., included in value of inventory, should not take into account any right arising as a consequence of payment, meaning any credit or set-off or rebate etc.

21.29 Income escaping assessment [Section 147]

21.29.1 Applicability

- (1) If the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of sections 148 to 153 assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section, or recompute the loss or the depreciation allowance or any other allowance, as the case may be, for the relevant assessment year.
- (2) Where an assessment under section 143(3) or 147 has already been made by the

Assessing Officer for the relevant assessment year, then, no action shall be taken under this section after the expiry of four years from the end of the relevant assessment year.

The exception would be in cases where any income chargeable to tax has escaped assessment for such assessment year by reason of the failure on the part of the assessee to make a return under section 139, or in response to a notice issued under section 142(1) or section 148 or to disclose, fully and truly, all material facts necessary for his assessment for that assessment year.

The above time limit shall also not apply in a case where income chargeable to tax, in relation to an asset (including financial interest in an entity) located outside India, has escaped assessment for any assessment year. In effect, in such cases, the Assessing Officer can initiate assessment proceedings under section 147 even after the expiry of 4 years inspite of the assessee having –

- (i) duly furnished his return of income and
- (ii) fully and truly disclosing all material facts necessary for his assessment

for that assessment year.

It is also clarified that, the above provision shall also be applicable for any assessment year beginning on or before 01.04.2012.

The Assessing Officer must have 'reason to believe' that income chargeable to tax had escaped assessment. The belief which prompts an Income-tax Officer to apply section 147 to any particular case must be that of an honest and reasonable person based upon reasonable grounds, and that the Assessing Officer may act under this section on direct or circumstantial evidence but not on a mere suspicion, gossip or rumor. The powers of the Assessing Officer are wide, but not plenary in nature. Care must be taken to note that the words used in the section are "reason to believe" and not 'reason to suspect'. The expression 'reason to believe' does not, however, mean a purely subjective satisfaction on the part of the Assessing Officer. The belief must be held in good faith. It cannot be a mere pretence. It is open to the Court to examine whether the reasons for the belief have a rational connection or a relevant bearing to the formation of the belief and are not extraneous or irrelevant to the purpose of the section. There is no requirement in any of the provisions of the Act or under any section laying down as a condition for the initiation of the proceeding that the reasons which induced the Assessing Officer, to issue the notice must also be communicated to the assessee. Therefore, the Assessing Officer need not communicate to the assessee the reasons, which led him to initiate the proceedings under section 147.

(3) The Assessing Officer may assess or reassess an income which is chargeable to tax and has escaped assessment other than the income involving matters which are the subject matter of any appeal, reference or revision.

Where reassessment is made under section 147 in respect of income which has escaped tax, the Assessing Officer's jurisdiction is confined to only such income which has escaped tax or has been underassessed and does not extend to revising, reopening or reconsidering the whole assessment or permitting the assessee to reagitate questions which had been decided

in the original assessment proceedings. It is only the underassessment which is set aside and not the entire assessment when reassessment proceedings are initiated. The Assessing Officer cannot make an order of reassessment inconsistent with the original order of assessment in respect of matters which are not the subject matter of proceedings under section 147. An assessee cannot resist validly initiated reassessment proceedings under this section merely by showing that other income which had been assessed originally was at too high a figure except in cases under section 152(2). The words "such income" in section 147 clearly refer to the income which is chargeable to tax but has "escaped assessment" and the Assessing Officer's jurisdiction under the section is confined only to such income which has escaped assessment. It does not extend to reconsidering generally the concluded earlier assessment.

(4) It has been clarified that production before the Assessing Officer of account books or other evidence from which material evidence could have been discovered by the Assessing Officer with due diligence will not necessarily amount to disclosure.

(5) For the purpose of this section, the following shall also be deemed to be cases where income chargeable to tax has escaped assessment:

- (i) Where no return of income has been furnished by the assessee although his total income or the total income of any other person in respect of which he is assessable under this Act during the previous year exceeded the maximum amount which is not chargeable to income-tax.
- (ii) Where a return of income has been furnished by the assessee but no assessment has been made and it is noticed by the Assessing Officer that the assessee has understated the income or has claimed excessive loss, deduction, allowance or relief in the return.
- (iii) where the assessee has failed to furnish a report in respect of any international transaction which he was so required under section 92E. (It is further clarified that this provision shall also be applicable for any assessment year beginning on or before 01.04.2012).
- (iv) Where an assessment has been made but:
 - (a) income chargeable to tax has been under-assessed
 - (b) such income has been assessed at too low a rate
 - (c) such income has been made the subject of excessive relief under this Act
 - (d) excessive loss or depreciation or any other allowance under this Act has been computed.
- (v) where a person is found to have any asset (including financial transaction in any entity) located outside India. (It is further clarified that this provision shall also be applicable for any assessment year beginning on or before 01.04.2012).
- (6) The Assessing Officer may assess or reassess the income in respect of any issue (which has escaped assessment) which comes to his notice subsequently in the course of proceedings under this section, even though the reason for such issue does not form part of the reasons recorded under section 148(2).

21.29.2 Issue of notice where income has escaped assessment [Section 148]

Before making the assessment, reassessment or recomputation under section 147, the Assessing Officer shall serve on the assessee, a notice requiring him to furnish a return within such period as may be specified in the notice, a return of his income or the income of any other person for whom he is assessable under the Act, during the previous year corresponding to the relevant assessment year in the prescribed form and verified in the prescribed manner and setting forth such other particulars may be prescribed. The provisions of this Act shall apply accordingly as if such return were a return required to be furnished under section 139.

The Assessing Officer shall, before issuing any notice under this section, record his reasons for doing so.

21.29.3 Time limit for notice [Section 149]: Notice under section 148 must be issued within the following time limit:

- (a) Where the income which has escaped assessment amounts to or is likely to amount to ₹ 1 lakh or more, the notice under section 148 shall be issued within six years from the end of the relevant assessment year.
- (b) In case income is in relation to such assets (including financial interest in any entity) located outside India has escaped assessment, an extended time limit of 16 years would be available for issue of notice under section 148 for an assessment or reassessment.
- (c) In other cases, the notice shall be issued within four years from the end of the relevant assessment year.

As per section 149(3), if the person on whom a notice under section 148 is to be served is a person treated as an agent of a non-resident under section 163 and the assessment, reassessment or re-computation in pursuance of the notice is to be made on him as the agent of such non-resident, there is a time limit of six years from the end of the relevant assessment year, beyond which such notice cannot be issued. It is also clarified that the extended time limit of six years shall also be applicable for any assessment year beginning on or before 1st April, 2012.

21.29.4 Provision for cases where assessment is in pursuance of an order on appeal, etc. [Section 150]

Section 150 provides that notwithstanding anything contained in section 149, notice under section 148 may be issued at any time in consequence of or to give effect to (a) any finding or direction in an order passed by any authority in appeal, reference or revision or (b) by a Court in any proceeding under any other law.

However, notice under section 148 cannot be issued, if at the time when the order which was the subject matter of appeal, reference, revision was passed, the time limit for the issue of such notice had expired. This is contained in section 150(2).

21.30 Sanction for issue of notice [Section 151]

- (1) In a case where an assessment under section 143(3) or section 147 has been made for the relevant assessment year no notice shall be issued under section 148 except by an Assessing Officer of the rank of Assistant Commissioner or Deputy Commissioner, unless the

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Joint Commissioner is satisfied on the reasons recorded by the Assessing Officer that it is a fit case for issue of notice.

(2) After the expiry of four years from the end of the relevant assessment year no such notice shall be issued unless the Chief Commissioner or Commissioner is satisfied on the reasons recorded by the Assessing Officer aforesaid thereof it is a fit case for the issue of such notice.

(3) In all other cases (*i.e.* non-scrutiny cases) no notice shall be issued under section 148 by an Assessing Officer who is below the rank of Joint Commissioner after the expiry of four years from the end of the relevant assessment year unless the Joint Commissioner is satisfied on the reasons recorded by such Assessing Officer that it is a fit case for the issue of such notice.

(4) The Joint Commissioner, the Commissioner or the Chief Commissioner, as the case may be, on being satisfied with the reasons recorded by the Assessing Officer about the fitness of a case for the issue of notice under section 148, need not issue the notice himself. Thus, where the approval of the Joint Commissioner/Chief Commissioner/ Commissioner is required for issue of notice under section 148, it is not necessary that such notice should be issued by the Joint Commissioner/Chief Commissioner/ Commissioner himself. It would be sufficient if the Assessing Officer issues the notice.

21.31 Other Provisions [Section 152]

As per section 152(1), in the case of any assessment or reassessment or recomputation made under section 147, the income escaping assessment shall be chargeable to tax at the rate applicable to the respective years in which such income is liable to be taxed.

As per section 152(2), where an assessment is reopened under section 147, the assessee may claim that the proceedings under section 147 shall be dropped on his showing that he had been assessed on an amount not lower than what he would be rightly liable for even if the income alleged to have escaped assessment had been taken into account. Alternatively, he can make such a claim on showing that the assessment or computation had been properly made. An assessee can avail this benefit only if he had not challenged any part of the original assessment order either by filing an appeal or filing a revision petition. The assessee, while making such claim, shall not be entitled to reopen matters concluded by an order under sections 154, 155, 260, 262 or 263.

21.32 Time limit for completion of assessments and reassessments [Section 153]

(1) No order of assessment shall be made under section 143 or 144 at any time after the expiry of 2 years from the end of the assessment year in which the income was first assessable [Section 153(1)].

(2) No order of assessment, reassessment or recomputation shall be made under section 147 after the expiry of 1 year from the end of the financial year in which the notice under section 148 was served [Section 153(2)].

(3) Sub-section (2A) of this section lays down certain time limits in cases where fresh assessment has to be made.

Accordingly, an order of fresh assessment in pursuance of an order under section 250 or 254 or 263 or 264, setting aside or canceling an assessment, may be made at any time before the expiry of 1 year from the end of the financial year in which the order under section 250 or 254 is received by the Chief Commissioner or Commissioner, or the order under section 263 or 264 is passed by the Chief Commissioner or Commissioner. This is notwithstanding anything contained in sub-sections (1), (1A), (1B) and (2) of section 153.

Where immediately after the exclusion of the time mentioned in the explanation, the period of limitation available to the Assessing Officer for making orders under sections 153(1), (1A), (1B), (2), (2A), (4) is less than 60 days, the remaining period shall be extended to 60 days and the aforesaid period of limitation shall be deemed to be extended accordingly.

The following shall be the time limit for assessment or reassessment under section 153 w.e.f. 1.7.2012:

Proceeding under section	Earlier time limit for completion of assessment or reassessment	New time limit for completion of assessment or reassessment	Applicability of new time limit
143(3) or 144	21 months from the end of the assessment year in which the income was first assessable	2 years from the end of the assessment year in which the income was first assessable	In case income is first assessable in the A.Y. 2010-11 or any subsequent assessment year
147	9 months from the end of the financial year in which the notice under section 148 was served	1 year from the end of the financial year in which the notice under section 148 was served	Where notice under section 148 is served on or after 01.04.2011.
Fresh assessment under section 143(3)/144/147 where the original assessment has been set aside, cancelled and referred back to the Assessing Officer by an order under section 254/263/264	9 months from the end of the financial year in which the said order under section 254 is received by the CIT or the order under section 263 or section 264 is passed by the CIT	1 year from the end of the financial year in which the said order under section 254 is received by the CIT or the order under section 263 or section 264 is passed by the CIT	Where order under section 254 is received by the CIT or order under section 263 or section 264 is passed by the CIT on or after 01.04.2011.

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(4) *No time limit* – The provisions of sub-sections (1), (1A), (1B) and (2) shall not apply to the following classes of assessments, reassessments and recomputations:

- (i) Where the assessment or reassessment is made on the assessee or any other person in consequence of or to give effect to any finding or direction contained in any order under sections 250, 254, 260, 262, 263 or 264 (in appeal, reference, revision) or an order by a Court in a proceeding otherwise than by way of appeal or reference under this Act.
- (ii) where in the case of a firm an assessment is made on a partner of the firm in the case of a firm an assessment of the escaped income is made on the firm under section 147 [Sub-section (3)].

(5) Section 153A(2) provides for revival of abated assessments/reassessments, where the assessment order or reassessment order has been annulled in any appeal or legal proceeding. The time limit for completion of such assessment or reassessment shall be one year from the end of the month in which the abated assessment revives or within the period already specified in section 153 or in sub-section (1) of section 153B, whichever is later [Sub-section (4)].

(6) *Exclusion of period* - In computing the period of limitation for the purposes of section 153 the following time periods shall be excluded.

- (a) The time taken in reopening the whole or any part of the proceedings in giving an opportunity to the assessee to be reheard when there is a change in the incumbency of the office under section 129.
- (b) Any time during which the assessment proceeding is stayed by an order of a court.
- (c) the period commencing from the date on which the Assessing Officer, under clause (i) of the proviso to section 143(3), intimates the Central Government or the prescribed authority, the contravention of the provisions of clause (21) or clause (22B) or clause (23A) or clause (23B) of section 10 or sub-clause (iv) or (v) or (vi) or (via) of section 10(23C), and ending with the date on which the copy of the order withdrawing the approval or rescinding the notification, as the case may be, under those clauses is received by the Assessing Officer.
- (d) Time taken for completion of audit of the accounts of the assessee under section 142(2A). The following time period should be excluded -

<i>the period commencing from</i>	<i>the period ending with</i>	
	<i>In a case where such direction is not challenged before a court</i>	<i>In a case where such direction is challenged before a court</i>
<i>the date on which the Assessing Officer directs the assessee to get his accounts audited under section 142(2A).</i>	<i>the last date on which the assessee is required to furnish a report of such audit under section 142(2A).</i>	<i>the date on which the order setting aside such direction is received by the Commissioner.</i>

- (e) Where a declaration under section 158A is made by an assessee commencing from the date on which the Assessing Officer received the declaration and ending with the date on which an order under section 158A(3) is made by the Assessing Officer. However the period cannot exceed 60 days.
- (f) In a case where an application for settlement of case has been rejected or is not allowed to be proceeded with, the period commencing from the date on which such application is made and ending with the date on which the order of the Settlement Commission is received by the Commissioner.
- (g) The period commencing from the date on which an application is made before the Authority for Advance Rulings under section 245Q(1) and ending with the date on which the advance ruling pronounced by it or the order rejecting the application is received by the Commissioner under section 245R(7)/(3).
- (h) The period beginning with the date on which a reference *or the first of the references* for exchange of information is made by an authority competent under an agreement referred to in sections 90 and 90A and ending with the date on which the information so requested is *last* received by the Commissioner or a period of one year, whichever is less, is excluded for computing the above time limits. This is for the purpose of excluding the time taken in obtaining information from the tax authorities in jurisdictions situated outside India (under an agreement referred to in section 90 or section 90A) from the prescribed time limit for completion of assessments/reassessments under section 153.

Explanation 1 to section 153 provides for exclusion of certain periods as specified therein in computing the period of limitation for the purposes of section 153. If after exclusion of such time period, the period of limitation available to the Assessing Officer is less than 60 days, such remaining period shall be extended to 60 days and the period of limitation shall be deemed to be extended accordingly.

- (7) In a case where a proceeding before the Settlement Commission abates under 245HA, the period of limitation available under this section to the Assessing Officer for making an order of assessment, reassessment or recomputation, as the case may be, shall, after the exclusion of the period under section 245HA(4), be not less than one year; and where such period of limitation is less than one year, it shall be deemed to have extended to one year: and for the purpose of determining the period of limitation under sections 149, 153B, 154, 155, 158BE and 231 and for the purpose of payment of interest under section 243 or section 244 or, as the case may be, section 244A, this provision shall also apply.
- (8) Where by an order in appeal reference or revision any income is excluded from the total income of the assessee for any assessment year, the assessment of such income for another assessment year shall, for the purpose of sections 150 and 153 be deemed to be one made in consequence of or to give effect to any finding or direction contained in the appellate order.
- (9) Where by an order in appeal, reference or revision, any income is excluded from the total income of one person and held to be the income of another person then an assessment of such income on such other person shall, for the purpose of section 150 and 153 be deemed to be one made in consequence of or to give effect to any finding or direction contained in the appellate order. The other person must be given an opportunity of being heard before the order of assessment is passed.

21.33 Limitation period for completion of assessments / reassessments

Section 153 lays down the time limit for making an order of assessment i.e. any time before expiry of 2 years from the end of the assessment year in which the income was first assessable. Also, *Explanation 1* below section 153 sets out certain circumstances in which certain periods as specified are excluded from the period of limitation.

In a case where an audit under section 142(2A) is ordered, the assessee is required to furnish a report of such audit within the prescribed time. The following time period is excluded while computing the period of limitation for the purposes of section 153 and 153B -

<i>the period commencing from</i>	<i>the period ending with</i>	
	<i>In a case where such direction is not challenged before a court</i>	<i>In a case where such direction is challenged before a court</i>
<i>the date on which the Assessing Officer directs the assessee to get his accounts audited u/s 142(2A).</i>	<i>the last date on which the assessee is required to furnish a report of such audit under section 142(2A).</i>	<i>the date on which the order setting aside such direction is received by the Commissioner.</i>

21.34 Assessment procedure in case of search or requisition [Section 153A/153B/153C]

The block assessment procedure introduced in 1995 and in operation since then for 8 years with various amendments from time to time has been abolished in respect of search carried out after 31st May, 2003. In the place of the block assessment, a new scheme of reassessment has been introduced by inserting three sections 153A, 153B and 153C with effect from 1st June, 2003 for assessment in case of search or making requisition.

Procedure for assessment where search is initiated under section 132 or books of account etc. are requisitioned under section 132A [Section 153A]

- The provisions of section 153A prescribing a procedure for assessment in the case of search or requisition will apply notwithstanding anything contained in sections 139/147/148/149/151 and 153.
- This section provides for the procedure for completion of assessment where a search is initiated under section 132 or books of account, other documents or any assets are requisitioned under section 132A after 31st May, 2003.
- In such cases, the Assessing Officer shall issue notice to such person. Such a person has to furnish a return of income within such period as may be specified in the notice setting forth such other particulars as may be prescribed.
- Such a return should be filed in respect of six assessment years immediately preceding the assessment year relevant to the previous year in which the search was conducted

under section 132 or requisition was made under section 132A.

- (e) The Assessing Officer shall assess or reassess the total income of each of these six assessment years.
- (f) The assessment or reassessment, if any, relating to any assessment year falling within the above period of six assessment years, pending on the date of the initiation of the search under section 132 or requisition under section 132A, as the case may be, shall abate. In other words, they will cease to be applicable.
- (g) The Central Government is empowered to notify class or classes of cases [except the cases where any assessment or reassessment has abated] in which the Assessing Officer shall not be required to issue notice for initiation of assessment or reassessment of total income for six assessment years immediately preceding the assessment year relevant to the previous year in which the search was conducted or requisition was made.

The assessment proceedings in the class or classes of cases so notified shall be carried out only for the assessment year relevant to the previous year in which search was conducted or requisition was made, except in cases where any assessment or reassessment in respect of any of the earlier six years has abated.

Accordingly, in exercise of this power, the Central Government has, through Notification No.42/2012 dated 4.10.2012, inserted Rule 112F which shall come into force from 1st July, 2012.

The said Rule provides that the Assessing Officer is not required to issue notice for assessing or reassessing the total income for six assessment years immediately preceding the assessment year relevant to the previous year in which search is conducted or requisition is made, in the following cases:

- (i) *where as a result of a search under section 132(1) or a requisition made under section 132A, a person is found to be in possession of any money, bullion, jewellery or other valuable articles or things, whether or not he is the actual owner of the same, and*
- (ii) *where such search is conducted or such requisition is made in the territorial area of an assembly or parliamentary constituency in respect of which a notification has been issued under section 30 read with section 56 of the Representation of the People Act, 1951, or where the assets so seized or requisitioned are connected in any manner to the ongoing election in an assembly or parliamentary constituency.*

However, this Rule is not applicable to cases where such search under section 132 or such requisition under section 132A has taken place after the hours of poll so notified.

Circular No.10/2012 dated 31.12.2012 clarifies that the aforesaid amendment was introduced with a view to reduce infructuous and unnecessary proceedings under the Income-tax Act, 1961 in cases where a search is conducted under section 132 or requisition is made under section 132A and cash or other assets are seized during the election period, generally on a single warrant, and no evidence is

available, or investigation required, for any assessment year other than the assessment year relevant to the previous year in which search is conducted or requisition is made.

In such cases, the officer investigating the case, with the approval of the Director General of Income-tax, is required to certify that -

- (i) the search is conducted under section 132 or the requisition is made under section 132A in the territorial area of an assembly or parliamentary constituency in respect of which a notification has been issued under section 30, read with section 56 of the Representation of the People Act, 1951; or*
- (ii) the assets seized or requisitioned are connected in any manner to the ongoing election process in an assembly or parliamentary constituency; and*
- (iii) no evidence is available or investigation is required for any assessment year other than the assessment year relevant to the previous year in which search is conducted or requisition is made.*

The certificate of the investigating officer shall be communicated to the Commissioner of Income-tax and the Assessing Officer having jurisdiction over the case of such person.

- (h) If any proceeding initiated under section 153A or any order of assessment or reassessment made under section 153A(1) has been annulled in any appeal or other legal proceeding, the abated assessment or reassessment relating to any assessment year shall stand revived with effect from the date of receipt of the order of such annulment by the Commissioner. If the order of annulment is set aside, such revival shall cease to have effect.
- (i) Unless section 153A, section 153B and section 153C provide otherwise, all other provisions of the Income-tax Act, 1961, shall apply to the assessment or reassessment made in respect of assessment year under this section.
- (j) The tax shall be chargeable at the rate or rates as applicable to such assessment year.

Time-limit for completion of search assessments [Section 153B]

- (a) Section 153B provides for the time-limit for completion of search assessments.
- (b) An assessment or reassessment order in respect of each assessment year falling within six assessment years under section 153A, should be made within a period of two years from the end of the financial year in which the last of the authorisations for search under section 132 or requisition under section 132A was executed.
- (c) The section also provides the time limit for completion of assessment in respect of the assessment year relevant to the previous year in which the search is conducted under section 132 or requisition is made under section 132A within a period of 2 years from the end of the financial year in which the last of the authorisations for search under section 132 or for requisition under section 132A, as the case may be, was executed.

- (d) In case of any other person referred to in section 153C, the time limit for making assessment or reassessment of total income of the assessment years referred to in clause (b) and clause (c) above, shall be the either 2 years from the end of the financial year in which the last of authorisations for search under section 132 or for requisition under section 132A was executed or 1 year from the end of the financial year in which books of account or documents or assets seized or requisitioned are handed over under section 153C to the Assessing Officer having jurisdiction over such other person, whichever is later.

The time limit for assessment or reassessment under section 153B with effect from 1st July, 2012 is as follows -

Proceeding under section	Earlier time limit for completion of assessment or reassessment	New time limit for completion of assessment or reassessment	Applicability of new time limit
153A – for the assessment year relevant to the previous year in which search is conducted and for 6 assessment years immediately preceding the assessment year relevant to the previous year in which search was conducted	21 months from the end of the financial year in which the last of the authorizations for search under section 132 or for requisition under section 132A was executed	2 years from the end of the financial year in which the last of the authorizations for search under section 132 or for requisition under section 132A was executed	In case where the last of authorizations for search under section 132 or for requisition under section 132A was executed during the financial year 2010-11 or any subsequent financial year
In case of a person assessed under section 153C – for the assessment year relevant to the previous year in which search is conducted and for 6 assessment years immediately preceding the assessment year	21 months from the end of the financial year in which last of the authorizations for search under section 132 or for requisition under section 132A was executed or 9 months from the end of the financial year in which books of account or documents or assets seized or requisitioned	2 years from the end of the financial year in which last of the authorizations for search under section 132 or for requisition under section 132A was executed or 1 year from the end of the financial year in which books of account or	In a case where last of the authorizations for search under section 132 or for requisition under section 132A was executed during the financial year 2010-11 or any subsequent financial year

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relevant to the previous year in which search was conducted	are handed over to the jurisdictional Assessing Officer under section 153C whichever is later	documents or assets seized or requisitioned are handed over to the jurisdictional Assessing Officer under section 153C whichever is later	

Time limit for completion of assessment/reassessment where a reference is made to the Transfer Pricing Officer

The time limit for completion of assessment/re-assessment where a reference is made to the Transfer Pricing Officer under section 92CA(1) is as under -

Section	Particulars	Time-limit
Third Proviso to section 153(1)	Completion of assessment under section 143 or section 144 for the A.Y. 2009-10 onwards.	3 years from the end of the assessment year in which the income was first assessable.
Fourth proviso to section 153(2)	Completion of assessment/reassessment/re-computation under section 147 if notice is served under section 148 on or after April 1, 2010.	2 years from the end of the financial year in which notice under section 148 is served.
Fourth proviso to section 153(2A)	Fresh assessment in pursuance of an order under section 254 (received by the Chief Commissioner / Commissioner on or after April 1, 2010) or an order passed by the Commissioner under sections 263 and 264 on or after April 1, 2010.	2 years from the end of the financial year in which such order is received by the Chief Commissioner / Commissioner or passed by the Commissioner, as the case may be.
Fourth Proviso to section 153B(1)	Completion of assessment in cases where the last of the authorizations for search under section 132 or for requisition under section 132A was executed during F.Y.2009-10 or thereafter.	3 years from the end of the financial year in which the last of the authorizations for search under section 132 or requisition under section 132A was executed.

Fifth Proviso to section 153B(1)	Completion of assessment/ reassessment in case of other person referred to in section 153C in cases where the last of the authorizations for search under section 132 or for requisition under section 132A was executed during F.Y.2009-10 or thereafter.	3 years from the end of the financial year in which the last of the authorizations for search under section 132 or for requisition under section 132A was executed or 2 years from the end of the financial year in which the books of account or documents or assets seized or requisitioned are handed over under section 153C to the Assessing Officer having jurisdiction over such other person, whichever is later.

Exclusions while computing period of limitation [Explanation to Section 153B]

In computing the period of limitation for completion of assessment or reassessment, the following periods should be excluded -

1. Stay or injunction - The period during which the assessment proceeding is stayed by an order or injunction of any court; or
2. Audit under section 142(2A) - The following time period should be excluded -

<i>the period commencing from</i>	<i>the period ending with</i>	
	<i>In a case where such direction is not challenged before a court</i>	<i>In a case where such direction is challenged before a court</i>
<i>the date on which the Assessing Officer directs the assessee to get his accounts audited u/s 142(2A).</i>	<i>the last date on which the assessee is required to furnish a report of such audit under section 142(2A).</i>	<i>the date on which the order setting aside such direction is received by the Commissioner.</i>

3. Re-hearing under section 129 - The time taken in reopening the whole or any part of the proceeding or giving an opportunity to the assessee of being re-heard under the proviso to section 129; or
4. Settlement - In a case where an application made before the Settlement Commission under section 245C is rejected by it or is not allowed to be proceeded with by it, the

period commencing on the date on which such application is made and ending with the date on which the order under section 245D(1) is received by the Commissioner under section 245D(2); or

5. **Advance Ruling** - The period commencing from the date on which an application is made before the Authority for Advance Ruling under section 245Q(1) and ending with the date on which the order rejecting the application is received by the Commissioner under section 245R(3); or
6. **Advance Ruling** - The period commencing from the date on which an application is made before the Authority for Advance Ruling under section 245Q(1) and ending with the date on which the advance ruling pronounced by it is received by the Commissioner under section 245R(7) or
7. **Setting aside of order of annulment** - The period commencing from the date of annulment of a proceeding or order of assessment or reassessment referred to in sub-section (2) of section 153A till the date of the receipt of the order setting aside the order of such annulments by the Commissioner.
8. **Obtaining information from tax authorities outside India** – The period beginning with the date on which a reference *or first of the references* for exchange of information is made by a competent authority and ending with the date on which the information so requested is *last* received by the Commissioner or a period of one year, whichever is less, is excluded for computing the above time limits. This is for the purpose of excluding the time taken in obtaining information from the tax authorities in jurisdictions situated outside India (under an agreement referred to in section 90 or section 90A) from the prescribed time limit for completion of assessments/reassessments under section 153B.

If, after the exclusion of the aforesaid period, the period of limitation available to the Assessing Officer for making an order of assessment or reassessment, as the case may be, is less than sixty days, such remaining period shall be extended to sixty days and the period of limitation shall be deemed to be extended accordingly.

Assessment or reassessment of income of any other person [Section 153C]

- (a) Section 153C provides for assessment or reassessment of income of any other person.
- (b) Where the Assessing Officer is satisfied that any money, bullion, jewellery or other valuable article or thing or books of account or documents seized or requisitioned belong or belongs to a person other than the person referred to in section 153A, then the books of account, or documents or assets seized or requisitioned shall be handed over to the Assessing Officer having jurisdiction over such other person [Section 153C(1)].
- (c) The Assessing Officer having jurisdiction shall proceed against such other person and issue such other person notice and assess or reassess income of such other person in accordance with the provisions of section 153A [Section 153C(1)].
- (d) The assessment or reassessment, if any, relating to any assessment year falling within the period of six assessment years referred to in the said section pending on the date of initiation of the search under section 132 or on the date of making of requisition under section 132A, as the case may be, shall abate.

- (e) In case of such other person, the reference to the date of initiation of the search under section 132 or making of requisition under section 132A in the second proviso to section 153A shall be construed as reference to the date of receiving the books of account or documents or assets seized or requisitioned by the Assessing Officer having the jurisdiction over such other person [Section 153C(1)].
- (f) The Central Government is empowered to notify class or classes of cases [except the cases where any assessment or reassessment has abated] in which the Assessing Officer shall not be required to issue notice for initiation of assessment or reassessment of total income for six assessment years immediately preceding the assessment year relevant to the previous year in which the search was conducted or requisition was made.

The assessment proceedings in the class or classes of cases so notified shall be carried out only for the assessment year relevant to the previous year in which search was conducted or requisition was made, except in cases where any assessment or reassessment in respect of any of the earlier six years has abated.

Accordingly, in exercise of this power, the Central Government has, through Notification No.42/2012 dated 4.10.2012, inserted Rule 112F which shall come into force from 1st July, 2012.

The said Rule provides that the Assessing Officer is not required to issue notice for assessing or reassessing the total income for six assessment years immediately preceding the assessment year relevant to the previous year in which search is conducted or requisition is made, in the following cases:

- (i) *where as a result of a search under section 132(1) or a requisition made under section 132A, a person is found to be in possession of any money, bullion, jewellery or other valuable articles or things, whether or not he is the actual owner of the same, and*
- (ii) *where, such search is conducted or such requisition is made in the territorial area of an assembly or parliamentary constituency in respect of which a notification has been issued under section 30 read with section 56 of the Representation of the People Act, 1951, or where the assets so seized or requisitioned are connected in any manner to the ongoing election in an assembly or parliamentary constituency.*

However, this Rule is not applicable to cases where such search under section 132 or such requisition under section 132A has taken place after the hours of poll so notified.

Circular No.10/2012 dated 31.12.2012 clarifies that the aforesaid amendment was introduced with a view to reduce infructuous and unnecessary proceedings under the Income-tax Act, 1961 in cases where a search is conducted under section 132 or requisition is made under section 132A and cash or other assets are seized during the election period, generally on a single warrant, and no evidence is available, or investigation required, for any assessment year other than the assessment year relevant to the previous year in which search is conducted or requisition is made.

In such cases, the officer investigating the case, with the approval of the Director General of Income-tax, is required to certify that -

- (i) the search is conducted under section 132 or the requisition is made under section 132A in the territorial area of an assembly or parliamentary constituency in respect of which a notification has been issued under section 30, read with section 56 of the Representation of the People Act, 1951; or*
- (ii) the assets seized or requisitioned are connected in any manner to the ongoing election process in an assembly or parliamentary constituency; and*
- (iii) no evidence is available or investigation is required for any assessment year other than the assessment year relevant to the previous year in which search is conducted or requisition is made.*

The certificate of the investigating officer shall be communicated to the Commissioner of Income-tax and the Assessing Officer having jurisdiction over the case of such person.

- (g) In respect of the assessment year relevant to the previous year in which search is conducted under section 132 or requisition is made under section 132A, in case of such other person, where -
 - (i) no return of income has been furnished by such person and no notice under section 142(1) has been issued to him, or
 - (ii) a return of income has been furnished by such person but no notice under sub-section (2) of section 143 has been served and limitation of serving the notice under sub-section (2) of section 143 has expired, or
 - (iii) assessment or reassessment, if any, has been made,
before the date of receiving of books of account or documents or assets seized or requisitioned by the Assessing Officer having jurisdiction over such other person, such Assessing Officer shall issue the notice and assess or reassess total income of such other person for such assessment year in the manner provided in section 153A. [Section 153C(2)].
- (h) The provisions of sub-section (2) would apply where books of account or documents or assets seized or requisitioned referred to in sub-section (1) has been received by the Assessing Officer having jurisdiction over such other person after the due date for furnishing the return of income for the assessment year relevant to the previous year in which search is conducted under section 132 or requisition is made under section 132A.

Prior approval of Joint Commissioner required for assessment or reassessment in respect of search cases [Section 153D]

Section 153D has been inserted to provide that assessment or reassessment of search cases in respect of each assessment year referred to in section 153A(b) or the assessment year referred to in 153B(1)(b) shall not be made by an Assessing Officer below the rank of Joint Commissioner without the previous approval of the Joint Commissioner.

Assessment to be made individually in search cases even where the authorization or requisition mentions the name of more than one person [Section 292CC]

- (i) Under section 132 and section 132A, an authorization can be issued or a requisition can be made, as the case may be, where the Director General or the Director, in consequence of information in his possession, has reason to believe that any person is in possession of any money, bullion, jewellery or other valuable article or thing. In such a case, he may authorize the income-tax authorities mentioned therein to enter and search any building, place, vehicle, etc. and seize any such books of accounts, other documents, undisclosed property, etc.
- (ii) In a case where search is initiated under section 132 or requisition is made under section 132A, assessment is to be completed under the provisions of section 153A or section 153C or section 143(3).
- (iii) Section 292CC provides that:
 - (1) it shall not be necessary to issue an authorization under section 132 or make a requisition under section 132A separately in the name of each person;
 - (2) where an authorization under section 132 has been issued or a requisition under section 132A has been made mentioning therein the name of more than one person, the mention of such names of more than one person on such authorization or requisition shall not be deemed to construe that it was issued in the name of an association of persons or body of individuals consisting of such persons;

These provisions would apply irrespective of anything contrary contained in any other provision of the Act.
- (v) Further, even if an authorization under section 132 has been issued or requisition under section 132A has been made mentioning therein the name of more than one person, the assessment or reassessment shall be made separately in the name of each of the persons mentioned in such authorization or requisition.

21.35 Rectification of Mistakes [Section 154]

With a view to rectifying any mistake apparent from the record, an income tax authority referred to in section 116 may:

- (a) amend any order passed by it under the provisions of this Act;
- (b) amend any intimation or deemed intimation under section 143(1);
- (c) amend any intimation under section 200A(1).

The jurisdiction of any authority under the Act to make an order under section 154 depends upon the existence of a mistake apparent on the face of the record. It may be a mistake of fact as well as mistake of law. For instance, the treatment of a non-agricultural income as agricultural income and granting exemption in respect of such income is an obvious mistake of law which could be rectified under section 154. However, a mere change of opinion cannot be the basis on which the same or the successor Assessing Officer can treat a case as one of

rectification of mistake. A mistake is one apparent from the record in case, where it is a glaring, obvious, patent or self-evident. Mistake, which has to be discovered by a long drawn process of reasoning or examination or arguments on points, where there may be two opinions, cannot be said to be mistake or error apparent from the record. A mistake arising as a result of subsequent interpretation of law by the Supreme Court would also constitute error apparent from the record. Retrospective amendment of law could also lead to rectification if an order is plainly and obviously inconsistent with the specific and clear provision, as amended retrospectively.

Where any matter has been considered and decided in any proceeding by way of appeal or revision relating to a rectifiable order the authority passing such order may, amend the order in relation to any matter other than the matter which has been so considered and decided.

The concerned authority may make an amendment of its own motion.

However, he should mandatorily make the amendment for rectifying any such mistake which has been brought to its notice by the assessee or the deductor. Where the authority concerned is the Deputy Commissioner (Appeals) or the Commissioner (appeals) the mistake can be pointed out by the Assessing Officer also.

An amendment which has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee or the deductor, shall not be made unless the authority concerned has given notice to the assessee or the deductor of its intention so to do and has allowed the assessee or the deductor a reasonable opportunity of being heard.

Where an amendment is made under this section, an order shall be passed in writing by the authority concerned. Where any such amendment has the effect of reducing the assessment, or otherwise reducing the liability of the assessee or the deductor, the Assessing Officer shall make any refund due to such assessee or the deductor. Where any such amendment has the effect of enhancing the assessment or reducing the refund already made or otherwise reducing the liability of the assessee or the deductor, the Assessing Officer shall serve on the assessee or the deductor, as the case may be, a notice of demand in the prescribed form specifying the sum payable. Except in cases which are specifically covered by section 155 or section 186(4) dealing with cancellation or registration no amendment under this section shall be made after the expiry of four years from the date of the order sought to be amended.

It is further provided that where an application for amendment is made by the assessee or the deductor, the income-tax authority shall pass an order within six months from the end of the month in which the order is received, either making the amendment or refusing the claim.

21.36 Other Amendments [Section 155]

Where any assessment made in respect of any assessment year is required to be amended on account of any specific provisions in the Act mentioned hereunder, such an amending order can be passed at any time within 4 years from the end of the year in which such provision is attracted.

1. Where a partner is assessed in respect of any remuneration from a firm under section 28(v) and later in the assessment of the firm, such remuneration is found not deductible under section 40(b), the assessment order of the partner shall be amended to exclude such

remuneration which is not deductible in the firm's case. This is in view of the proviso to clause (v) of section 28 which states that the remuneration disallowed in the firm's case cannot be charged to tax in the partner's case [Sub-section (1A)].

2. The amendment of the assessment of a member of an association of persons (AOP) consequent upon the assessment or reassessment or any enhancement or reduction in the income of the AOP as a result of an order in appeal, reference, revision or rectification or as a result of an order made by the Settlement Commission [Sub-section (2)].

3. Amendments resulting from any proceedings initiated under section 147 on account of recomputation of total income, where excessive loss or depreciation allowance had been allowed or losses had been set off and carried forward under the different heads [Sub-section (4)].

4. Recomputation of the total income of the assessee consequent upon deduction allowed in excess of expenditure actually incurred on approved programme of scientific research (Such deduction originally allowed to him but consequently withdrawn on the ground that the prescribed conditions have not been complied with) [Sub-section (5B)].

5. Under the provisions of section 47A, capital gains which were not charged to tax by virtue of section 47(iv) or (v) may be deemed to be chargeable in certain circumstances. The Assessing Officer may accordingly make an order of amendment at any time before the expiry of four years from the end of the previous year in which the relevant capital asset was converted into or treated as stock in trade or as the case may be the parent company ceasing to hold the entire share capital of the subsidiary company before 8 years from the date of transfer [Sub-section (7B)].

6. Where TDS/TCS certificates are not furnished along with the return of income and such certificates are produced before the Assessing Officer within two years from the end of the Assessment year in which the income covered by the TDS/TCS certificate is assessable [Sub-section (14)].

However, such rectification under section 155(14) is possible only if the income from which tax has been deducted or the income on which tax has been collected has been disclosed in the return of income filed by the assessee for the relevant assessment year.

7. Where the Assessing Officer adopts stamp duty as full value of consideration under section 50C and later, such value is revised in any appeal or revision or reference [Sub-section (15)].

8. Where capital gains is recomputed on account of any reduction of any compensation in a compulsory acquisition by any Court, Tribunal, or any other authority, the Assessing Officer shall revise the assessment [Sub-section (16)].

9. Where deduction under section 80RRB is allowed and subsequent to the allowance of such deduction in respect of any patent, the Controller or the High Court passes an order under the Patents Act, 1970 revoking the patent or excluding the name of the assessee from the Patents Register as patentee in respect of that patent [Sub-section (17)].

Note – For the purpose of amending the order under any of the sub-sections (1A), (7B) or (16) or (17) of section 155, the time permissible is four years from the end of the year in which the event giving necessity to such amendment occurs.

21.37 Notice of Demand [Section 156]

When any tax, interest, penalty or fine or any other sum is payable consequent to any order passed under this Act, the Assessing Officer shall serve upon the assessee a notice of demand in the prescribed form, specifying the sum so payable.

The Apex Court in *Sri Mohan Wahi v. CIT*, 248 ITR 799 has held that failure to serve notice of demand renders the recovery proceedings invalid.

An intimation under section 143(1) or section 200A(1) would be deemed to be a notice of demand for the purpose of section 156, where any sum is determined to be payable by the assessee under section 143(1) or by the deductor under section 200A(1).

21.38 Intimation of Loss [Section 157]

When, in the course of the assessment of total income of any assessee, it is established that a loss has taken place which the assessee is entitled to have carried forward and set-off under the provisions of section 72(1) or 73(2) or 74(1) or 74(3) or 74A(3), the Assessing Officer shall notify the assessee by an order in writing the amount of the loss as computed by him for this purpose.

Settlement of Tax Cases

22.1 Settlement Commission

- ◆ Introduction: The Wanchoo Committee felt that in the administration of fiscal laws, where the primary objective is to raise revenue, there has to be room for compromise and settlement. A rigid attitude would not only inhibit a one-time tax evader or an unintending defaulter from making a clean breast of his affairs but would also unnecessarily strain the investigational resources of the Department in cases of doubtful benefit to revenue, while needlessly proliferating litigation and holding up collections. Even in the United Kingdom, the 'confession' method has been in vogue since 1923. In the U.S. Law also, there is a provision for compromise with the tax payer as to his tax liabilities. A provision of this type facilitating settlement in individual cases will have this advantage over general disclosure schemes. Hence the Committee recommended the setting up of a high level settlement machinery. Accordingly, Chapter XIXA incorporating the recommendations of the Wanchoo Committee was enacted by Taxation Laws (Amendment) Act, 1975 with effect from April 1, 1976. The provisions relating to Settlement Commission are discussed below.
- 1. The Central Government has constituted a Settlement Commission. It shall consist of a Chairman and as many Vice-Chairmen and other members as the Central Government thinks fit. Where a member of the Central Board of Direct Taxes is appointed as the chairman or a member of the commission, he ceases to be a member of the Board.
- 2. The Chairman, Vice-Chairman and other members of the Settlement Commission are to be appointed by the Central Government from amongst persons of integrity and outstanding ability, having special knowledge of, and experience in, problems relating to direct taxes and business accounts.
- 3. The Commission functions within the Department of Revenue and Banking of the Central Government.

22.2 Definition of 'Case' [Section 245A(b)]

For the purpose of settlement of cases, the term 'case' has been defined to mean any proceeding for assessment under the Income-tax Act 1961, of any person in respect of any assessment year or years which may be pending before an Assessing Officer on the date on which an application under section 245C(1) is made.

However, the following are not "proceedings for assessment" –

- (i) a proceeding for assessment/reassessment/recomputation under section 147;

22.2 Income tax

(ii) a proceeding for making a fresh assessment in pursuance of an order under section 254 or section 263 or section 264, setting aside or cancelling an assessment.

Therefore, the proceedings for assessment or reassessment resulting from search/requisition would now fall within the definition of a “case” which can be admitted by the Settlement Commission.

The deemed date of commencement of these proceedings are shown in the following table -

Proceeding	Deemed date of commencement of proceeding
Proceeding for assessment or re-assessment or re-computation	Date on which notice under section 148 was issued.
Proceeding for making fresh assessment in pursuance of an order under section 254 or 263 or 264, setting aside or cancelling an assessment.	Date on which order under section 254 or 263 or 264 setting aside or cancelling an assessment was passed.

Note - In the case of a person whose income is being assessed or reassessed as a result of search or as a result of requisition of books of account or other documents or any assets, the proceedings for assessment or reassessment shall be deemed to have commenced on the date of issue of notice initiating such proceedings and concluded on the date on which the assessment is made.

Any other proceeding for assessment, other than those referred to in the table and note above, shall be deemed to have commenced from 1st April of the assessment year and concluded on the date on which the assessment is made.

22.3 Application for Settlement of Cases [Section 245C]

1. An assessee may, at any stage of a case relating to him, make an application in the prescribed form and manner, containing a full and true disclosure of his income which has not been disclosed before the Assessing Officer [Sub-section (1)].
2. He should also disclose the following to the Settlement Commission for settlement of his case –
 - (i) the manner in which such income has been derived,
 - (ii) the additional amount of income-tax payable on such income and
 - (iii) other particulars as may be prescribed [Sub-section (1)].
3. As per section 245C, an application can be filed before the Settlement Commission, only if the additional amount of income-tax payable on the income disclosed in the application exceeds the specified limit.
4. Section 245A provides that the proceedings for assessment or reassessment resulting from search/requisition would fall within the definition of a “case” which can be admitted by the Settlement Commission. Consequently, section 245C provides that the additional amount of income-tax payable on income disclosed in the application should exceed ₹ 50 lakh, for an

application to be made before the Settlement Commission in such cases. In other cases, the additional amount of income-tax payable on income disclosed in the application should exceed ₹ 10 lakh, for an application to be made before the Settlement Commission.

5. Such tax and interest thereon, which would have been payable had such income been disclosed in the return of income before the Assessing Officer on the date of application, should be paid on or before the date of making the application. Further, proof of such payment should be attached with the application.

6. Therefore, if proceedings have been initiated against the applicant (hereinafter referred to as specified person) under section 153A or under section 153C as a result of search or a requisition of books of account, an application can be made before the Settlement Commission if the additional amount of income-tax payable on the income disclosed in the application exceeds ₹ 50 lakh.

7. An application can also be made, where the applicant is related to the specified person (mentioned in (6) above) and in whose case also proceedings have been initiated as a result of search, provided the additional income-tax payable on the income disclosed in the application exceeds ₹ 10 lakh.

8. Therefore, the limit of ₹ 50 lakh would be applicable to the tax payer who is the subject matter of search and the limit of ₹ 10 lakh would be applicable to entities related to such a tax payer, who are also the subject matter of search.

9. The applicant, in relation to the specified person, means –

	Specified person		Related entity
(i)	Individual	(1)	Relative of the individual
		(2)	Any person who has substantial interest in the business or profession of the individual. In addition, the following are also considered as related entity - • If such person is an individual, any relative of such individual. • If such person is a company, any director of such company or any relative of such director. • If such person is a firm, any partner of such firm, or any relative of such partner. • If such person is an AOP or HUF, any member of the AOP or HUF, or any relative of such member.
		(3)	A company, whose director has a substantial interest in the business or profession of the individual; Any director of such company; Any relative of such director.

		(4) A firm, whose partner has a substantial interest in the business or profession of the individual; Any partner of such firm; Any relative of such partner. (5) An AOP, whose member has a substantial interest in the business or profession of the individual; Any member of such AOP; Any relative of such member. (6) A HUF, whose member has a substantial interest in the business or profession of the individual; Any member of such HUF; Any relative of such member. (7) Where the individual or his relative has a substantial interest in a business or profession carried on by any other person, the person who carries on such business or profession.
(ii)	Company	(1) Director of the company or any relative of such director (2) Any person who has substantial interest in the business or profession of the company. In addition, the following are also considered as related entity - • If such person is an individual, any relative of such individual. • If such person is a company, any director of such company or any relative of such director. • If such person is a firm, any partner of such firm, or any relative of such partner. • If such person is an AOP or HUF, any member of the AOP or HUF, or any relative of such member. (3) A company, whose director has a substantial interest in the business or profession of this company; Any director of such company; Any relative of such director. (4) A firm, whose partner has a substantial interest in the business or profession of the company; Any partner of such firm; Any relative of such partner.

(iii)	Firm	(5) An AOP, whose member has a substantial interest in the business or profession of the company; Any member of such AOP; Any relative of such member. (6) A HUF, whose member has a substantial interest in the business or profession of the company; Any member of such HUF; Any relative of such member. (7) Where the company or its director or relative of such director has a substantial interest in a business or profession carried on by any other person, the person who carries on such business or profession. (1) Partner of the firm or any relative of such partner (2) Any person who has substantial interest in the business or profession of the firm. In addition, the following are also considered as related entity - • If such person is an individual, any relative of such individual. • If such person is a company, any director of such company or any relative of such director. • If such person is a firm, any partner of such firm, or any relative of such partner. • If such person is an AOP or HUF, any member of the AOP or HUF, or any relative of such member. (3) A company, whose director has a substantial interest in the business or profession of the firm; Any director of such company; Any relative of such director. (4) A firm, whose partner has a substantial interest in the business or profession of this firm; Any partner of such firm; Any relative of such partner. (5) An AOP, whose member has a substantial interest in the business or profession of the firm; Any member of such AOP; Any relative of such member.

(iv)	AOP	(6) A HUF, whose member has a substantial interest in the business or profession of the firm; Any member of such HUF; Any relative of such member. (7) Where the firm or its partner or relative or such partner has a substantial interest in a business or profession carried on by any other person, the person who carries on such business or profession. (1) Member of AOP or any relative of such member (2) Any person who has substantial interest in the business or profession of the AOP. In addition, the following are also considered as related entity - • If such person is an individual, any relative of such individual. • If such person is a company, any director of such company or any relative of such director. • If such person is a firm, any partner of such firm, or any relative of such partner. • If such person is an AOP or HUF, any member of the AOP or HUF, or any relative of such member. (3) A company, whose director has a substantial interest in the business or profession of the AOP; Any director of such company; Any relative of such director. (4) A firm, whose partner has a substantial interest in the business or profession of the AOP; Any partner of such firm; Any relative of such partner. (5) An AOP, whose member has a substantial interest in the business or profession of this AOP; Any member of such AOP; Any relative of such member. (6) A HUF, whose member has a substantial interest in the business or profession of the AOP; Any member of such HUF; Any relative of such member.

(v)	HUF	(7) Where the AOP or its member or relative of such member has a substantial interest in a business or profession carried on by any other person, the person who carries on such business or profession. (1) Member of HUF or relative of such member (2) Any person who has substantial interest in the business or profession of the HUF. In addition, the following are also considered as related entity - • If such person is an individual, any relative of such individual. • If such person is a company, any director of such company or any relative of such director. • If such person is a firm, any partner of such firm, or any relative of such partner. • If such person is an AOP or HUF, any member of the AOP or HUF, or any relative of such member. (3) A company, whose director has a substantial interest in the business or profession of the HUF; Any director of such company; Any relative of such director. (4) A firm, whose partner has a substantial interest in the business or profession of the HUF; Any partner of such firm; Any relative of such partner. (5) An AOP, whose member has a substantial interest in the business or profession of the HUF; Any member of such AOP; Any relative of such member. (6) A HUF, whose member has a substantial interest in the business or profession of this HUF; Any member of such HUF; Any relative of such member. (7) Where the HUF or its member or relative of such member has a substantial interest in a business or profession carried on by any other person, the person who carries on such business or profession.

10. A person shall be deemed to have a substantial interest in a business or profession, if –
- (i) in a case where the business or profession is carried on by a company, such person is, *on the date of search*, the beneficial owner of shares (not being shares entitled to a fixed rate of dividend, whether with or without a right to participate in profits) carrying not less than 20% of the voting power.
 - (ii) in any other case, such person is, *on the date of search*, beneficially entitled to not less than 20% of the profits of such business or profession.

Such beneficial ownership/beneficial entitlement may be at any time during the previous year.

11. The additional amount of income-tax has to be calculated in the following manner as provided in sub-section (1B) read with sub-section (1C), in a case where the income disclosed in the application relates to only one previous year–

(i)	If the applicant has not furnished a return in respect of the total income of that year.	Tax should be calculated on the income disclosed in the application as if such income is the total income. Such tax represents the additional amount of income-tax.
(ii)	If the applicant has furnished a return in respect of the total income of that year.	The tax should be calculated on the aggregate of total income returned and the income disclosed in the application i.e. as if the aggregate represents the total income. The additional amount of income-tax is the amount calculated on such aggregate as reduced by the amount of tax calculated on the total income returned for that year.

12. Where the income disclosed in the application relates to more than one previous year, then the above procedure is to be adopted in respect of each previous year and the aggregate of tax payable is to be calculated [Sub-section (1D)].

13. Every settlement application made under sub-section (1) should be accompanied by the prescribed fees of ₹ 500 [Sub-section (2)].

14. The settlement application made under sub-section (1) cannot be withdrawn by the applicant [Sub-section (3)].

15. The assessee should also intimate to the Assessing Officer in the prescribed manner that he has made an application to the Settlement Commission. Such intimation should be made on the same date when he makes an application to the Settlement Commission [Sub-section (4)].

22.4 Procedure on receipt of application [Section 245D]

- (1) Admission of Petition [Sub-section (1)]

- (i) On receipt of the settlement application, the Settlement Commission shall issue a notice to the applicant, requiring him to explain as to why the application made by him be allowed to be proceeded with, within 7 days from the date of receipt of application.

- (ii) After hearing the applicant, the Settlement Commission shall pass an order either rejecting or allowing the application to be proceeded with within 14 days from the date of application.
- (iii) Application not disposed off within 14 days shall be treated as admitted.
- (2) Copy of every order under section 245D(1) has to be sent to the applicant and to the Commissioner [Sub-section (2)].
- (3) Time limit for furnishing report by Commissioner and passing order by the Settlement Commission [Sub-sections (2B) & (2C)]
 - (i) The Settlement Commission shall call for a report from the Commissioner within 30 days from the date of application.
 - (ii) The Commissioner is required to furnish the report within 30 days from the receipt of communication from the Settlement Commission.
 - (iii) The Settlement Commission can also pass an order declaring the application as invalid on the basis of the report of the Commissioner.
 - (iv) Such order should be passed in writing within 15 days of the receipt of report after giving the applicant an opportunity of being heard.
 - (v) A copy of the order should be sent to the applicant and the Commissioner.
 - (vi) However, in a case where the Commissioner has not furnished the report within the prescribed time, the Settlement Commission shall proceed further in the matter without the report of the Commissioner.
- (4) Proceedings after admission [Sub-section (3)]
 - (i) The Settlement Commission may call for records from the Commissioner in respect of an application which has not been declared invalid under sub-section (2C) or an application which has been allowed to be further proceeded with under sub-section (2D).
 - (ii) After examination of such records, the Settlement Commission may require the Commissioner to make further enquiry or investigation and furnish a report on the matters covered by the application and any other matter relating to the case.
 - (iii) The Commissioner shall furnish the report within a period of 90 days of the receipt of communication from the Settlement Commission.
 - (iv) If the Commissioner fails to furnish the report within the said period of 90 days, the Settlement Commission may proceed to pass an order under sub-section (4) without such report.
- (5) Final order of settlement [Sub-sections (4) and (4A)]
 - (i) The Settlement Commission may pass such order as it thinks fit on the matters covered by the application and any other matter relating to the case not covered by the application but referred to in the report of the Commissioner.
 - (ii) Such order should be passed by the Settlement Commission after –

- (1) examining the records and report of the Commissioner, if any, received at the time of admission or on investigation or enquiry conducted as per the instructions of the Settlement Commission;
 - (2) giving an opportunity of being heard to the applicant and the Commissioner;
 - (3) examining such further evidence as may be placed before it or obtained by it.
- (iii) The time limit for passing such order is –

(1)	In respect of an application made on or after 1.6.2010	Within 18 months from the end of the month in which the application was made.
(2)	In respect of an application made between 1.6.2007 and 31.5.2010	Within 12 months from the end of the month in which the application was made.

- (6) Before passing any order and subject to the provisions dealing with the jurisdiction of Settlement Commission, the various materials brought on record before the Settlement Commission must be considered by the members of the concerned Bench and in cases where there is any difference of opinion among the members, the opinion of the majority shall prevail and the order of the Settlement Commission must also be expressed in terms of the views of the majority [Sub-section (5)].
- (7) All the orders passed by the Settlement Commission under section 245D(4) must provide for the terms of the settlement including any demand by way of tax, penalty, the manner in which any amount due as a result of the settlement should be paid and all other matters which are essential to make the settlement of the case effective [Sub-section (6)].
- (8) The order should also provide that the settlement shall be void if it is subsequently found by the Settlement Commission that the settlement order was obtained by fraud or any misrepresentation of facts by the applicant. In cases where the settlement becomes void, the proceeding, in respect of which the settlement order was passed, must be deemed to have been revived from the stage at which the application was allowed to be proceeded with by the Settlement Commission and the Income-tax authority concerned may complete the proceedings for assessment or re-assessment of income or the levy of penalty, fine, etc., at any time before the completion of two years from the end of the financial year in which the settlement becomes void [Sub-sections (6) & (7)].
- (9) Where the tax payable in pursuance of an order passed by the Settlement Commission is not paid by the assessee within 35 days of receipt of a copy of final order, the assessee shall be liable to pay simple interest @ 1¼% for every month or part of a month on the outstanding amount from the date of expiry of 35 days. Such liability will arise even in cases where the Commission extended the time allowed for such payment or permitted payment by installment [Sub-section (6A)].
- (10) The Settlement Commission may amend any order passed by it under section 245D(4) to rectify any mistake apparent from the record. However, the time limit for effecting such amendment is within six months from the date of its order, as against the permissible time limit of four years provided for under section 154(7). Further, the Settlement

Commission should not make a rectification which has the effect of modifying the liability of the applicant, without –

- (i) giving a notice to the applicant and the Commissioner of its intention to do so; and
 - (ii) allowing the applicant and the Commissioner an opportunity of being heard [Sub-section (6B)]
- (11) The time limit for completion of assessments and re-assessments contained in section 153 shall have no application to any order passed by the Settlement Commission or to any order of assessment or re-assessment or recomputation required to be made by the Assessing Officer in pursuance of any directions contained in an order passed by the Settlement Commission [Sub-section (8)].

22.5 Power of Settlement Commission to order Provisional Attachment to protect revenue [Section 245DD]

- (i) Under section 245DD, the Settlement Commission is empowered to provisionally attach the property belonging to the applicant for protecting the interest of the revenue. The manner in which such provisional attachment is to be effected is provided in the Second Schedule. Such provisional attachment is valid for a period of 6 months, after which it ceases to have effect.
- (ii) The Settlement Commission may, for reasons to be recorded in writing, extend the aforesaid period by such further period or period as it thinks fit.

22.6 Re-opening of completed proceedings [Section 245E]

The Settlement Commission shall not have any power to reopen the proceedings in respect of an application made on or after 1.6.2007.

22.7 Jurisdiction and Powers of the Settlement Commission

- (a) The jurisdiction, powers and authority of the Settlement Commission may be exercised by benches thereof.
- (b) A bench shall be presided over by the Chairman or a Vice-chairman and shall consist of two other members.
- (c) The bench for which the Chairman is the presiding officer shall be the principal bench and the other benches shall be known as additional benches.
- (d) The Chairman may authorise the Vice-chairman or other Member appointed to one bench to discharge also the functions of the Vice-chairman or other member of another bench.
- (e) Where the presiding officer or other member of a bench is unable to discharge his functions owing to absence, illness or any other cause or where a vacancy occurs in the office of the presiding officer or a member the remaining two persons may function as the bench and if the presiding officer is not one of the members, the senior member will be the presiding officer. However, if it is felt that the case is such that it should be heard by a bench of three members the chairman has powers to transfer the case to such a bench. The chairman for the disposal of a particular case, institute a Special Bench consisting of more than three members.

- (f) The places at which the Principal Bench and the Additional Benches shall ordinarily sit shall be notified by the Central Government. The Central Government has specified that New Delhi is the place where the Principal Bench and Bombay, Calcutta and Madras as the places where Additional Benches of the Settlement Commission shall ordinarily sit.
- (g) The Vice-chairman has been empowered to act as chairman and discharge his functions under certain circumstances as vacancy, death, resignation etc.
- (h) On the application of the assessee or the Commissioner and after notice to them and hearing, the chairman may transfer any case pending before one bench, for disposal, to another bench.
- (i) If the members of a bench differ in opinion on any point the point shall be decided according to the opinion of the majority. If they are equally divided they shall state the point on which they differ and make a reference to the chairman who shall either hear the point himself or refer the point to one or more of the other members and such point shall be decided according to the opinion of the majority of the members who have heard the case including those who first heard it.
- (j) The Settlement Commission has been vested with all the powers which are vested in an Income-tax authority under the Income-tax Act, 1961.
- (k) Accordingly, in cases where an application made by the assessee under section 245C has been allowed by the Settlement Commission to be proceeded with under section 245D, the Settlement Commission is empowered to exercise exclusively the jurisdiction and powers and perform the functions allotted to an Income-tax authority under the Income-tax Act until an order for settlement of the case is passed.
- (l) Such exclusive jurisdiction would begin with the date of filing of application with the Settlement Commission.
- (m) The exclusive jurisdiction of the Settlement Commission would end on –
 - (a) the date of passing an order under section 245D(4); or
 - (b) the date of passing the order rejecting the application under section 245D(1); or
 - (c) the date on which the application is not allowed to be proceeded with under section 245D(2A); or
 - (d) the date on which the application is declared invalid under section 245D(2C); or
- (n) However, in the absence of any express direction to the contrary by the Settlement Commission, the operation of any other provision of the Income-tax Act, 1961 requiring the applicant to pay the tax on the basis of self-assessment shall continue to be applicable in relation to matters which are before the Settlement Commission for consideration. Further, in the absence of any express directions by the Settlement Commission to the contrary, the provisions of sections 245A to 245L would not affect the operation of any other provision of the Income-tax Act, 1961 insofar as those provisions relate to any matters other than those covered by the case before the Settlement Commission.
- (o) The Commission shall subject to the provisions of this Chapter have power to regulate its own procedure and the procedure of benches thereof in all matters arising out of the exercise of its powers or of the discharge of its functions including the places at which the Board shall hold their sittings.

- (p) **Inspection of reports:** According to section 245G, no person is entitled to inspect or obtain copies of any reports made by any Income-tax authority to the Settlement Commission in relation to the case, but, the Settlement Commission may, in its discretion, furnish copies thereof to any person or receipt of an application made to it in this behalf and on payment of the prescribed fee. However, in order to enable any person whose case is under consideration to rebut any evidence which has been brought on record against him in any such report, the Settlement Commission shall, on receipt of an application in this behalf and on payment of the prescribed fee, furnish to the applicant, a certified copy of any such report or particular thereof which may be relevant for the purpose.

22.8 Power to grant immunity from prosecution and penalty [Section 245H]

- (i) The Settlement Commission may, if it is satisfied that any person who made the application for settlement under section 245C has co-operated with the Settlement Commission in the conduct of the proceedings before it and has made a true disclosure of his income, and the manner in which such income has been derived, grant to such person immunity from prosecution for any offence under the Income-tax Act, 1961 or under the Wealth-tax Act, 1957.
- (ii) Such an immunity may also be granted in the matter of imposition of any penalty under the Income-tax Act, 1961 in respect of the case which is covered by the settlement.
- (iii) The Commission can grant partial immunity from imposition of penalty to the applicant.
- (iv) The power of the Settlement Commission to grant immunity from prosecution and the imposition is, however, subject to such conditions as the commission may think fit to impose in the circumstances of the case.
- (v) No such immunity shall be granted by the commission in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of the application for settlement.
- (vi) Under section 245H, the Settlement Commission may grant immunity from prosecution for any offence under the Indian Penal Code, Income-tax Act, 1961 and any other Central Act. This power has now been restricted in respect of application made under section 245C on or after 1.6.2007. In respect of such cases, the Settlement Commission shall not grant immunity from prosecution for any offence under the Indian Penal Code or under any Central Act other than the Income-tax Act, 1961 and Wealth-tax Act, 1957. However, in respect of applications pending as on 1.6.2007, the Settlement Commission has the power to grant immunity from prosecution for any offence under the Indian Penal Code and other Central Acts also.
- (vii) An immunity granted under this section shall stand withdrawn if such person fails to pay any sum specified in the order of settlement within the time specified in the order or within such further time as may be allowed by the Commission or fails to comply with any

other condition subject to which the immunity was granted and thereupon the provisions of this Act shall apply as if such immunity had not been granted.

- (viii) An immunity granted by the Settlement Commission to any person may, at any time, be withdrawn by it in cases where it is satisfied that the person concerned had, in the course of the settlement proceedings concerned may be tried for the offence with respect to which the immunity was granted or for any other offence in respect of which he has been found guilty in connection with the settlement.
- (ix) After the withdrawal of the immunity from prosecution, the person concerned may also become liable to the imposition of the penalty under the Income-tax Act, 1961 to which he would otherwise have been liable in the absence of the immunity given to him under section 245H.

22.9 Abatement of Proceeding before the Settlement Commission [Sections 245HA & 245HAA]

- (i) In the following cases, the proceedings before the Settlement Commission shall abate on the specified date as given below –

	Case	Specified date
(1)	where an application made to the Settlement Commission on or after 1.6.2007 has been rejected under section 245D(1).	The date on which the application was rejected.
(2)	where an application has been declared invalid under section 245D(2C).	The last day of the month in which the application was declared invalid.
(3)	Where an order under section 245D(4) has not been passed within the time allowed under section 245D(4A).	The date on which the time or period specified in section 245D(4A) expires.

- (ii) On abatement of proceedings, the case would revert back to the Assessing Officer having jurisdiction or any other income-tax authority before whom the proceedings were pending at the time of making the application. Such income-tax authority shall dispose of the case in accordance with the provisions of the Act.

- (iii) For completing the proceedings, the Assessing Officer or other Income-tax authority shall be entitled to use the material and information produced by the assessee before the Settlement Commission as if such material and information had been produced before the Assessing Officer or other income-tax authority. Similarly, the Assessing Officer or other Income-tax authority shall be entitled to use the results of the inquiry held or evidence recorded by the Settlement Commission in the course of the proceedings before it, as if such inquiry or evidence had been held or recorded by him in the course of the proceedings before him.

- (iv) The period from the date on which the application was made before the Commission up to the date on which proceedings get abated shall be excluded from the time limit for

completion of proceedings by the Assessing Officer and for payment of interest under section 243, 244 or 244A.

(v) In case of abatement of settlement proceedings, the Assessing Officer is required to give credit for the tax and interest paid on or before the date of making the application or during the pendency of the case before the Settlement Commission. This has been provided by insertion of section 245HAA.

22.10 Order of Settlement Commission to be conclusive [Section 245-I]

Section 245-I provides that every order of the Settlement Commission passed under section 245D(4) shall be conclusive in respect of the matters contained therein and consequently no matter covered by the settlement order shall be liable to be reopened in any proceeding under the Income-tax Act or under any other law for the time being in force except, however, in those cases wherein the reopening of the case is specifically provided under section 245D(7).

22.11 Recovery of settled amount [Section 245J]

According to section 245J, any amount specified in an order of settlement passed by the Settlement Commission under section 245D(4), may be recovered and any penalty for default in making the payment may be imposed and recovered from the person concerned in accordance with the provisions of the Income-tax Act, 1961. The power for making the recovery if any, as may be specified by the Settlement Commission in the order passed by it. The right of recovery may be exercised by the Assessing Officer having jurisdiction over the person who has made the application for settlement under section 245C.

22.12 Bar on subsequent application for settlement [Section 245K]

- (i) In the event of occurrence of any of the following, the person concerned shall not be entitled to apply for settlement in relation to any other matter –
 - (1) the order of settlement passed under section 245D(4) provides for imposition of penalty for concealment of income; or
 - (2) after the passing of order under section 245D(4) in relation to a case, the person is convicted of an offence under Chapter XXII in relation to that case; or
 - (3) the case of such person was sent back to the Assessing Officer by the Settlement Commission on or before 1.6.2002.
- (ii) Further, with effect from 1.6.2007, the option of going to the Settlement Commission would be available only once in the lifetime of a person. Therefore, where an application for settlement is made on or after 1.6.2007 and such application has been allowed to be proceeded with, then such person will not be subsequently entitled to make any application under section 245C.

22.13 Proceedings to be judicial proceedings [Section 245L]

All the proceedings under the Income-tax Act, 1961 before the Settlement Commission shall be deemed to be judicial proceedings within the meaning of sections 193, 196 and 228 of the Indian Penal Code.

22.14 Order to be Conclusive

Every order of settlement passed by the Commission shall be conclusive as to the matter stated therein. No matter covered by such order shall be reopened in any proceeding under this Act or under any other law for the time being in force. The only exception is the power given to commission itself to reopen the completed proceedings.

However, the Supreme Court has held in *CIT vs. B.N. Bhattacharjee (1979) 118 ITR 461* that Article 136 of the Constitution was wide enough to bring within the Supreme Court's jurisdiction orders passed by the Settlement Commission.

23.1 Introduction

Chapter XIX-B, consisting of sections 245N to 245V provides a scheme for giving advance rulings in respect of transactions involving non-residents and specified residents with a view to avoiding needless litigation and promoting better tax-payer relations.

23.2 Definitions

23.2.1 Advance Ruling [Section 245N(a)]: This term means

- (i) a determination by the Authority in relation to a transaction which has been undertaken or is proposed to be undertaken by a non resident applicant and such determination shall include the determination of any question of law or of fact specified in the application; or
- (ii) a determination by the Authority in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such non-resident.

However, advance rulings pronounced before 14.5.03, being the date on which the Finance Bill, 2003, received the assent of the President, in respect of an application by a resident applicant shall be binding on persons specified in section 245S.

- (iii) a determination or decision by the Authority in respect of an issue relating to computation of total income which is pending before any Income-tax Authority or the Appellate Tribunal and such determination or decision shall include the determination or decision on any question of law or fact in relation to such computation of total income specified in the application.

23.2.2 Applicant [Section 245N(b)]: 'Applicant' means any person who –

- (i) is a non-resident referred to in (i) of section 245N(a);
- (ii) is a resident referred to in (ii) of section 245N(a);
- (iii) is a resident falling within such class or category of persons as the Central Government may, by notification in the Official Gazette, specify in this behalf, and
- (iv) makes an application for advance ruling under section 245Q.

In this connection, the Central Government has notified the following class of persons as applicants for the purposes of this Chapter–

- (a) Public sector company as defined under section 2(36A) of the Income-tax Act, 1961;

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- (b) a person seeking advance ruling in relation to the tax liability of a non-resident arising out of a transaction undertaken by him with a non-resident.

[Notification No.SO 473 (E) dated 21.6.1999]

The AAR shall, however, not allow an application in respect of the following :

- (i) any question pending before any Income-tax Authority, Appellate Tribunal or Court (except in case of a resident applicant mentioned in section 245N(b)(iii);
- (ii) any question that involves determination of fair market value of any property; and
- (iii) any question in relation to a transaction which is designed *prima facie* for the avoidance of income-tax (except in case of a resident applicant mentioned in section 245N(b)(iii).

Restrictions on Appellate Authority: Section 245RR has been inserted providing that where a resident applicant has made an application to AAR and referred issues therein for decision of AAR, then, any Income-tax Authority or Tribunal should not take any decision in respect of such issues. In other words, a resident assessee cannot pursue both the remedies, i.e. an appeal or revision before Income-tax Authority/Appellate Authority as well as an application for Advance Ruling to AAR, in respect of an issue.

23.3 Authority for Advance Rulings [Section 245-O]

1. The Authority for Advance Rulings shall be constituted by the Central Government.
2. The Authority for Advance Rulings will consist of a Chairman, who will be a retired Judge of the Supreme Court and two other members thereon from the Indian Revenue Service and Indian Legal Service.
3. The headquarters of the authority will be in Delhi.
4. The Central Government shall provide the Authority with such officers and staff as may be necessary for the efficient exercise of the powers of the Authority under this Act.

23.4 Vacancies, etc., not to invalidate proceedings [Section 245P]

No proceeding before, or pronouncement of advance ruling by, the Authority shall be questioned or shall be invalid on the ground merely of the existence of any vacancy or defect in the constitution of the Authority.

23.5 Application for advance ruling [Section 245Q]

Any applicant desirous of obtaining an advance ruling may make an application in the form and manner to be prescribed by rules along with the payment of a fee of ₹ 10,000 or such fee as may be prescribed in this behalf, whichever is higher. Such an application may be withdrawn within 30 days from the date of application.

23.6 Procedure on receipt of application [Section 245R]

The Authority on receipt of an application will send a copy to the Commissioner concerned and wherever considered necessary, also call upon the Commissioner to furnish relevant records. Such records will be returned to the Commissioner as soon as possible.

The Authority may either allow or reject an application. However, the Authority shall not allow an application where the question raised in the application:

- (i) is already pending in the case of the applicant either before any income-tax authority, or Appellate Tribunal (except in case of a resident applicant falling within any such class or category of persons as the Central Government may notify in this behalf) or any court.
- (ii) involves the determination of the fair market value of any property;
- (iii) relates to a transaction or issue which is designed *prima facie* for avoidance of income-tax (except in case of a resident applicant falling within any such class or category of persons as the Central Government may notify in this behalf).

However, no application shall be rejected unless an opportunity has been given to the applicant. Further, where an application is rejected the reason for rejection shall be given in the order.

An applicant on request can appear either in person or can be represented through a duly authorised representative. The authority will pronounce the advance ruling within 6 months from the receipt of application by the authority.

23.7 Applicability of Advance Ruling [Section 245S]

The advance ruling shall be binding only on the applicant who has sought it and in respect of the specific transaction in relation to which advance ruling was sought. It will also be binding on the Commissioner and the Income-tax Authorities subordinate to the Commissioner who are having jurisdiction over the applicant.

The advance ruling will continue to remain in force unless there is a change either in law or in fact on the basis of which the advance ruling was pronounced.

23.8 Advance Ruling to be void in certain circumstances [Section 245T]

Where an advance ruling has been obtained by the applicant by fraud or misrepresentation of facts, the Authority may, by order, declare such ruling to be *void ab initio*. The provisions of the Act shall apply (excluding the period beginning with the date of such advance ruling and ending with the date of order under this section) to the applicant as if such advance ruling had never been made. A copy of this order shall be sent to the applicant and the Commissioner.

23.9 Powers of the Authority [Section 245U]

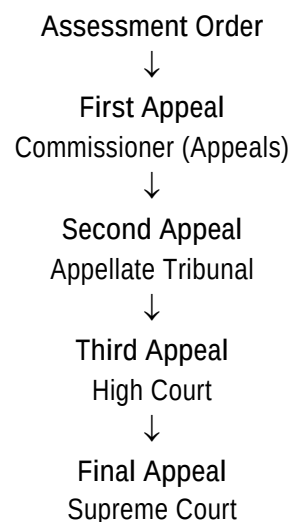
The authority will have all the powers of the Civil Court in respect of discovery and inspection, enforcing the attendance of any person, including any officer of a banking company and examining on oath, issuing commissions and compelling the production of books of accounts and other record. It will also have the power to regulate its own procedure in all matters arising out of exercise of its powers under the Act. The authority would be deemed to be a Civil Court for the purposes of section 195 of the Code of Criminal Procedure, 1973 and every proceeding before the authority shall be deemed to be a judicial proceeding under the Indian Penal Code.

23.10 Procedure of Authority [Section 245V]

The Authority shall, subject to the provisions of this Chapter, have power to regulate its own procedure in all matters arising out of the exercise of its powers under the Act.

Appeals and Revision

The assessee is given a right of appeal by the Act where he feels aggrieved by the order of the assessing authority. However, the assessee has no inherent right of appeal unless the statute specifically provides that a particular order is appealable. There are four stages of appeal under the Income-tax Act, 1961 as shown hereunder –



24.1 Appealable Orders before Commissioner (Appeals) [Section 246A]

24.1.1 An assessee or any deductor aggrieved by any of the following orders may appeal to the Commissioner (Appeals) against such orders under section 246A -

- (a) an order passed by a Joint Commissioner under section 115VP(3)(ii) or an order against the assessee where the assessee denies his liability to be assessed under this Act or an intimation under section 143(1)/(1B) or section 200A(1), where the assessee or the deductor objects to the making of adjustments, or any order of assessment under section 143(3) (except an order passed in pursuance of the directions of Dispute Resolution Panel) or section 144, to the income assessed, or to the amount of tax determined, or to the amount of loss computed, or to the status under which he is assessed;
- (b) an order of assessment, reassessment or recomputation under section 147 (except an order passed in pursuance of the directions of Dispute Resolution Panel) or section 150;
- (c) an order of assessment or reassessment under section 153A, except an order passed in pursuance of the directions of the Dispute Resolution Panel;

- (d) an order made under section 154 or section 155 having the effect of enhancing the assessment or reducing a refund or an order refusing to allow the claim made by the assessee under either of the said sections;
- (e) an order of assessment or reassessment passed by the Assessing Officer under section 92CD(3) in accordance with the Advance Pricing Agreement pursuant to a modified return filed in accordance with section 92CD(1);
- (f) an order made under section 163 treating the assessee as the agent of a non-resident;
- (g) an order made under section 170(2)/(3);
- (h) an order made under section 171;
- (i) an order made under section 201;
- (j) an order made under section 206C(6A) [Right of appeal by a person deemed to be an assessee in default for failure to collect or pay tax];
- (k) an order made under section 237;
- (l) an order imposing a penalty under
 - (i) Section 221; or
 - (ii) Section 271, section 271A, section 271AA, section 271AAA, section 271AAB, section 271F, section 271FB or section 272BB;
- (m) an order of assessment made by an Assessing Officer under section 158BC(c), in respect of search initiated under section 132 or books of account, other documents or any assets requisitioned under section 132A on or after 1st January, 1997;
- (n) an order imposing penalty under section 271B or section 271BB;
- (o) an order made by a Deputy Commissioner imposing a penalty under section 271C, section 271CA, section 271D, or section 271E;
- (p) an order made by a Deputy Commissioner or a Deputy Director imposing a penalty under section 272A;
- (q) an order made by a Deputy Commissioner imposing a penalty under section 272AA;
- (r) an order imposing or enhancing penalty under section 275(1A);
- (s) an order imposing a penalty under Chapter XXI;
- (t) an order made by an Assessing Officer other than a Deputy Commissioner under the provisions of this Act in the case of such person or class of persons, as the Board may, having regard to the nature of the cases, the complexities involved and other relevant considerations direct.

It is also provided that the aforesaid provision will apply to all orders whether made before or after the appointed date which has been defined in the section as “the day appointed by the Central Government by notification in the Official Gazette.”

It is further provided that every appeal which is pending before the appointed day before the Deputy Commissioner (Appeals) and any matter arising out of or connected with such appeal

24.3 Income tax

and which is so pending shall stand transferred on that day to the Commissioner (Appeals) and the Commissioner (Appeals) may proceed with such appeal or matter from the stage in which it was on that day.

It is also provided that an appellant may demand that before proceeding further with the appeal and the matter, the previous proceedings or any part thereof be re-opened or the appellant be re-heard.

24.1.2 Appeal by person denying liability to deduct tax under section 195 [Section 248]: This section provides that where under an agreement or other arrangement, the tax deductible on any income, other than interest, under section 195 is to be borne by the person by whom the income is payable, and such person having paid such tax to the credit of the Central Government, claims that no tax was required to be deducted on such income, he may appeal to the Commissioner (Appeals) for a declaration that no tax was deductible on such income.

This section restricts the eligibility of filing an appeal only to cases where the tax is borne by the assessee. Therefore, the cases where the tax is to be borne by the non-resident is outside the scope of section 248 and no appeal can be filed in such cases.

24.1.3 Form of appeal and prescribed fees [Section 249(1)]: Every appeal shall be in the prescribed form and shall be verified in the prescribed manner.

Prescribed fees - In case of an appeal made to the Commissioner (Appeals), irrespective of the date of initiation of the assessment proceedings, the appeal shall be accompanied by a fee of:

(i) where the total income of the assessee as computed by the Assessing Officer is ₹ 1,00,000 or less	₹ 250
(ii) where the total income of the assessee computed as above is more than ₹ 1,00,000 but not more than ₹ 2,00,000	₹ 500
(iii) where the total income of the assessee computed as above is more than ₹ 2,00,000	₹ 1,000
(iv) in any case other than (i), (ii) and (iii) above	₹ 250

24.1.4 Time limit [Section 249(2) & (3)]: An appeal to the Commissioner (Appeals) against any order which is appealable is to be presented within 30 days from the dates specified below in the particular cases. However, the Commissioner (Appeals) may admit an appeal even after the expiry of the said period of thirty days, if he is satisfied that the appellant had sufficient cause for not presenting the appeal within the specified time. The dates from which the limitation period of 30 days has to be reckoned are as follows:

	Appeal relating to	30 days to be reckoned from
1.	Section 248	Date of payment of tax
2.	Assessment/penalty	Date of service of notice of demand
3.	Any other case	Date on which intimation of the order sought to be appealed against is served.

24.1.5 Exemption in respect of tax to be paid at the time of filing the appeal [Section 249(4)]: No appeal to the Commissioner (Appeals) shall be admitted for consideration unless, at the time of filing the appeal, the assessee has paid the tax on the amount of income returned by him in cases where a return has been filed by the assessee. If, however, no return has been filed by the assessee and an assessment has been made on him by the Assessing Officer, then the assessee must pay an amount equal to the amount of advance tax which was payable by him before filing the appeal. The Commissioner (Appeals) is, however, empowered for good and sufficient reasons to be recorded in writing, to exempt an appellant from the operation of the requirement in regard to payment of advance tax, on receipt of an application from the appellant made specifically for this purpose, giving the reasons for the non-payment of the tax. The concerned authority is also required to pass an order in writing while granting the exemption indicating also the reasons on account of which the exemption is granted to the assessee.

24.1.6 Procedure in appeal [Section 250]: On account of an appeal, the Commissioner (Appeals) shall fix a day and place for the hearing of the appeal and shall give notice of the same to the assessee and to the Assessing Officer, against whose order the appeal is made. Both the assessee and the Assessing Officer have the right to be heard at the hearing of the appeal either in person or by an authorised representative.

The Commissioner (Appeals), before passing an order on an appeal, may make such further enquiries as he thinks fit or direct the Assessing Officer to make further enquiries and report the same to him. He may also allow the appellant to go into any grounds of appeal not specified previously by the appellant if he is satisfied that the omission of that ground was not wilful or unreasonable.

The order of the Commissioner (Appeals) disposing of the appeal shall be in writing and shall state the points for determination, the decision thereon and the reasons for the decision. On disposal of the appeal the Commissioner (Appeals) must communicate the order passed by him to the assessee as well as the Commissioner.

In every appeal the Commissioner (Appeals), where it is possible, may hear and decide such appeal within a period of one year from the end of the financial year in which such appeal is filed under sub-section (1) of section 246A.

24.1.7 Powers of the Commissioner (Appeals) [Section 251]: While disposing of an appeal the Commissioner (Appeals) is vested with the following powers viz.,

- (i) In an appeal against an order of assessment, he may confirm, reduce, enhance or annul the assessment.
- (ii) In an appeal against the assessment order in respect of which the proceeding before the Settlement Commission abates under section 245HA, to confirm, reduce, enhance or annul the assessment after taking into consideration the following -
 - (1) all the material and other information produced by the assessee before the Settlement Commission;
 - (2) the results of the inquiry held by the Settlement Commission;

- (3) the evidence recorded by the Settlement Commission in the course of the proceeding before it; and
- (4) such other material as may be brought on his record.
- (iii) In an appeal against an order imposing a penalty he may confirm or cancel such order or vary it in such a way as to enhance or reduce the penalty.
- (iv) In any other case the Commissioner (Appeals) may pass such orders in the appeal as he deems fit.

The Commissioner (Appeals), however, is not empowered to enhance an assessment or a penalty or to reduce a refund due to the assessee without giving the assessee a reasonable opportunity of showing cause against such an enhancement or reduction. In disposing of an appeal, the Commissioner (Appeals) may consider and decide any matter arising out of the proceedings in which the order appealed against was passed even if such matters were not raised before the Commissioner (Appeals) by the appellant.

24.2 Appeals to the Appellate Tribunal [Sections 252 to 255]

24.2.1 Constitution - The Central Government shall constitute an Appellate Tribunal consisting of judicial and accountant members to exercise the powers and discharge the functions conferred on the Tribunal by the Act.

Judicial Member - qualification

- 1. Must have held at least for 10 years a judicial office in the territory of India; or
- 2. Must have been a member of the Indian Legal Service in Grade II or any equivalent or higher post for at least three years; or
- 3. Must have been an advocate for at least 10 years.

Accountant Member - qualification

- 1. Minimum 10 years in the practice of accountancy as a Chartered Accountant; or
- 2. Must have been a member of the Indian Income-tax Service, Group A and must have held the post of Additional Commissioner of Income-tax or any equivalent or higher post for at least three years.

The Central Government shall appoint –

- (i) *a person who is a sitting or retired Judge of a High Court and who has completed not less than 7 years of service as a Judge in a High Court; or*
- (ii) *the Senior Vice-President or one of the Vice Presidents of the Appellate Tribunal to be the President thereof.*

The Government may appoint one or more members of the Tribunal to be the Vice-President or Vice-Presidents thereof. The Central Government may appoint one of the Vice-Presidents to be the Senior Vice-President. The Senior Vice-President or a Vice-President shall exercise such of the powers and perform such of the functions of the President as may be delegated to him by the President in writing.

24.2.2 Orders appealable before the Appellate Tribunal [Section 253]: Section 253(1) provides that an assessee aggrieved by any of the following orders may appeal to the Appellate Tribunal against such order -

Order passed by	Section	Particulars
1. Assessing Officer	115VZC(1)	Power of Assessing Officer to exclude a tonnage tax company from the tonnage tax scheme if such company is a party to any transaction or arrangement which amounts to an abuse of such scheme.
	143(3)/147/153A/153C	An order of assessment passed by an Assessing Officer in pursuance of the directions of Dispute Resolution Panel or an order passed under section 154 in respect of such order
2. Commissioner (Appeals)	154	Order rectifying a mistake
	250	Order of the Commissioner (Appeals) disposing of the appeal
	271	Order imposing penalty for failure to furnish return, comply with notices, concealment of income etc.
	271A	Order imposing penalty for failure to keep, maintain or retain books of account, documents etc.
3. Commissioner	12AA	Order refusing/canceling registration of trust or institution
	80G(5)(vi)	Refusal to grant approval to the Institutions or Fund
	263	Revision of erroneous order passed by Assessing Officer
	271	Order imposing penalty for failure to furnish return, comply with notices, concealment of income etc.
	272A	Order imposing penalty for failure to answer questions, sign statements, furnish information returns or statements, allow inspections etc.
	154	Amending the order passed under section 263.
4. Chief Commissioner or Director General or Director	272A	Order imposing penalty for failure to answer questions, sign statements, furnish information returns or statements, allow inspections etc.

Section 253(2) provides that the Commissioner may, if he objects to any order passed by the Commissioner (Appeals) under section 154 or section 250, direct the Assessing Officer to appeal to the Appellate Tribunal against such order.

24.2.3 Time limit for filing appeal or memorandum of cross objection under section 253(1) & (2) [Section 253(3) & (4)]: An assessee can appeal to the Appellate Tribunal. The Commissioner, if he objects to any order passed by a Commissioner (Appeals) under section 154 or 250 may direct the Assessing Officer to file an appeal to the Tribunal. Every appeal to the Appellate Tribunal has to be filed within 60 days from the date on which the order sought to be appealed against is communicated to the assessee or the Commissioner, as the case may be.

The Assessing Officer or the assessee, as the case may be, on receipt of notice that an appeal against the order of Commissioner (Appeals) has been preferred under section 253(1) & (2), by the other party, may file a memorandum of cross-objections, verified in the prescribed manner, against such order or any part of such order within 30 days of receipt of such notice. Such memorandum shall be disposed of by the Appellate Tribunal as if it were an appeal presented within the specified time period.

However, the Appellate Tribunal may admit an appeal or permit the filing of a memorandum of cross objection even after expiry of the prescribed time limit, if he is satisfied that there was sufficient cause for not presenting it within that period.

24.2.4 Income-tax authorities authorized to file an appeal to Income-tax Appellate Tribunal against the order passed in pursuance of the directions of the Dispute Resolution Panel [Sections 253 & 254]

- (i) As per section 144C(8), the DRP has the power to confirm, reduce or enhance the variation proposed in the draft order. Under section 144C(10), the directions given by the Dispute Resolution Panel (DRP) are binding on the Assessing Officer. The taxpayer has been given a right to appeal directly to the Income-tax Appellate Tribunal (ITAT) against the order passed by the Assessing Officer in pursuance of the directions of the DRP.
- (ii) By virtue of the provisions of section 253(2A), the Department is also vested with the right to file an appeal against the directions given by the DRP. Section 253(2A) provides that:
 - (1) in case the Assessing Officer passes any order completing the assessment or reassessment in pursuance of the direction issued by the DRP under section 144C(5), in respect of any objection filed by the assessee under section 144C(2) on or after 1st July, 2012, and
 - (2) the Commissioner objects to such direction issued by the DRP, then the Commissioner may direct the Assessing Officer to file an appeal to the Appellate Tribunal against the order.
- (iii) Every appeal under sub-section (2A) shall be filed within 60 days of the date on which the order sought to be appealed against is passed by the Assessing Officer in pursuance of the directions of the DRP under section 144C(5).
- (iv) Further, the Assessing Officer or the assessee, as the case may be, on receipt of a notice that an appeal has been filed against the order passed in pursuance of the directions of the DRP under this section by the other party, may file a memorandum of cross-objections, against such order or any part of such order of the Assessing Officer within 30 days of receipt of such notice. This is irrespective of the Assessing Officer or

the assessee, as the case may be, not having filed an appeal against such order or any part thereof.

Such memorandum shall be disposed of by the Appellate Tribunal as if it were an appeal presented within the specified time period.

- (v) In respect of every appeal filed under section 253(2A), the Appellate Tribunal, where it is possible, may hear and decide such appeal within a period of 4 years from the end of the financial year in which such appeal is filed. [Section 254(2A)]

24.2.5 Fees

- (1) Where the total income of the assessee as computed by the Assessing Officer in the case to which the appeal relates is ₹ 1,00,000 or less: ₹ 500
- (2) Where the total income exceeds ₹1,00,000 but is not more than ₹2,00,000 : ₹ 1,500.
- (3) Where the total income is more than ₹ 2,00,000 : 1% of the assessed income subject to a maximum of ₹ 10,000.
- (4) A fee of ₹ 500 will be payable in any case other than those mentioned in (1) to (3) above.
- (5) No fee need be paid by a Commissioner or in the case of filing of memorandum of cross-objections.
- (6) An application for stay of demand shall be accompanied by a fee of ₹ 500.

The Appellate Tribunal may, after giving both the parties to the appeal a reasonable opportunity of being heard, pass such orders on any appeal as it thinks fit. Such orders passed by the Appellate Tribunal shall be final unless appeal is made to the High Court under section 260A up to the date when the National Tax Tribunal is constituted. Thereafter, such orders passed by the Appellate Tribunal shall be final unless appeal is made to the National Tax Tribunal (NTT) under section 15 of the National Tax Tribunal Act, 2005.

24.2.6 Rectification: The Appellate Tribunal may, at any time within 4 years from the date of the order, with a view to rectifying any mistake apparent from records, amend any order passed by it. However, if the mistake is brought to its notice by the assessee or the Assessing Officer, the Tribunal is bound to rectify the same. In cases where the amendment has the effect of enhancing the assessment or reducing a refund or otherwise increasing the liability of the assessee, the Tribunal shall not pass any order of amendment unless it has given notice to the assessee of its intention to do so and has allowed him a reasonable opportunity of being heard. The Tribunal must send a copy of any orders passed by it to the assessee and to the Commissioner.

24.2.7 Fees for rectification: Any application for rectification filed by the assessee on or after 1-10-1998 shall be accompanied by a fee of ₹ 50.

24.2.8 Time limit: In every appeal, the Appellate Tribunal, where it is possible, may hear and decide such appeal within a period of four years from the end of the financial year in which such appeal is filed under sub-section (1)/(2)/(2A) of section 253 [Sub-section (2A)].

Under section 254(2A), the Appellate Tribunal can grant stay of demand of tax which can extend only up to 180 days from the date of granting such stay. If the appeal is not disposed

of within 180 days, the stay order shall stand vacated after the expiry of the said period.

Where an order of stay has been passed and the appeal has not been disposed of within the specified period of 180 days from the date of such order, the Appellate Tribunal may extend the period of stay or pass an order of stay for a further period or periods, as it thinks fit, on an application made in this behalf by the assessee and on being satisfied that the delay in disposing of the appeal is not attributable to the assessee.

However, the aggregate of the period originally allowed and the period or periods so extended or allowed shall not, in any case, exceed 365 days, even if the delay in disposing of the appeal is not attributable to the assessee. If the appeal is not disposed of within such period or periods, the order of stay shall stand vacated after the expiry of such period or periods.

24.2.9 Cost of appeal: The cost of any appeal to the Appellate Tribunal shall be at the discretion of that Tribunal [Sub-section (2B)].

24.2.10 Final authority on facts: On all questions of fact the orders passed by the Appellate Tribunal on appeal shall be final and binding on the assessee as well as the Department [Section 255].

24.2.11 Benches: The powers and functions of the Appellate Tribunal may be exercised and discharged by Benches constituted by the President of Tribunal from amongst the members thereof. Ordinarily, a Bench shall consist of one judicial member and one accountant member. However, the President or any other member of the Appellate Tribunal authorised in this behalf by the Central Government may, sitting singly, dispose of any case which has been allotted to the Bench of which he is a member and which pertains to an assessee whose total income as computed by the Assessing Officer in the case does not exceed ₹ 5,00,000. The President may, for the disposal of any particular case constitute a special Bench consisting of three or more members, one of whom must necessarily be a judicial member and one an accountant member.

Where members differ - If the member of a Bench differ in opinion on any point the point shall be decided according to the opinion of the majority, if there is a majority. But if the members are equally divided they should state the points on which they differ and the case shall be referred by the President of the Tribunal for hearing on such point by one or more of the other members of the Tribunal: then, such points shall be decided according to the opinion of the majority of the members of the Tribunal who have heard the case, including those who first heard it.

Regulating power - The Appellate Tribunal is empowered to regulate its own procedure and the procedure of its Benches in all matters arising out of the exercise of its power of the discharge of its functions, including the places at which the Benches shall hold their sittings. The Tribunal is vested with all the powers which are exercisable by Income-tax authorities under section 131 for the purpose of discharging its functions. Any proceeding before the Appellate Tribunal shall be deemed to be a judicial proceeding for the purpose of the Income-tax Act and the Indian Penal Code and that Appellate Tribunal shall be deemed to be a Civil Court for all the purposes of the Income-tax Act, 1961 and the Code of Criminal Procedure, 1898.

24.3 Effect to the Decision of Supreme Court and of the NTT [Section 260]

(i) Sub-section (1) provides that the Supreme Court upon hearing any reference made to it by the Appellate Tribunal under section 257 shall decide the question of law raised therein, and shall deliver its judgment thereon containing the grounds on which such decision is founded.

[Note - Section 257 provides for direct reference by the Appellate Tribunal to the Supreme Court against an application made by the assessee or the Commissioner under section 256 for reference to the High Court, where there is a conflict in the decisions of the High Courts in respect of any particular question of law. It may be noted that an application under section 256 can be made only against order passed by the Appellate Tribunal before 1.10.98]

(ii) A copy of the judgment shall be sent under the seal of the Court and the signature of the Registrar to the Appellate Tribunal.

(iii) The Appellate Tribunal shall pass such orders as are necessary to dispose of the case conforming to such judgment.

(iv) Sub-section (2) provides that where the National Tax Tribunal delivers a judgment in an appeal filed before it or in any matter transferred to it under the National Tax Tribunal Act, 2005, effect shall be given to the order of that Tribunal by the Assessing Officer on the basis of a certified copy of the judgment.

(v) Sub-section (3) provides that the cost of any reference to the Supreme Court (which shall not include the fee for making the reference) shall be at the discretion of the Court.

Note – This section would come into force only from the date on which the National Tax Tribunal is constituted [See Note at the end of the chapter].

24.4 Appeal to High Court [Section 260A]

Section 260A provides for direct appeal to the High Court against the orders of the Appellate Tribunal.

(i) **Appeal** - Section 260A(1) provides that an appeal shall lie to the High Court from every order passed in appeal by the Appellate Tribunal up to the date of establishment of the NTT, if the High Court is satisfied that the case involves a substantial question of law. If the High Court is so satisfied, it shall formulate that question. After the establishment of the NTT, the appeal shall lie to the NTT.

The Chief Commissioner or the Commissioner or an assessee aggrieved by any order passed by the Appellate Tribunal may file an appeal to the High Court under this section.

(ii) **Form for appeal** - The appeal shall be in the form of a memorandum of appeal, precisely stating in it the substantial question of law involved.

(iii) **Time limit for appeal** - The appeal shall be filed within 120 days from the date on which the order appealed against is received by the assessee, or the Chief Commissioner or Commissioner.

The High Court has and always had the power to condone the delay and admit an appeal after the expiry of the period of 120 days, if it is satisfied that there was sufficient cause for not filing

the appeal within that period.

(iv) **Matters on which appeal can be heard** - The appeal shall be heard only on the question formulated. However, the respondent shall at the hearing of appeal, be allowed to argue that the case does not involve such question. Further, the Court shall also have power to hear the appeal on any other substantial question of law not formulated by it, if it is satisfied that the case involves such question. However, such power shall be exercised by the Court only after recording the reasons for hearing such other question.

Further, the High Court may determine any issue which -

- (a) has not been determined by the Appellate Tribunal; or
- (b) has been wrongly determined by the Appellate Tribunal, by reason of a decision on such question of law as is referred to in section 260A(1).

(v) **Delivery of judgment** - After the appeal is heard, the High Court shall decide the question of law so formulated and deliver such judgment thereon, but such judgment should contain the grounds on which such decision is founded.

(vi) **Award of costs** - The High Court is empowered to award such costs as it deems fit.

(vii) **Code of Civil Procedure** - Unless otherwise provided in this Act, the Code of Civil Procedure, 1908, relating to appeals to the High Court, shall apply to appeals under this section.

(viii) **Case before High Court to be heard by not less than two judges** [Section 260B]

Strength of the bench hearing the appeal - The appeal shall be heard by a bench of not less than 2 judges of the High Court.

Decision of the majority - The appeal shall be decided in accordance with the opinion of the judges or the majority, if any.

Where there is no such majority, the point of law upon which the judges differ shall be referred to one or more of the other judges of the High Court and such point shall be decided according to the opinion of the majority of the Judges who have heard the case, including those who first heard it.

24.5 Appeal to the Supreme Court [Section 261]

According to section 261, an appeal shall lie to the Supreme Court from any judgment of the High Court delivered before the establishment of the NTT, in a case which the High Court certifies to be a fit one for appeal to the Supreme Court. Thereafter, an appeal shall lie to the Supreme Court from any judgment of the NTT as per the provisions of the National Tax Tribunal Act, 2005 : The provisions of the Code of Civil Procedure, 1908 in regard to appeal shall apply in the case of all appeals to the Supreme Court in the same manner as in the case of all appeals from decrees of a High Court. The cost of appeal shall be decided at the discretion of the Supreme Court. Where the judgment of a High Court is varied in the appeal, effect should be given to the order of the Supreme Court in the same manner as provided in the case of a judgment of the High Court.

24.6 Provision for avoiding repetitive appeals [Section 158A]

(1) Section 158A makes provision for avoiding repetitive appeals when identical question of law is pending before High Court or Supreme Court. This is applicable to a situation where an assessee claims that any question of law arising in his case for an assessment year which is pending before the Assessing Officer or any appellate authority is identical with a question of law arising in his case for another assessment year which is pending before the High Court on an appeal under section 260A before the High Court or in appeal under section 261 before the Supreme Court. In such a situation, notwithstanding anything contained in the Act, the assessee may furnish a declaration in Form No.8 that if the Assessing Officer or the appellate authority, as the case may be, agrees to apply in the present case, the final decision passed on the other case, the assessee shall not raise again the same question of law in appeal before any appellate authority or in appeal before the High Court under section 260A or in appeal before the Supreme Court under section 261.

(2) Where such a declaration is furnished by the assessee to an appellate authority, the appellate authority shall call for a report from the Assessing Officer on the correctness of the claim. Where the Assessing Officer makes a request to the appellate authority to give him an opportunity of being heard, it shall allow him such opportunity.

(3) The Assessing Officer or the appellate authority, as the case may be, may, by order in writing –

(i) admit the claim if satisfied that the question of law is identical in the present as well as the other case; or

(ii) reject the claim, if not so satisfied.

(4) Where a claim is admitted, -

(i) the Assessing Officer or appellate authority, as the case may be, may make an order disposing of the present case without waiting for the final decision on the other case.

(ii) the assessee shall then not be entitled to raise in relation to the relevant case, such question of law in appeal before any appellate authority or in appeal before the High Court under section 260A or the Supreme Court under section 261.

(5) When the final decision on the question of law is passed in the other case, the Assessing Officer or the appellate authority, as the case may be shall apply it to the present case and amend the order passed, if necessary, in order to conform to such decision.

(6) An order under sub-section (3) above admitting or rejecting the claim of the assessee, as the case may be, shall be final and cannot be called in question in any proceeding by way of appeal, reference, revision under the Act.

(7) For the purposes of this section –

(i) “Appellate authority” means the Deputy Commissioner (Appeals), the Commissioner (Appeals) or the Appellate Tribunal.

(ii) “Case” means any proceeding under the act for assessment of the total income of the assessee or for the imposition of any penalty or fine on him.

24.7 Revision by the Commissioner [Sections 263 and 264]

24.7.1 Revision of Orders prejudicial to the Revenue [Section 263]

- (i) The Commissioner may call for and examine the record of any proceeding under the Act. If he considers that any order passed by the Assessing Officer is erroneous in so far as it is prejudicial to the interests of the revenue, he may, after giving the assessee an opportunity of being heard and after making or causing to be made such inquiry as may be necessary, pass a suitable order.
- (ii) He can enhance, modify or cancel an assessment. He can also direct that a fresh assessment should be made.
- (iii) The term 'record' shall include and shall be deemed always to have included all records relating to any proceedings under the Act available at the time of examination by the Commissioner.
- (iv) Where any order referred to in section 263(1) passed by the Assessing Officer had been the subject-matter of any appeal, the powers of the Commissioner under section 263(1) shall extend and shall be deemed always to have extended to such matters as had not been considered and decided in such appeal.
- (v) No order shall be made after the expiry of 2 years from the end of the financial year in which the order sought to be revised was passed.
- (vi) In computing the period of 2 years, the time taken in giving an opportunity to the assessee to be reheard under section 129 and any period during which the revision proceeding is stayed by an order or injunction of any court shall be excluded.
- (vii) The time limit, however, does not apply in case where the Commissioner has to give effect to a finding or direction contained in the order of the Appellate Tribunal, High Court or the Supreme Court.

24.7.2 Revision of other orders [Section 264]: In the case of any other order (not being an order prejudicial to the Revenue) passed by any subordinate authority including the Deputy Commissioner (Appeals) the Commissioner may either on his own motion or on receipt of an application from the assessee, call for the record of any proceedings under the Act in the course of which the order was passed. After making such enquiries as may be necessary the Commissioner may pass such order as he thinks fit. The Commissioner is not empowered to revise any order on his own motion if a period of more than one year has expired from the date of the order sought to be revised. If the application for revision is made by the assessee, it must be made within one year from the date on which the order in question was communicated to him or the date on which he otherwise comes to know of it, whichever is later. However, the Commissioner may admit an application even after the expiry of one year, if he is satisfied that the assessee was prevented by sufficient cause from making the application within that period. The application to the Commissioner for revision must be accompanied by a fee of ₹500. If an order is passed by the Commissioner declining to interfere in any proceeding, it shall not be deemed to be an order prejudicial to the assessee.

However, the Commissioner is not empowered to revise any order in the following cases, viz.,

- (i) where an appeal against the order lies to the Commissioner (Appeals) or the Tribunal but has not been made and the time within which the appeal may be made has not expired or in the case of an appeal to the Tribunal the assessee has not waived his right of appeal;
- (ii) where the order is pending on an appeal before the Deputy Commissioner (Appeals);
- (iii) where the order has been made subject to an appeal to the Commissioner (Appeals) or the Appellate Tribunal.

24.7.3 Limitation of time for revision of orders by Commissioner of Income-tax under section 264 : Under section 264, the Commissioner of Income-tax is empowered to revise an order passed by the subordinate authority where no appeal has been filed. There is a limitation of one year for filing the application.

(a) It shall be obligatory on the Commissioner to pass an order within a period of one year from the end of financial year in which such application is made by the assessee for revision.

(b) In computing the above referred period of limitation, the time taken in giving an opportunity to the assessee to be re-heard under the proviso to section 129 and any period during which any proceeding under this section is stayed by an order or injunction of any Court shall be excluded [Explanation to section 264(6)].

(c) The aforesaid time limit shall not apply to any order which has been passed in consequence of or to give effect to any finding or direction contained in an order of the Appellate Tribunal, NTT, High Court or the Supreme Court.

The assessee is bound to pay the tax due from him in accordance with the assessment made on him irrespective of the fact that a reference to the High Court or an appeal to the Supreme Court has been made to him [Section 265]. The High Court may, on a petition made to it for the execution of the order to the Supreme Court in respect of any costs awarded, thereby transmit the order for execution to any Court subordinate to it [Section 266]. Where as a result of an appeal under section 246 or section 246A or section 253, any change is made in the assessment of a body of individuals or an association of persons or a new assessment of a body of individuals or an association of persons is ordered to be made, the Commissioner (Appeals) or the Appellate Tribunal, as the case may be, shall pass an order authorizing the Assessing Officer either to amend the assessment made on any member of the body or association or make a fresh assessment on any member of the body or association [Section 267].

Section 268 - In computing the period of limitation prescribed for an appeal under this Act, the day on which the order complained of was served and, if the assessee was not furnished with a copy of the order when the notice of the order was served upon him, the time requisite for obtaining a copy of such order, should be excluded.

24.7.4 Consequence of non-filing of appeal in respect of cases where the tax effect is less than the prescribed monetary limit [Section 268A]

- (i) As per section 268A(1), the CBDT is empowered to issue orders, instructions or directions to other income tax authorities, fixing such monetary limits as it may deem fit. Such fixing of monetary limit is for the purpose of regulating filing of appeal or application for reference by any income tax authority.
- (ii) Where an income-tax authority has not filed any appeal or application for reference on any issue in the case of an assessee for any assessment year, due to abovementioned order/instruction/direction of the CBDT, such authority shall not be precluded from filing an appeal or application for reference on the same issue in the case of –
 - (1) the same assessee for any other assessment year; or
 - (2) any other assessee for the same or any other assessment year.
- (iii) Further, in such a case, it shall not be lawful for an assessee to contend that the income-tax authority has acquiesced in the decision on the disputed issue by not filing an appeal or application for reference in any case.
- (iv) The Appellate Tribunal or Court should take into consideration the above mentioned orders/instructions/directions of the CBDT and the circumstances under which such appeal or application for reference was filed or not filed in respect of any case.
- (v) Every order/instruction/direction which has been issued by the CBDT fixing monetary limits for filing an appeal or application for reference shall be deemed to have been issued under sub-section (1) and all the provisions of this section shall apply accordingly.

24.8 Doctrine of Partial Merger and Doctrine of Total Merger

The second proviso in section 147, provides that the doctrine of partial merger shall apply to reopening in a case where an assessee has filed an appeal etc. for an assessment year. It has been provided that the Assessing Officer may assess or reassess such income, other than income which has been the subject matter of any appeal or reference or revision, which is chargeable to tax and has escaped assessment. The doctrine of partial merger also holds good for section 154 and section 263.

However, the concept of total merger would apply in the case of section 264. The Commissioner of Income-tax has no power to revise any order under section 264, if the order has been made subject to an appeal to the Appellate Tribunal, even if the relief claimed in the revision is different from the relief claimed in the appeal and irrespective of the fact whether the appeal is by the assessee or by the Department as the concept of total/complete merger is applicable for section 264.

Note: National Tax Tribunal (NTT) means the National Tax Tribunal established under section 3 of the National Tax Tribunal Act, 2005. The National Tax Tribunal Act, 2005 has been enacted by the Parliament in pursuance of Article 323B of the Constitution. It came into force with effect from December 28th, 2005. The notified date of establishment of the National Tax Tribunal by the Central Government is 6th January, 2006.

The objective behind the enactment of the National Tax Tribunal Act, 2005 is to modify the present system of appeals under the Income-tax Act, 1961 by substituting the National Tax Tribunal for the High Court, for facilitating quick adjudication of disputes under direct and indirect tax laws and achieve uniformity in the interpretation of central legislation.

This Act provides that, on establishment of the National Tax Tribunal, High Courts will not have appellate jurisdiction in matters of direct and indirect taxes. This Act vests jurisdiction in NTT to decide direct and indirect tax disputes on appeal from the decision of the respective Appellate Tribunals. Appeal to NTT can be filed both by the assessee and the revenue, from an order passed by the ITAT or CESTAT, on a substantial question of law. Appeal to NTT will lie only if the NTT is satisfied that the case involves a substantial question of law. The NTT shall formulate the substantial question of law for the purpose of hearing of appeal by it.

A party to an appeal, other than the Government, may either appear in person or authorize one or more chartered accountants or legal practitioners or any person duly authorized by him or it to present the case before the NTT. The Government may authorize one or more legal practitioners or any of its officers to present its case before the NTT. It may be noted that the Act does not permit chartered accountants to present the case of the Government before the NTT.

The Act provides that any person, including any department of the Government, aggrieved by any decision or order of NTT may file an appeal to the Supreme Court within 60 days from the date of communication of the decision or order of the NTT to him. The Supreme Court can allow filing of the appeal beyond 60 days, if the appellant was prevented by sufficient cause from filing the appeal within the said period of 60 days.

However, the Bombay High Court, in *P.C. Joshi vs. Union of India* (2006) 152 Taxman 285, has passed an ad-interim order restraining the Government from constituting the NTT and transferring the matters pending in the High Court to the NTT. Therefore, the constitution of the NTT will take effect only after the stay is vacated.

25.1 Introduction

The Income-tax Act, 1961 provides for the imposition of a penalty on an assessee who wilfully commits any offence under the provisions of the Act. Penalty is levied over and above the amount of any tax or interest payable by the assessee and thus, penalty is distinct and different from the tax payable. Penalty proceedings, however, are a part of the assessment proceedings. The authority concerned is entitled to levy penalty only if he is satisfied in the course of any proceedings under the Act that a person has been found guilty of any default in complying with the provisions of the Act. If the order of the penalty is set aside in appeal on the ground the assessee was not given a reasonable opportunity of being heard, the Assessing Officer would be entitled to levy a penalty again after rectifying the mistakes in proceedings. The penalty to be levied on an assessee is to be based upon the law as it stood at the time the default was committed and not the law as it stands in the financial year for which the assessment is made.

25.2 Penalties

The various sections prescribe the minimum and the maximum penalty that can be levied in certain cases though the Commissioner is empowered to waive or reduce the penalty in some cases. The authority concerned has been given the discretion to levy or not to levy a penalty. But if a penalty is levied, it cannot be less than the prescribed minimum nor can it exceed the maximum amount prescribed by the Act. The quantum of penalty levied by a lower authority can be modified by a higher authority on appeal, reference or revision. The various defaults in respect of which penalty can be levied under the Act are discussed as follows:

Section	Nature of Default	Penalty Leviable	Remarks
221(1)	Default in making payment of tax u/s 220	As directed by Assessing Officer. Total amount of penalty cannot exceed the amount of tax in arrears.	1. This is in addition to arrears and interest payable u/s 220(2)
			2. Where the assessee proves to the satisfaction of Assessing Officer that the default was for

			good and sufficient reasons, no penalty is leviable
			3. Even if tax is paid after default, it makes no difference
271(1)(b)	Failure to comply with a notice u/s 142(1)/143(2) or direction u/s 142(2A).	₹ 10,000 for each such failure.	This will be in addition to tax, if any, payable
271(1)(c)	Concealment of particulars of income or furnishing of inaccurate particulars of income	Minimum 100% Maximum 300% of tax sought to be evaded - in addition to tax, if any, payable.	Explanations to section 271(1) extend the scope of concealed income (see after Table for details)
271(4)	Where profits of registered firm are distributed otherwise than in accordance with partnership deed and consequently the partner has not disclosed his correct income in his return.	Minimum as per Assessing Officer's discretion- Maximum 150% of tax on assessed income less tax on returned income. This will be in addition to tax, if any, payable by him.	
271A	Failure to keep or maintain or retain books of account, documents etc. as required u/s 44A	₹ 25,000	
271AA	Failure to keep and maintain any information and document as required under sub-section (1) or (2) of section 92D; Failure to report such transaction which he is required to do so; Maintaining or furnishing an incorrect information or document.	2% of the value of each international transaction or specified domestic transaction entered into by such person	

25.3 Income tax

271AAA	Penalty@ 10% of undisclosed income of the specified previous year in respect of searches initiated under section 132 on or after 1.6.2007 but before 1.7.2012		However, no penalty is leviable if disclosure is made under section 132(4), manner of earning is disclosed and tax and interest is paid.
271AAB (a)	In case of search initiated under section 132 on or after 1.7.2012 If undisclosed income is admitted during the course of search in the statement furnished under section 132(4), and the assessee explains the manner in which such income was derived, pays the tax, together with interest if any, in respect of the undisclosed income, on or before the specified date (i.e., the due date of filing return of income or the date on which the period specified in the notice issued under section 153A expires, as the case may be) and furnishes the return of income for the specified previous year declaring such undisclosed income.	10% of undisclosed income	Undisclosed income, for the purpose of this section, means: (1) any income of the specified previous year represented, either wholly or partly, by any money, bullion, jewellery or other valuable article or thing or any entry in the books of account or other documents or transactions found in the course of a search under section 132, which has- (a) not been recorded on or before the date of search in the books of account or other documents maintained in the normal course relating to such previous year; or (b) otherwise not been disclosed to the Chief Commissioner or Commissioner before the date of search; or
(b)	If undisclosed income relating to the specified previous year is not admitted during the course of search in the	20% of undisclosed income	(2) any income of the specified previous year represented, either wholly or partly, by any entry in respect of an expense

	statement furnished under section 132(4) but the same is disclosed in the return of income filed after the date of search and the tax along with the interest, if any, is paid before the specified date.		recorded in the books of account or other documents maintained in the normal course relating to the specified previous year which is found to be false and would not have been found to be so had the search not been conducted.
(c)	In all other cases	30% to 90% of undisclosed income	
271B	Failure to get accounts audited or obtain audit report under section 44AB or to furnish the report of such auditor with return of income.	½% of total sales turnover or gross receipts of business/gross receipts of profession or ₹ 1,50,000 whichever is less.	
271BA	Failure to furnish audit report as required under section 92E	₹ 1,00,000	
271C	Failure to deduct tax at source as per chapter XVII-B or to pay any part of the tax as required by - (i) Section 115-O(2) or (ii) the proviso to section 194B.	A sum equal to the amount of tax which he failed to deduct or pay.	With effect from 1.10.1998, penalty under sections 271C/271CA/271D/271E shall be imposed by the Joint Commissioner.
271CA	Failure to collect the whole or any part of as required by or under the provisions of Chapter XVII-BB	A sum equal to the amount of tax which he failed to collect.	
271D	Failure to comply with the provisions of section 269SS.	Penalty of a fixed sum equal to amount of loan or deposit taken.	
271E	Failure to comply with the provisions of section 269T	A sum equal to the amount of deposit or loan so repaid.	

25.5 Income tax

271F	Failure to furnish return under section 139(1) before the end of the relevant assessment year.	Penalty of ₹ 5,000.	
271FA	Failure to furnish Annual Information Return (AIR) within the time prescribed u/s 285BA(2).	A sum of ₹ 100 for every day during which failure continues.	
	<i>Failure to furnish Annual Information Return (AIR) within the time prescribed u/s 285BA(5).</i>	<i>A sum of ₹ 500 for every day during which failure continues.</i>	
271G	Failure to furnish information or document under section 92D	2% of the value of the international transaction for each such failure	
271H (a)	Failure to furnish TDS/TCS statements within the prescribed time.	₹ 10,000 to ₹ 1,00,000	No penalty would be leviable if the person proves that after paying tax deducted or collected along with the fee under section 234E and interest, if any, to the credit of the Central Government, he had delivered or caused to be delivered the TDS/TCS statements before the expiry of one year from the time prescribed for delivering or causing to be delivered such statements.
(b)	Furnishing incorrect information in the said statements in respect of tax deducted or collected on or after 1.7.2012	₹ 10,000 to ₹ 1,00,000`	

272A(1)	-Refusal to answer questions put by income tax authority -Refusal to sign statements made in the course of income tax proceedings. -Non-compliance with summons issued under section 131(1) to give evidence or produce books of accounts.	₹ 10,000 for each such default or failure	
272A(2)	Failure: To comply with notice u/s 94(6) To give notice of discontinuance of business / profession u/s 176(3) To furnish in due time returns statements mentioned in sections 133, 206, 206C or 285B. To allow inspection of register referred in section 134 To furnish returns of income u/s 139(4A) or 139(4C) To deliver or cause to be delivered copy of the declaration u/s 197A To furnish a certificate as required in section 203 or 206C To deduct and pay tax u/s 226(2) To furnish a statement as required by section 192(2C)	₹ 100 for everyday during which default continues.	Section 272A(3) specifies that for the default committed u/s 272(A)(1) and (2), the penalty can be imposed by an income-tax authority not lower in rank than a Joint Director or a Joint Commissioner. Section 272A(4) provides for grant of hearing before imposition of penalty under this provision.

25.7 Income tax

	To deliver or cause to be delivered in due time a copy of the declaration referred to in section 206C(1A) To deliver or cause to be delivered the statements within the time specified in section 206A(1).		
272AA	Failure to comply with the provision of section 133B	Any amount upto ₹ 1,000	
272B	Failure to comply with the provisions of section 139A (w.e.f. 1.6.2002)	₹ 10,000	
	Failure to quote/intimate PAN u/s 139A(5A) or 139A(5C) or quoting / intimating false PAN	₹ 10,000	
272BB	Failure to comply with the provisions of section 203A Quoting false TAN willfully in challans/ certificates/statements/ other documents referred to in section 203A(2)	₹ 10,000	

No order shall be passed under sections 272A, 272AA, 272B, 272BB and 272BBB unless the person on whom the penalty is proposed to be imposed is given an opportunity of being heard in the matter.

25.3 Penalty not leviable in certain cases [Section 273B]

No penalty is leviable under sections 271(1)(b), 271A, 271AA, 271B, 271BA, 271BB, 271C, 271CA, 271D, 271E, 271F, 271FA, 271FB, 271G, 271H, 272A(1)(c) or 272(A)(1)(d), 272A(2), 272AA(1), 272B, 272BB(1) & (1A), 272BBB(1), 273(1)(b), 273(2)(b) or 273(2)(c) if the assessee proves that there was reasonable cause for the said failure.

25.4 Extension of scope of concealed income

Penalty under section 271(1)(c) - If the Assessing Officer or the Commissioner (Appeals) in the course of proceedings under the Act, is satisfied that any person has concealed the particulars of his income or furnished inaccurate particulars of income, then, he may direct that such person shall pay penalty which shall not be less than the tax sought to be evaded, but which shall not exceed three times the amount of tax sought to be evaded. The penalty is in addition to the tax, if any, payable by the assessee. Therefore, section 271(1)(c) is attracted where (a) any person has concealed the particulars of his income, or (b) has furnished inaccurate particulars of such income.

The Explanations to section 271(1) extend the scope of the provisions relating to levy of penalty.

25.4.1 Explanation 1 : For the purpose of levy of penalty for concealment of income the assessee would be deemed to have concealed the particulars of his income or to have furnished false or inaccurate particulars thereof in cases where, in respect of any facts material to the computation of the taxable income of the assessee:

- (i) he has failed to offer a satisfactory explanation or the explanation offered by him is found by the Assessing Officer or the Commissioner (Appeals) or the Commissioner to be false; or
- (ii) the assessee offers an explanation which he is not able to substantiate and fails to prove that such *Explanation* is *bonafide* and that all the facts relating to the same and material to the computation of his total income have been disclosed by him.

Under these circumstances the amount added or disallowed in the computation of the taxable income as a result of the unsatisfactory or the false statement of the assessee would be deemed to represent concealed income in respect of which fake particulars had been furnished by the assessee.

Students may note that the burden to prove that his explanation is *bonafide* etc. has been specifically placed upon the assessee.

25.4.2 Explanation 2: In case where the source of any receipt, deposit or outgoing or investment in any assessment year is claimed by any assessee to be an amount which had been added in computing his taxable income or deducted in computing the assessable loss in his assessment for any earlier assessment year/years, but in respect of which no penalty under section 271(1)(c)(iii) had been levied, then, that part of the amount which had been so added or deducted in the earlier assessment year immediately preceding the year in which the receipt, deposit, outgoing or investment appears, which is sufficient to cover the amount represented by such receipts, or outgoings or the value of such investments (otherwise known as the utilised amount or value) must be treated as the income of the assessee the particulars of which had been concealed or inaccurate particulars whereof had been furnished for the first preceding year. Where the amount so added or deducted in the first preceding year is not sufficient to cover the utilised amount, then, that part of the sum added or deducted in the year immediately preceding the first preceding year which is sufficient to cover such part of the utilised amount as is not so covered must be treated as the income of the assessee which had been concealed for the year immediately preceding the first preceding year, and so on, until

the entire utilised amount is covered by the amount so added to the income or deducted from the loss of such earlier assessment year or years.

Where any penalty is imposable by virtue of this *Explanation*, proceedings for imposition of penalty may be initiated even if the proceedings in the course of which penalty proceedings could have been initiated have been completed. This is provided for in section 271(1A).

25.4.3 Explanation 3 : Where any person fails without reasonable cause to furnish within the period specified in section 153(1), a return of his income which he is required to furnish under section 139 in respect of any assessment year commencing on or after the 1st April 1989 and until the expiry of the period aforesaid, no notice has been issued to him under section 142(1) or 148 and the Assessing Officer or Commissioner (Appeals) is satisfied that in respect of such assessment year such person has taxable income such person shall be deemed to have concealed the particulars of his income notwithstanding that such person furnishes a return of income at any time after the expiry of the period aforesaid in pursuance of a notice under section 148.

25.4.4 Explanation 4 : This seeks to define the meaning and scope of the expression “the amount of tax sought to be evaded” which is the basis for levying penalty for concealment of income. Accordingly, the meaning of the expression will have to be taken as follows:

1. In cases where the amount of income, in respect of which particulars have been concealed or inaccurate particulars have been furnished has the effect of reducing the loss declared in the return or converting that loss into income, means the tax that would have been chargeable on the income in respect of which particulars have been concealed or inaccurate particulars have been furnished had such income been the total income.
2. In cases where the provisions of *Explanation 3* apply, the amount of tax sought to be evaded by the assessee would mean the tax on the total income assessed as reduced by the amount of advance tax, TDS, TCS and self-assessment tax paid before the issue of notice under section 148.
3. In any other case, the amount of tax sought to be evaded must be taken to mean the amount of difference between the tax on the total income actually assessed and the tax that would have been chargeable had such total income been reduced by the amount of income in respect of which particulars had been concealed or false particulars had been furnished.

25.4.5 Explanation 5A : Explanation 5A would be applicable in respect of searches conducted on or after 1st June, 2007. This Explanation provides that where an assessee is found to be the owner of any -

- asset and he claims that such assets have been acquired by him by utilizing his income for any previous year; or
- income based on any entry in the books of account or documents or transactions and he claims that such entry represents his income for any previous year,

which has ended before the date of the search and the due date for filing of the return has expired and return has not been filed, such income would be deemed to be concealed income, even if such income is declared in the return of income filed on or after the date of search.

The scope of *Explanation 5A* has been expanded retrospectively w.e.f. 1st June, 2007 to cover cases where the assessee has filed the return of income for any previous year before the date of search and the income found during the course of search relating the such previous year is not disclosed in the return of income. In such cases also, the assessee would be deemed to have concealed the particulars of income and would be liable for penalty under section 271.

25.4.6 Explanation 6: Penalty for concealment of income shall not be imposed on so much of the income on which additional income tax has been charged under section 143(1)(a).

25.4.7 Explanation 7: In the case of an assessee who has entered into an international transaction under section 92B or a specified domestic transaction under section 92BA, if any amount is added or disallowed in computing the total income under section 92C(4), then the amount so added or disallowed shall be deemed to be income in respect of which particulars have been concealed or inaccurate particulars have been furnished unless the assessee proves to the satisfaction of the Assessing Officer or Commissioner (Appeals) or the Commissioner that the price charged or paid in such transaction was computed in accordance with the provisions of section 92C in the prescribed manner under that section, in good faith and with due diligence.

Section 271(1B) clarifies that where any amount is added or disallowed in computing the total income or loss of an assessee in any order of assessment or reassessment, and such order contains a direction for initiation of penalty proceedings under section 271(1)(c), such an order of assessment or reassessment shall be deemed to constitute satisfaction of the Assessing Officer for initiation of the penalty proceedings.

25.5 Penal Provisions on Undisclosed Income Found During the Course of Search [Section 271AAB]

(i) In respect of searches initiated between 1.6.2007 and 30.6.2012, penalty was leviable @10% of undisclosed income under section 271AAA, if the undisclosed income related to -

- (1) the previous year which had ended before the date of search, but the due date of filing return had not expired before the date of search and the return had not been furnished; or,
- (2) the previous year in which search was conducted.

However, no penalty was leviable if the assessee admitted the undisclosed income in a statement under section 132(4) recorded in the course of search and specified the manner in which such income had been earned and paid the tax together with interest, if any, in respect of such income.

(ii) Consequently, undisclosed income (for the current year in which search takes place or the previous year which has ended before the search and for which the due date of filing of return has not expired and the return is yet to be filed) found during the course of search attracted no penalty if such undisclosed income was admitted in the course of search and penalty@10%, if such undisclosed income was not admitted in the course of search.

(iii) In order to deter the practice of concealing income, the penal provisions have been made more stringent by insertion of section 271AAB which provides for levy of penalty on

undisclosed income found during the course of a search, which has been initiated on or after 1st July, 2012, which relates to specified previous year, i.e.-

- (1) the previous year which has ended before the date of search, but the due date of filing return of income for the same has not expired before the date of search and the return has not yet been furnished;
 - (2) the previous year in which search is conducted.
- (iv) Accordingly, under section 271AAB,
- (1) penalty@10% would be attracted, if undisclosed income is admitted during the course of search in the statement furnished under section 132(4), and the assessee explains the manner in which such income was derived, pays the tax, together with interest if any, in respect of the undisclosed income, on or before the specified date (i.e., the due date of filing return of income or the date on which the period specified in the notice issued under section 153A expires, as the case may be) and furnishes the return of income for the specified previous year declaring such undisclosed income.
 - (2) If undisclosed income relating to the specified previous year is not admitted during the course of search in the statement furnished under section 132(4) but the same is disclosed in the return of income filed after the date of search and the tax along with the interest, if any, is paid before the specified date, then, the taxpayer will be liable for penalty@20% of undisclosed income.
 - (3) In all other cases, penalty ranging from 30% to 90% of undisclosed income would be attracted.
- (v) Undisclosed income, for the purpose of this section, means:
- (1) any income of the specified previous year represented, either wholly or partly, by any money, bullion, jewellery or other valuable article or thing or any entry in the books of account or other documents or transactions found in the course of a search under section 132, which has-
 - (a) not been recorded on or before the date of search in the books of account or other documents maintained in the normal course relating to such previous year; or
 - (b) otherwise not been disclosed to the Chief Commissioner or Commissioner before the date of search; or
 - (2) any income of the specified previous year represented, either wholly or partly, by any entry in respect of an expense recorded in the books of account or other documents maintained in the normal course relating to the specified previous year which is found to be false and would not have been found to be so had the search not been conducted.
- (vi) No penalty under section 271(1)(c) is leviable in respect of such undisclosed income.
- (vii) An order imposing penalty under section 271AAB would be appealable under section 246A before the Commissioner (Appeals).
- (viii) Section 274 providing for the procedure for imposing penalties and section 275 providing for a bar of limitation for imposing penalties, shall, to the extent relevant apply to penalty under section 271AAB.

25.6 Summary of penalty attracted in respect of undisclosed income found during the course of search

Section	Relevant previous year	Penalty
Explanation 5A to section 271(1)	P.Y. which has ended before the date of search, in respect of which the due date has expired, but the return has not been furnished. For example, in respect of P.Y.2013-14, if the date of search is 15.11.2014, then the P.Y. has ended before that date (i.e., on 31.3.2014) and the due date of filing return (31.7.2014/30.9.2014, as the case may be) has also expired, but the return has not been furnished. In such a case, penalty would be attracted under this section.	100% to 300% of the tax sought to be evaded.
Explanation 5A to section 271(1)	P.Y. which has ended before the date of search, in respect of which return has been furnished, but income found during the search has not been disclosed in the return. In such a case also, penalty would be attracted under this section.	100% to 300% of the tax sought to be evaded.
271AAA (in respect of search initiated u/s 132 before 1.7.2012)	(i) P.Y. which has ended before the date of search, but the due date for filing return has not expired before the date of search, and the return has not been furnished. For example, in respect of P.Y.2012-13, if the date of search is 15.5.2012, then the P.Y. has ended before the date of search, but the due date of filing the return has not expired. (ii) P.Y. in which the search is conducted.	10% of the undisclosed income. However, no penalty is leviable if disclosure is made under section 132(4), manner of earning is disclosed and tax and interest is paid.
271AAB (in respect of search initiated u/s 132 on or after 1.7.2012)	<i>Levy of penalty on undisclosed income found during the course of a search, which has been initiated on or after 1st July, 2012, which relates to specified previous year, i.e.-</i> (1) <i>the previous year which has ended before the date of search, but the due date of filing return of income for the same has not expired before the date of search and the return has not yet been furnished;</i> <i>For example, in respect of P.Y.2013-14, if the</i>	(1) <i>Penalty@10% would be attracted, if undisclosed income is admitted during the course of search in the statement furnished under section 132(4)</i> (2) <i>If undisclosed income relating to the specified previous</i>

	date of search is 1.6.2013, then the P.Y. has ended before the date of search, but the due date of filing the return has not expired. (2) the previous year in which search is conducted.	year is not admitted during the course of search in the statement furnished under section 132(4) but the same is disclosed in the return of income filed after the date of search and the tax along with the interest, if any, is paid before the specified date, then, the taxpayer will be liable for penalty@20% of undisclosed income. (3) In all other cases, penalty ranging from 30% to 90% of undisclosed income would be attracted.

25.7 Penalty in the case of firm [Section 271(2)]

In all the above cases where the person liable to pay penalty in a registered firm or an unregistered firm which is assessed as registered under section 183(b) then, the penalty imposable on the firm shall be the same amount as would be imposable on that firm if it were unregistered.

25.8 Penalty for failure to furnish Annual Information Return [Section 271FA]

Section 271FA provides that if a person who is required to furnish an annual information return, as required under section 285BA(1), fails to furnish such return within the time prescribed under section 285BA(2), the prescribed income-tax authority [i.e., Director of Income-tax (Central Information Branch)] may direct that such person shall pay, by way of penalty, a sum of ₹100 for every day during which the failure continues.

Further, where such person fails to furnish the annual information return within the period specified in the notice under section 285BA(5), he shall pay, by way of penalty, a sum of five hundred rupees for every day during which the failure continues, beginning from the day immediately following the day on which the time specified in such notice for furnishing the return expires.

The penal provisions under section 271FA w.e.f. 1st April, 2014 are summarized below -

Non-compliance of section	Penalty under section 271FA	Period
285BA(1)	₹ 100 per day of continuing default	1 st September immediately following the financial year in which the transaction is registered or recorded till the date of furnishing the AIR or the date of expiry of the time specified in the notice under section 285BA(5), whichever is earlier.
285BA(5)	₹ 500 per day of continuing default	The day immediately following the day on which the time specified in notice under section 285BA(5) for furnishing the AIR expires till the date of furnishing of AIR.

Illustration

A private bank has not filed its annual information return in relation to the specified financial transactions for the financial year 2012-13. A notice was issued by the prescribed income-tax authority on 1st October, 2013 requiring the bank to furnish the return by 31st October, 2013. The bank, however, furnished the AIR only on 16th November, 2013. What would be the penalty leviable under section 271FA?

Answer

(1)	(2)	(3)	(4)	
Non-compliance of section	Penalty under section 271FA	Period	Quantum of penalty under section 271FA	
			(2) × (3)	(₹)
285BA(1)	₹ 100 per day of continuing default	1.9.2013 to 31.10.2013	61 days × ₹ 100	6,100
285BA(5)	₹ 500 per day of continuing default	1.11.2013 to 15.11.2013	15 days × ₹ 500	<u>7,500</u>
				<u>13,600</u>

25.9 Procedure for assessment of penalties [Section 274]

Section 274 provides that no order imposing a penalty exceeding ₹ 10,000 shall be made by an Assessing Officer. Where the penalty exceeds ₹ 25,000, the Deputy Commissioner (Appeals) has to get the prior approval of the Joint Commissioner.

In all cases before a penalty is imposed, the assessee should be given a reasonable opportunity of being heard.

Further, where the authority imposing penalty is not the Assessing Officer, a copy of the penalty order should be sent to the Assessing Officer.

25.10 Reduction or waiver of penalty and interest

25.10.1 Reduction or waiver of penalty [Section 273A] : Section 273A authorises the Commissioner of Income-tax to reduce or waive the amount of penalty payable by an assessee. The exercise of this power by the Commissioner is purely at his discretion and may be done either on his own motion or otherwise, that is on receipt of an application from the assessee.

The Commissioner would be entitled to reduce or waive the penalty payable by any person only if the following conditions are satisfied:-

(i) In cases where penalty is levied or leviable on an assessee for concealment of income, the reduction or waiver by the Commissioner would be permissible only, if, prior to the detection of the concealment by the Assessing Officer, the assessee has made a full and true disclosure of all the particulars in respect of his income and, that, too voluntarily and in good faith.

(ii) Further, it is essential that the assessee must have co-operated with the department in any enquiry relating to the assessment of his income and he must also have either paid or made satisfactory arrangements for the payment of any tax or interest, which may become payable in consequence of any order passed under the Income-tax Act, 1961 in respect of the assessment year.

(iii) For purposes of waiver of the penalty, a person must be deemed to have made a full and true disclosure of his income or of all the particulars relating thereto in any case where the excess of income assessed over the income returned is of such a nature as not to attract the imposition of any penalty under section 271(1)(c). In other words in every case where there is the scope for levying penalty on an assessee for having concealed his income liable to tax or for having furnished false or inaccurate particulars of such income, the assessee would not be deemed to have made a full and true disclosure of his income.

(iv) However, the Commissioner of Income-tax would be entitled to exercise his power only after getting the previous approval of the Chief Commissioner or Director General in the following case:

In a case falling under section 271(1)(c) the amount of income in respect of which the penalty is imposed or imposable for the relevant assessment year or where such disclosure relates to more than one assessment year, the aggregate amount of such income for those years exceeds ₹ 5,00,000.

(v) While exercising the powers of reduction or waiver of penalty the Commissioner is required to pass an order in writing and also to record his reasons for so doing. These powers could be exercised by the Commissioner either on his own motion or on receipt of an application from the assessee or from anyone else, he is also entitled to stay or compound any proceedings for the recovery of any penalty which might have been levied on the assessee in cases where he satisfied that:

- (i) to do otherwise would cause genuine hardship to the assessee having due regard to all the facts and circumstances of the case; and
- (ii) the assessee has co-operated in any enquiry relating to the assessment or any proceeding for the recovery of any amount due from him.

The Commissioner's order for reduction or waiver of penalty is final and cannot be challenged in any court or before any authority.

25.10.2 Reduction or waiver of penal interest [Notification No.F.No.400/234/95 I.T (B) dated 23.5.1996] :

1. The Central Board of Direct Taxes has authorised the Chief Commissioners and Directors and Directors-General (Investigation) to reduce or waive penal interest charged under section 234A/234B/234C in the following circumstances, namely:

- (i) Where, in the course of search and seizure operation, books of accounts have been taken over by the Department and were not available to the taxpayer to prepare his return of income;
- (ii) Where, in the course of search and seizure operation, cash had been seized which was not permitted to be adjusted against arrears of tax or payment of advance tax instalments falling due after the date of the search.
- (iii) Any income other than "capital gains" which was received or accrued after the date of first or subsequent instalment of advance tax, which was neither anticipated nor contemplated by the taxpayers and on which advance tax was paid by the tax payer after the receipt of such income;
- (iv) Where, as a result of any retrospective amendment of law or the decision of the Supreme Court after the end of the relevant previous year, Certain receipts which were hitherto treated as exempt, become taxable. Since no advance tax would normally be paid in respect of such receipts during the relevant financial year, penal interest is levied for the default in payment of advance tax;
- (v) Where return of income is filed voluntarily without detection by the Income-tax Department and due to circumstances beyond control of the taxpayer such return of income was not filed within the stipulated time-limit or advance tax was not paid at the relevant time.

However, no reduction or waiver of such interest shall be ordered unless the assessee has filed the return of income for the relevant assessment year and paid the entire tax due on the income as assessed except the amount of interest for which reduction or waiver has been requested for. The Chief Commissioner of Income-tax or the Director-General of Income-tax may also impose any other conditions deemed fit for the said reduction or waiver of interest.

2. The class of income of cases in which the reduction or waiver of interest under section 243A or section 234B or, as the case may be, section 234C can be considered, are as follows:

- (a) Where during the course of proceedings for search and seizure under section 132 or otherwise, the books of account and other incriminating documents have been seized and for reasons beyond the control of the assessee, he has been unable to furnish the return of income for the previous year during which the action under section 132 has taken place, within the time specified in this behalf and the Chief Commissioner or, as the case may be, Director-General is satisfied having regard to the facts circumstances of the case that the delay in furnishing such return of income cannot reasonably be attributed to the assessee.
- (b) Where during the course of search and seizure operation under section 132, cash is seized which is not allowed to be utilised for payment of advance tax instalments as they fall due after the seizure of cash and the assessee has not paid fully or partly advance tax on the current income and the Chief Commissioner or the Director-General is satisfied that the assessee is unable to pay the advance tax.

- (c) Where any income chargeable to income-tax under any head of income, other than 'Capital Gains' is received or accrues after the due date of payment of the first or subsequent instalments of advance tax which was neither anticipated nor was in the contemplation of the assessee and the advance tax on such income is paid in the remaining instalment(s) and the Chief Commissioner/Director-General is satisfied that this is a fit case for reduction or waiver of interest chargeable under section 234C.
- (d) Where any income which was not chargeable to income-tax on the basis of any High Court order passed in the case of an assessee, and as a result, he did not pay income-tax in relation to such income in any previous year and subsequently after the end of the previous year, in consequence of any retrospective amendment of law or, as the case may be, the decision of the supreme court in his own case, in any assessment or reassessment proceedings the advance tax paid by the assessee during the financial year immediately preceding the relevant assessment year is found to be less than the amount of advance tax payable on his current income, the assessee is chargeable to interest under section 234B or section 234C and the Chief Commissioner or Director-General is satisfied that this is a fit case for reduction or waiver of such interest.
- (e) Where a return of income could not be filed by the assessee due to unavoidable circumstances and such return of income is filed voluntarily by the assessee or his legal heirs without detection by the Assessing Officer.

3. The Chief Commissioner of Income-tax/Director General of Income-tax may order the waiver or reduction of interest under sections 234A, 234B and 234C but shall not so reduce or waive penal interest in those cases where waiver or reduction of such interest has been rejected in the past on the merits of the case.

25.11 Power of Commissioner to grant immunity from penalty [Section 273AA]

Section 273AA empowers the Commissioner to grant immunity from penalty.

- (i) The application for the immunity has to be made by the assessee (person whose case has been abated under section 245HA) to the Commissioner of Income-tax.
- (ii) Where penalty was levied before or during the pendency of settlement proceedings, then the assessee can approach the Commissioner for immunity at any time.
- (iii) However, if no penalty was levied till the time of abatement of proceedings before Settlement Commission, then the assessee must make an application for immunity before the imposition of penalty by the Income-tax authority.
- (iv) The Commissioner can grant immunity, subject to such conditions as he may think fit to impose, on being satisfied that the assessee has –
 - (i) co-operated in the proceedings after abatement; and
 - (ii) made a full and true disclosure of his income and the manner in which such income has been derived.
- (v) The immunity granted shall stand withdrawn, if such assessee fails to comply with any condition subject to which the immunity was granted.

- (vi) The immunity granted to a person may, at any time, be withdrawn by the Commissioner, if he is satisfied that such person had, in the course of any proceedings, after abatement,
 - (i) concealed any particulars material to the assessment from the income-tax authority; or
 - (ii) given false evidence.

Consequently, such person would become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

25.12 Time limit for imposition of penalty [Section 275]

- (i) Section 275(1) provides the time limit for imposing penalty under Chapter XXI of the Income-tax Act, 1961, as under -
 - (1) In a case where the relevant assessment or other order is the subject matter of an appeal to the Commissioner (Appeals) under section 246 or section 246A or an appeal to the Appellate Tribunal under section 253, an order imposing a penalty shall not be passed –
 - (a) after the expiry of the financial year in which the proceedings, in the course of which action for the imposition of penalty has been initiated, are completed; or
 - (b) six months from the end of the month in which the order of the Commissioner (Appeals) or, as the case may be, the Appellate Tribunal is received by the Chief Commissioner or Commissioner,
 whichever period expires later.
 - (2) However, this limitation is applicable only if the Commissioner (Appeals) passed the order before 1st June, 2003 disposing of the appeal made to him.
 - (3) In a case where the relevant assessment or other order is the subject matter of an appeal to the Commissioner (Appeals) under section 246 or section 246A, and the Commissioner (Appeals) passes the order on or after 1st June, 2003 disposing of such appeal, an order imposing penalty shall be passed –
 - (a) before the expiry of the financial year in which the proceedings, in the course of which action for imposition of penalty has been initiated, are completed; or
 - (b) within one year from the end of the financial year in which the order of the Commissioner (Appeals) is received by the Chief Commissioner or Commissioner,
 whichever is later.
 - (4) In a case where the relevant assessment or other order is the subject matter of revision under section 263 or section 264, an order imposing penalty shall not be passed after the expiry of six months from the end of the month in which such order of revision is passed;
 - (5) In any other case, an order imposing penalty shall not be passed after the expiry of the financial year in which the proceedings, in the course of which action for the imposition of penalty has been initiated, are completed, or six months from the end of the month in which action for imposition of penalty is initiated, whichever period expires later.
- (ii) Sub-section (1A) facilitates the revision of an order for the imposition of penalty or dropping the proceedings for the imposition of penalty, on the basis of subsequent

revision of assessment by Commissioner (Appeals) or Appellate Tribunal or High Court or Supreme Court or by the Commissioner under section 263 or section 264.

(iii) It has been provided that in a case where the relevant assessment or other order is the subject-matter of -

- (1) an appeal to the Commissioner (Appeals) under section 246 or section 246A; or
- (2) an appeal to the Appellate Tribunal under section 253; or
- (3) an appeal to the High Court under section 260A; or
- (4) an appeal to the Supreme Court under section 261; or
- (5) revision under section 263 or section 264

and an order imposing or enhancing or reducing penalty or dropping the proceedings for the imposition of penalty is passed before the order of -

- (1) the Commissioner (Appeals); or (2) the Appellate Tribunal; or (3) the High Court; or (4) the Supreme Court

is received by the Chief Commissioner or the Commissioner, or the order of revision under section 263 or 264 is passed, an order imposing or enhancing or reducing penalty or dropping the proceedings for the imposition of penalty may be passed on the basis of assessment as revised by giving effect to such order of the Commissioner (Appeals) or, the Appellate Tribunal or, the High Court, or the Supreme Court or order of revision under section 263 or 264. A revision order under this sub-section can again be revised under this sub-section.

(iv) It has also been provided that no such order imposing or enhancing or reducing or canceling penalty or dropping the proceedings shall be passed without hearing the assessee or giving him a reasonable opportunity of being heard.

(v) Further, no such order can be passed after the expiry of six months from the end of the month in which -

- (1) the order of the Commissioner (Appeals) or the Appellate Tribunal or the High Court or the Supreme Court is received by the Chief Commissioner or the Commissioner; or
- (2) the order of revision under section 263 or section 264 is passed.

(vi) Also, it has been provided that the provisions of section 274(2) shall apply in respect of such order imposing or enhancing or reducing penalty.

Note - Section 274(2) provides that for passing an order imposing penalty exceeding ₹ 10,000, the Income-tax authority has to take the prior approval of the Joint Commissioner. Also, for passing an order imposing penalty exceeding ₹ 20,000, the Assistant Commissioner or the Deputy Commissioner should take the prior approval of the Joint Commissioner.

(vii) In computing the period of limitation, the time taken to give the assessee a reasonable opportunity of being heard or reheard under section 129 and any period during which he proceedings for the levy of the penalty are stayed by an order or injunction of the Court or any period during which the immunity granted under section 245H received in force will be excluded.

Offences and Prosecution

26.1 Summary of Offences and Prosecution

The punishable offences as well as the prosecution for such offences under the Income-tax Act, 1961 are discussed under Chapter XXII. Prosecution provisions under the Income-tax Act, 1961 are used as a tool for effective enforcement of tax laws and deterring tax avoidance and tax evasion.

While penalties may be imposed by the income-tax authorities, the imposition of a fine or the launching of prosecution for any offence under the Act can be made only by the Magistrate of a Court under sections 275A to 280. In respect of the same default of an assessee, penalty may be imposed and a prosecution also may be launched against him.

Section	Nature of default	Rigorous imprisonment	Fine
275A	Contravention of order made under the second proviso to sub-section (1) or sub-section (3) of section 132 regarding search and seizure	Upto 2 Years	No limit specified
275B	Failure to afford the authorized officer the necessary facility to inspect the books of account or other documents as required under section 132(1)(iib)	Upto 2 years	No limit specified
276	Removal, concealment, transfer or delivery of property to thwart tax recovery	Upto 2 years	No limit specified
276A	Failure to comply with the provisions of section 178(1) and (3) regarding company in liquidation or parting with any of the assets of the company or the properties in his hands in contravention of the provision of section 276A	6 months to 2 years	No limit specified
276AB	Failure to comply with the provisions of section 269UC or 269UE or 269UL relating surrendering of property to Central Government	6 months to 2 years	No limit specified
276B	Failure to pay to the Central Government, tax deducted under the provisions of	3 months to 7 years	No limit specified

	Chapter XVII-B or the tax payable by him, as required by (i) section 115-O(2); or (ii) Second proviso to section 194B		
276BB	Failure to pay to the Central Government tax collected under section 206C	3 months to 7 years	No limit specified
276C(1)	Wilful attempt to evade tax, penalty or interest.	Evaded tax exceeding 25 lakh: 6 months to 7 years Other cases : 3 months to 2 years	No limit specified
276C(2)	Wilful attempt to evade payment of tax, penalty or interest.	3 months to 2 years	No limit specified
276CC	Wilful failure to furnish in due time a return of income u/s 139(1) or u/s 142(1)(i) or u/s 148 or u/s 153A. Note: If return of income under section 139(1) is furnished before expiry of the assessment year or the tax payable by him on the total income determined on regular assessment reduced by advance tax and TDS does not exceed ₹ 3000 - No prosecution.	Evaded tax exceeding 25 lakh : 6 months to 7 years Other cases: 3 months to 2 years	No limit specified
276D	Willful failure to produce accounts and documents under section 142(1)/ 142(2A)	Up to one year	₹ 4 to ₹ 10 for every day of default.
277	False statements in verification.	Evaded tax exceeding 25 lakh: 6 months to 7 years In other cases: 3 months to 2 years	No limit specified
277A	Falsification of books or documents, etc. to induce or abet any person to evade any tax, penalty or interest chargeable or imposable under the Act. It is not necessary to prove that the other person has actually evaded any tax, penalty or interest chargeable or imposable under the Act for the purpose of establishing the charge under this section.	Imprisonment of 3 months to 2 years.	No limit specified

278	Abetment of false return etc. (relating to any income chargeable to tax)	Evaded tax exceeding 25 lakh: 6 months to 7 years In other cases: 3 months to 2 years	No limit specified
278A	Second and subsequent offences under section 276B, 276C(1), 276CC, 276DD, 276E, 277, 278.	6 months to 7 years for every subsequent offence	No limit specified
280(1)	Disclosure of particulars by public servants in contravention of Section 138(2). Prosecution after previous sanction of Central Government under section 280(2).	Up to 6 months	No limit specified

Section 278AA provides that where a reasonable cause for the failure is proved, punishment shall not be imposed for offences specified in sections 276A, 276AB and 276B.

For the purposes of offences and prosecutions, the following individuals will be deemed to be guilty of the offence committed by the respective person

Person	Section	Individual
Company	278B	Every person in charge of affairs; Director, Manager, Secretary and every officer who is guilty of offence
Firm	278B	Partner
AOP/BOI	278B	Members controlling the affairs
HUF	278C	Karta or member either by acquiescence or negligence.

Section 278B(3) provides that if an offence under the Act has been committed by a person being a company, it shall be punished with fine. Every other person who was in charge of and was responsible for the conduct of business of the company, or any director, manager, secretary or other officer of the company (with whose consent or connivance or due to whose neglect the offence was committed) would be liable for punishment of imprisonment and fine wherever so provided.

26.2 Power of Commissioner to grant immunity from prosecution [Section 278AB]

Section 278AB empowers the Commissioner to grant immunity from prosecution -

- The application for the immunity must be made by the assessee (person whose case has been abated under section 245HA) to the Commissioner of Income-tax before institution of the prosecution proceedings after abatement.
- The assessee can approach the Commissioner for immunity any time if prosecution proceedings were instituted before or during the pendency of settlement proceedings.

However, if the assessee has received any notice etc. from the Income-tax authority for institution of prosecution, then he must apply to the Commissioner for immunity, before actual institution of prosecution.

- (iii) The Commissioner can grant immunity, subject to such conditions as he may think fit to impose, on being satisfied that the assessee has –
 - (a) co-operated in the proceedings after abatement; and
 - (b) made a full and true disclosure of his income and the manner in which such income has been derived.
- (iv) Where application for settlement under section 245C had been made before the 1st June, 2007, the Commissioner can also grant immunity from prosecution for any offence under this Act or under the Indian Penal Code or under any other Central Act.
- (v) If the assessee fails to comply with any condition subject to which the immunity was granted, the same would be withdrawn.
- (vi) The immunity granted to a person may, at any time, be withdrawn by the Commissioner, if he is satisfied that such person had, in the course of any proceedings, after abatement, -
 - (a) concealed any particulars material to the assessment from the income-tax authority; or
 - (b) given false evidence.

Consequently, the person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the proceedings.

26.3 Presumption with regard to assets, books of accounts [Section 278D]

Section 278D provides that in case where, during the course of any search made under section 132, any money, bullion, jewellery or other valuable articles or things or any books of account or other documents had been found in the possession or control of any person and such assets or books of account or other documents are tendered by the prosecution in evidence against such person and/or against any person who is convicted of an offence under section 278, the provisions of section 132(4A) would apply, in relation to all such books of account and other documents. Accordingly, it would be presumed that such books of account or other documents and assets belong to the person in whose control or possession they were found, at the time of search and also that the contents of such books of account and other documents are true.

Similarly, in cases where any books of accounts or other documents and assets are taken into custody from the possession or control of any person by the officer or authority specified in section 132A(1)(a) or (c) and these are delivered to the requisitioning officer under section 132A(2), it would be presumed that the presumption similar to the one mentioned earlier would operate in these cases as well. It would be for assessee to rebut the presumption wherever necessary by producing cogent and reliable evidence.

26.4 Presumption as to culpable mental state [Section 278E]

- (1) In any prosecution for any offence under this Act which requires a culpable mental state on the part of the accused, the court shall presume the existence of such mental state but it shall be a defence for the accused to prove the fact that he had no such mental state with respect to the act charged as an offence in that prosecution.
- (2) 'Culpable mental state' includes intention, motive or knowledge of a fact or belief in, or reason to believe, a fact.
- (3) For the purposes of this section a fact is said to be proved only when the court believes it to exist beyond reasonable doubt and not merely when its existence is established by a preponderance of probability.

Students may note that penalty proceedings being quasi-criminal in nature, it has been judicially held in the context of various penalty and prosecution proceedings, that the burden is on the department to establish that the assessee concealed the particulars of his income or deliberately furnished inaccurate particulars thereof and it is not enough for the revenue merely to show that a certain amount was received by the assessee. Section 278E has clearly overruled this view and has specifically placed the burden of proof on the assessee.

It specifically provided that where any prosecution requires a culpable mental state (*mens rea*) the court shall presume the existence of such mental state but the assessee is entitled to prove that he had no such mental state with respect to the act charged with. Thus, the burden to prove the non-existence of *mens rea* has been effectively placed on the assessee.

26.5 Prosecution to be made at the instance of the Chief Commissioner or Commissioner [Sections 279 and 279A]

Section 279(1) provides that the proceedings to punish a person for an offence under Sections 275A, 275B, 276, 276A, 276B, 276BB, 276C, 276CC, 276D, 277, 277A and 278 can be initiated only after previous sanction of the Commissioner or the Commissioner (Appeals) or the appropriate authority. However, the Chief Commissioner or the Director General may issue such instructions or directions to the said authorities for institution of proceedings under section 279(1). An offence may either before or after the institution of prosecution proceedings be compounded by the concerned authorities under section 279(2). If a person is proceeded against under any of the provisions of sections 275A to 278, then a statement made or account or documents produced before any authority under Act shall not be inadmissible as evidence for purpose of the prosecution proceedings merely on the ground that such account or document was produced or statement was made in the belief that the penalty imposable would be reduced or waived under section 273A or that the offence would be compounded.

Section 279A provides that offences punishable under Sections 276B, 276C, 276CC, 277 and 278 shall be deemed to be non-cognizable offences. Section 279B deals with proof of entries in record or other documents in the custody of income-tax authority. Section 280 deals with disclosure of particulars by public servants.

26.6 Proof of entries in records or documents [Section 279B]

Entries in the records or other documents in the custody of an income-tax authority shall be admitted in evidence in any proceedings for the prosecution of any person for an offence under this Chapter, and all such entries may be proved either by the production of the records or other documents in the custody of the income-tax authority containing such entries, or by the production of a copy of the entries certified by the income-tax authority having custody of the records or other documents under its signature and stating that it is a true copy of the original entries and that such original entries are contained in the records or other documents in its custody.

26.7 Disclosure of particulars by public servants [Section 280]

If a public servant furnishes any information or produces any document in contravention of section 138(2), he shall be punishable with imprisonment which may extend to 6 months and shall also be liable to pay fine.

However, no prosecution shall be instituted under this section except with the previous sanction of the Central Government.

26.8 Constitution of Special Courts & Offences triable by Special Court [Sections 280A & 280B]

- (1) Under section 280A, for the purpose of trial of offences under Chapter XXII i.e. Offences & Prosecution, one or more courts of Magistrate of the first class may be designated by the Central Government, in consultation with the Chief Justice of the High Court, by way of a notification as Special Court for such area or areas or for such cases or class or group of cases as may be specified in the notification.
- (2) A Special Court, while trying an offence punishable under the Act, shall also try any other offence with which the accused may be charged, under the Code of Criminal Procedure, 1973.
- (3) Under section 280B, the offences punishable under Chapter XXII, shall be triable only by the Special Court, if so designated, for the area or areas or for cases or class or group of cases, as the case may be, in which the offence has been committed. This is notwithstanding anything containing in the Code of Criminal Procedure, 1973
- (4) However, a court competent to try offences under section 292 which has been designated as a Special Court under this section, shall continue to try the offences before it or offences arising under the Act after such designation. Further, a court competent to try offences under section 292, which has not been designated as a Special Court under this section, may continue to try such offence pending before it till its disposal.
- (5) Further, notwithstanding anything contained in the Code of Criminal Procedure, 1973, a Special Court may take cognizance of the offence for which the accused is committed for trial, upon a complaint made by an authority authorized in this behalf under the Act.

26.9 Trial of offences as summons case [Section 280C]

- (1) The Special Court shall, notwithstanding anything contained in the Code of Criminal Procedure, 1973, try an offence under Chapter XXII punishable with imprisonment not exceeding two years or with fine or with both, as a summons case.
- (2) When an offence is so tried as a summons case, the provisions of the Code of Criminal Procedure, 1973, as applicable in the case of trial of summons case, would be applicable.

26.10 Application of Code of Criminal Procedure, 1973 to proceedings before Special Court [Section 280D]

- (1) The provisions of the Code of Criminal Procedure, 1973, including the provisions regarding bails and bonds, would apply to proceedings before a Special Court, unless otherwise provided under the Income-tax Act, 1961.
- (2) The person conducting the prosecution before the Special Court shall be deemed to be a Public Prosecutor.
- (3) The Central Government may also appoint a Special Public Prosecutor for any case or class or group of cases.
- (4) A person shall be qualified for appointment as a Public Prosecutor or a Special Public Prosecutor only if he has been in practice as an advocate for at least seven years, requiring special knowledge of law.
- (5) Every person appointed as Public Prosecutor or Special Public Prosecutor under this section shall be deemed to be a Public Prosecutor within the meaning of section 2(u) of the Code of Criminal Procedure, 1973. The provisions of the Code of Criminal Procedure, 1973, would have effect accordingly.

Miscellaneous Provisions

27.1 Mode of taking or accepting certain loans and deposits [Section 269SS]

Section 269SS provides that no person shall accept any loan of ₹ 20,000 or more from any other person except by account payee cheque or account payee bank draft. This requirement also applies in cases where on the date of taking or accepting a loan or deposit from a person, any earlier loan or deposit taken or accepted from the same person and remaining unpaid on that date, is ₹ 20,000 or more. The requirement also applies if the aggregate amount of such earlier loan or deposit and to amount of loan or deposit proposed to be taken or accepted from that person is ₹ 20,000 or more.

The requirement will not however, apply to loan or deposit taken or accepted from, or any loan or deposit taken from or accepted by Government, any banking company, post office saving bank or any cooperative bank, any corporation established by a Central, State or Provincial Act: or any Government company as defined in section 617 of the Companies Act, 1956¹. The provisions of this section will also not apply to any loan or deposit taken, or accepted from, or any loan or deposit taken from or accepted by, any institution, association or body which the Central Government may, for reasons to be recorded in writing in this behalf notify in the Official Gazette. This requirement will not apply to those cases where the persons involved in the transaction derive income only from agriculture or where neither of them has any income chargeable to tax under the Act.

The expression “loan or deposit” in this section will mean any loan or deposit of money.

Section 271D provides for penalty for failure to comply with the provisions of section 269SS – If a person takes or accepts any loan or deposit in contravention of the provisions of section 269SS, he shall be liable to pay, by way of penalty, a sum of equal to the amount of the loan or deposit taken or accepted. Such penalty shall be imposed by the Joint Commissioner.

27.2 Mode of repayment of certain deposits [Section 269T]

Section 269T provides that no branch of the banking company or a co-operative bank or any other company or co-operative society or a firm or other person, shall repay any loan or deposit made with it otherwise than by account payee cheque or account payee bank draft, drawn in the name of the person who has made the loan or deposit if the amount of loan or deposit together with interest, if any, payable thereon or the aggregate amount of such loans

¹ Section 2(45) of the Companies Act, 2013

or deposits held by such person with the branch or the banking company or cooperative bank or as the case may be, the other company or cooperative society or the firm, or any other person either-in his own name or jointly with any other person on the date of such repayment, together with the interest if any payable on such loan or deposit is ₹ 20,000 or more. However, if the repayment is made by a branch of bank or a cooperative bank, such repayment could be made by crediting the amount of such loan or deposit to the saving bank account or the current account, if any, with such branch of the person to whom such loan or deposit has to be repaid.

However, the provisions of this section shall not apply in case of repayment of any loan or deposit taken or accepted from -

- (i) Government;
- (ii) any banking company, post office savings bank or co-operative bank;
- (iii) any corporation established by a Central, State or Provincial Act;
- (iv) any Government company as defined in section 617 of the Companies Act, 1956²;
- (v) such other institution, association or body or class of institutions, associations or bodies which the Central Government may, for reasons to be recorded in writing, notify in this behalf in the Official Gazette.

For the purposes of this section and 269SS, the expression “banking company” will mean a company to which the Banking Regulation Act, 1949 applies and includes any bank or banking institution referred to in section 51 of that Act. The expression “co-operative bank” will have the meaning assigned to it in Part V of the Banking Regulation Act, 1949.

‘Loan or Deposit’ means any loan or deposit of money which is repayable after notice or repayable after a period. In the case of any person other than a company, loan or deposit of any nature will be covered by this section.

27.3 Special Bearer Bonds [Section 269TT]

Section 269TT, similarly, provides that the amount payable on redemption of Special Bearer Bonds, 1991 shall be paid only by an account payee cheque or account payee bank draft drawn in the name of the person to whom such repayment is to be made.

27.4 Transfers to defraud revenue void [Section 281]

As a safeguard against non-realisation of revenue due to fraudulent transference of assets by a defaulting assessee it is provided under this Section that, certain transfers specified therein are deemed to be void for purpose of income-tax. Accordingly, in cases where, during the pendency of any proceeding under the Income-tax Act, 1961 or after the completion thereof, but before the service of notice by the Tax Recovery Officer any assessee creates a charge on, or parts with, the property by way of sale, mortgage, gift, exchange, or any other mode of transfer whatsoever of any of his assets in favour of any other person such a charge or transfer must be deemed to be void as against any claim in respect of any tax, penalty,

² Section 2(45) of the Companies Act, 2013

27.3 Income tax

interest or fine payable by the assessee as a result of the completion of the proceedings or otherwise. However, the charge or transfer made by the assessee would not be void in case where it is made.

- (a) for adequate consideration and without any notice of the pendency of such proceeding or, as the case may be, without any notice of such tax or other monies remaining payable by the assessee; or
- (b) with the previous permission of the Assessing Officer.

This provision applies to all cases where the amount of tax or other sum of money which is payable or likely to be payable exceeds ₹ 5,000 and the assets which are charged or transferred by the assessee exceeds ₹ 10,000 in value, in the aggregate. For this purpose, the term 'assets' should be taken to mean land, buildings, machinery, plant, shares, securities and fixed deposits in bank to the extent to which any of these assets do not form part of the stock-in-trade of the business carried on by the assessee. In other words, if these items of Properties represent the stock-in-trade of the assessee's business, their transfer would not be treated as void.

27.5 Provisional Attachment to protect the interest of the revenue [Section 281B]

According to this section, cases where, during the pendency of any proceeding for the assessment of any income or for the assessment or reassessment of any income which has escaped assessment, the Assessing Officer is of the opinion that, for the purpose of protecting the interest of the Revenue, it is necessary to do so, he may, by an order in writing, attach provisionally any property belonging to the assessee. However, before passing an order, the Assessing Officer is required to take the prior permission of the Chief Commissioner, Commissioner, Director General or Director of Income-tax. The attachment in all such cases should be in the same manner as is provided under the rules laid down in the Second Schedule in the Income-tax Act, 1961. Every provisional attachment would cease to be effective after the expiry of a period of six months from the date on which order for the attachment is passed by the Assessing Officer. However, the Chief Commissioner or Commissioner is entitled, for reasons to be recorded in writing, to extend the validity of the period during which the order for attachment would be operative by such further period or periods as he deems fit. However, in no case shall the total period of provisional attachment of the property exceed two years from the date of the original order of the Assessing Officer.

Where an application for settlement under section 245C is made, the period commencing from the date on which such application is made and ending with the date on which the order under section 245D(1) is made shall be excluded for computing the period of 2 years.

In several cases, the assessee has filed writ petitions in High Courts and Supreme Court and have obtained stay of the assessment proceedings. Generally, such stay remains in force for several years during which the validity of provisional attachment order expires. Therefore, it has been provided that the period during which the proceedings for assessment or reassessment are stayed by an order or injunction of any Court, shall also be excluded in calculating the period of 2 years specified above.

27.6 Service of Notice [Sections 282, 283 & 284]

As per section 282, a notice or requisition under the Act may be served on the person named therein either by post or as if it were a summons issued by a court. With effect from 1st October, 2009, such notice or requisition can be served by electronic mail also.

Accordingly, the service of notice or summon or requisition or order or any other communication under this Act may be made by delivering or transmitting a copy thereof to the person named therein -

- (1) by post or such courier services as approved by the CBDT; or
- (2) in such manner as provided in the Code of Civil Procedure, 1908 for the purposes of service of summons; or
- (3) in the form of any electronic record as provided in Chapter IV of the Information Technology Act, 2000; or
- (4) by any other means of transmission as may be provided by rules made by the CBDT in this behalf.

The CBDT is empowered to make rules providing for the addresses (including the address for electronic mail or electronic mail message) to which such communication may be delivered or transmitted to the person named therein.

Following is a list of persons on whom notice should be served and such a notice will be notice to the corresponding assessee mentioned.

	Assessee	Addressee
(i)	An existing firm	Any member of the firm
(ii)	An existing H.U.F.	The Manager or any adult member of the family.
(iii)	A Company	The Principal Officer thereof
(iv)	Local authority	The Principal Officer thereof
(v)	An existing association or body of individuals	The Principal Officer or any member thereof
(vi)	An individual	The individual himself
(vii)	Any other person	The person incharge of the management and control of his affairs.
(viii)	A dissolved firm	Any adult person who was a partner immediately before dissolution.
(ix)	A partitioned H.U.F.	The last manager of the family; if he is dead, all adults who were members immediately before the partition.
(x)	A dissolved association of persons	Any person who was a member immediately before dissolution

(xi)	A discontinued business	The assessee; In the case of a firm or an association of persons, any person who was a member at the time of discontinuance; In the case of a company, its Principal Officer.

27.7 Authentication of notices and other documents [Section 282A]

- (i) Section 282A provides that where any notice or other document is required to be issued by any income-tax authority, such notice or other document should be signed in manuscript by that authority.
- (ii) Every notice or other document required to be issued, served or given for the purposes of this Act by any income-tax authority, shall be deemed to be authenticated if the name and office of a designated income-tax authority is printed, stamped or otherwise written thereon.
- (iii) A designated income-tax authority means any income-tax authority authorised by the CBDT to issue, serve or give such notice or other document after authentication in the manner as provided in (ii) above.

27.8 Non-resident having liaison office required to submit statement in prescribed form to the Assessing Officer [Section 285]

- (i) A non-resident can operate in India through a branch or a liaison office set up after getting the approval of the Reserve Bank of India. Since the branch constitutes a permanent establishment of the non-resident, it has to file its return of income. However, there is no such requirement as regards a liaison office since no business activity is allowed to be carried out in India via a liaison office of a non-resident.
- (ii) With effect from 1.6.2011, such a non-resident would be required to file a statement in the prescribed form to the Assessing Officer having jurisdiction, within 60 days from the end of the financial year, providing the details in respect of activities carried out by the liaison office in India during the financial year.
- (iii) This requirement has to be complied with by every person, being a non-resident having a liaison office in India set up in accordance with the guidelines issued by the RBI under the Foreign Exchange Management Act, 1999.
- (iv) Since the provision has been made effective from 01.06.2011, the requirement to file such statements would arise for financial year 2011-12 and thereafter and the statement of a particular financial year should be filed on or before 30th May, of the succeeding financial year. For example, the statement for F.Y. 2013-14 should be filed on or before 30th May, 2014.

- (v) Notification of form and particulars of Annual Statement to be furnished by a non-resident having Liaison Office in India [Notification No. 5/2012 dated 6-2-2012]
- (a) For the purpose of this section, the CBDT has, vide this notification, prescribed the form and particulars of the Annual Statement to be furnished by the non-resident having Liaison Office in India. The statement shall be given in Form 49C and shall be submitted in the electronic form along with the digital signature.
- (b) The statement is to be verified by a Chartered Accountant or by the Authorized Signatory i.e., the person authorized by the non-resident in this behalf.
- (c) The procedure for filing such Annual Statement shall be specified by the Director General of Income-tax (Systems). He shall also ensure that appropriate policies for security, archival and retrieval in relation to such statements furnished, are formulated and implemented.

27.9 Submission of statements by producers of films [Section 285B]

Any person who carries on the production of a cinematograph film during the whole or any part of any financial year is under a statutory obligation, in respect of the period during which such production is carried on by him during the financial year to prepare and deliver or caused to be delivered to the Assessing Officer within 30 days from the end of the financial year or within 30 days from the date of completion of the production of the film, whichever is earlier, a detailed statement in the prescribed form containing the particulars of all the payments exceeding ₹ 50,000 in the aggregate made by him or due from him to each person who is was engaged in the production of the film.

27.10 Annual Information Return [Section 285BA]

- (a) Section 285BA provides that any assessee, who enters into any financial transaction, as may be prescribed, with any other person, shall furnish, within the prescribed time, an annual information return in such form and manner, as may be prescribed, in respect of such financial transactions entered into by him during any previous year.
- (b) Sub-section (1) casts responsibility on –
 - an assessee or
 - the prescribed person in the case of an office of Government or
 - certain other authorities,
 - who are responsible for registering or maintaining books of account or other documents containing a record of any specified financial transaction, to furnish an annual information return.
- (c) Such annual information return should be furnished to the prescribed income-tax authority or such other authority or agency as may be prescribed in respect of –
 - (i) such transactions registered or recorded by him during any financial year beginning on or after 1st April, 2004, and

- (ii) information relating to which is relevant and required for the purposes of this Act
- (d) The annual information return has to be furnished within the prescribed time after the end of such financial year in such form and manner (including on a floppy, diskette, magnetic cartridge tape, CD-ROM or any computer readable media) as may be prescribed.
- (e) The expression “specified financial transaction” has been defined to include the following transactions, which may be prescribed by the CBDT –
 - a. a transaction of purchase, sale or exchange of goods or property or right or interest in a property, or
 - b. a transaction for rendering any service, or
 - c. a transaction under a works contract, or
 - d. a transaction by way of an investment made or an expenditure incurred, or
 - e. a transaction for taking or accepting any loan or deposit
- (f) The CBDT may prescribe different values for different transactions in respect of different persons, having regard to the nature of such transactions.
- (g) The value or the aggregate value of such transactions during a financial year so prescribed referred to above should not be less than fifty thousand rupees.
- (h) Where the prescribed income-tax authority considers that the annual information return is defective he may intimate such defect to the person who has furnished such return and give him an opportunity to rectify the same within one month or such further period as he may allow in his discretion.
- (i) If the defect is not rectified within such period, such return would be treated as an invalid return and the provisions of the Act would apply as if such person had failed to furnish the annual information return.
- (j) Where a person referred to in sub-section (1) has not furnished the annual information return within the prescribed time, the prescribed income-tax authority may serve a notice requiring him to furnish such return within a period of sixty days from the date of service of such notice. Such person should furnish such return within the time specified in the notice.

27.11 Publication of Information [Section 287]

The Central Government is empowered to publish the name and address of any assessee and other particular relating to them, if it considers it necessary or expedient in the public interest to do so. But no such publication relating to any penalty or prosecution shall be made until the time for presenting appeal to the Commissioner (Appeals) has expired without an appeal having been presented or until the appeal, if presented, has been disposed of. In the case of a firm, company or other association of persons the names of the partners of the firm, directors or manager of the company or members of the associations, as the case may be may also be published if, in the opinion of the Central Government, the circumstances of the case justify the same.

27.12 Appearance by Registered Valuers [Section 287A]

Any tax payer who is entitled to or required to attend before any income tax authority or the Appellate Tribunal in connection with any matter relating to the valuation of any asset, otherwise than he is required under section 131 to attend personally for examination on oath or affirmation, may attend by a registered valuer. For this purpose, a registered valuer means a person who is registered as a valuer for the purpose of section 34AB of the Wealth-tax Act, 1957.

27.13 Appearance by Authorised Representative [Section 288]

1. Section 288 deals with appearance by authorised representative. Accordingly, any assessee who is entitled or required to attend before any income-tax authority of the Appellate Tribunal in connection with any proceeding under this Act otherwise than when required under section 131 to attend personally for examination on oath or affirmation, may attend by an authorised representative.
2. For the purpose of this section, "authorised representative" means, a person authorised by the assessee in writing to appear on his behalf. The following persons can be authorised representatives:
 - (a) A person related to the assessee in any manner by a person regularly employed by the assessee
 - (b) any officer of a Scheduled Bank with which the assessee maintains a current account or has other regular dealings
 - (c) any legal practitioner who is entitled to practice in any Civil Court in India
 - (d) an Accountant [i.e., a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949]
 - (e) any person who has passed any accountancy examination recognised in this behalf by the Board. Rule 50 prescribes the accountancy examination recognised for this purpose. They are as follows:
 - (i) The National Diploma in Commerce awarded by the All India Council for Technical Education under the Ministry of Education, New Delhi, provided the diploma-holder has taken Advanced Accountancy and Auditing as an elective subject for the Diploma Examination
 - (ii) Government Diploma in Company Secretaryship awarded by the Department of Company Affairs under the Ministry of Industrial Development and Company Affairs, New Delhi
 - (iii) Final Examination of the Institute of Company Secretaries of India, New Delhi
 - (iv) The Final Examination of the Institute of Cost and Work Accountants of India constituted under the Cost and Works Accountants Act, 1959
 - (v) The Departmental Examination conducted by or on behalf of the Central Board of Direct Taxes for promotion

- (vi) The Revenue Audit Examination for Section Officers conducted by the Office of the Comptroller and Auditor General of India
- (f) any person who has acquired such education qualifications as the Board may, prescribe for this purpose. Rule 51 prescribes the concerned educational qualifications as follows:
A degree in Commerce or Law conferred by any of the following Universities:
 - (i) Indian Universities: Any Indian University incorporated by any law for the time being in force.
 - (ii) Rangoon University
 - (iii) English and Welsh Universities: The Universities of Birmingham, Bristol, Cambridge, Durham, Leeds, Liverpool, London, Manchester, Oxford, Reading, Sheffield and Wales
 - (iv) Scottish Universities: The Universities of Aberdeen, Edinburgh, Glasgow and St. Andrews
 - (v) Irish Universities: The Universities of Dublin (Trinity College), the Queen's University, Belfast and the National University of Dublin
 - (vi) Pakistan Universities: Any Pakistan University incorporated by any law for the time being in force.
- 3. The following persons shall not be qualified to represent an assessee:
 - (i) A person who has been dismissed or removed from government service after the first day of April 1938. In this case, he will be disqualified for all times.
 - (ii) A person who has been convicted of an offence connected with any income-tax proceeding or on whom a penalty has been imposed under this Act other than a penalty imposed on him under section 271(10)(ii) - In this case, the person will be disqualified for such time as the Chief Commissioner or the Commissioner may, by order, determine.
 - (iii) A person has become insolvent - In this case, he will be disqualified for a period during which the insolvency continues.
- 4. If any person is a legal practitioner or an accountant and is found guilty of misconduct in his professional capacity by any authority entitled to institute disciplinary proceedings against him, an order passed by that authority shall have effect in relation to his right to attend before an income-tax authority as it has in relation to his right to practice as a legal practitioner or accountant.
- 5. If a person is not a legal practitioner or an accountant and is found guilty of misconduct in connection with any income-tax proceedings by the prescribed authority, the prescribed authority, may direct that he shall thenceforth be disqualified to assessee.
- 6. Before any order or direction of disqualification under sub-section 4(b) or 5(b) is made, the following conditions must be satisfied :
 - (a) No such order or direction shall be made in respect of any person unless he has been given a reasonable opportunity of being heard
 - (b) any person against whom any such order or direction is made, may within one month of

the making of the order or direction, may appeal to the Board to have the order or direction cancelled

- (c) No such order or direction shall take effect until the distraint of one month from the making thereof or where an appeal has been preferred until the disposal of the appeal.
- 7. A person disqualified to represent an assessee under Indian Income-tax Act, 1922 shall stand disqualified under this Act also.

27.14 Rounding off of income, tax etc. [Sections 288A & 288B]

The total income of any assessee shall be rounded off to the nearest ten rupees.

Further, any amount payable, and the amount of refund due, under the provisions of the Income-tax Act, 1961, shall be rounded off to the nearest multiple of ten rupees. For this purpose, any part of a rupee consisting of paise shall be ignored. Thereafter, if such amount is not a multiple of ten, then, if the last figure in that amount is five or more, the amount shall be increased to the next higher amount which is a multiple of ten and if the last figure is less than five, the amount shall be reduced to the next lower amount which is a multiple of ten.

27.15 Receipt [Section 289]

The Department or the person or authority receiving any money paid by or recovered from the assessee or any other person shall issue a receipt for the same.

27.16 Indemnity [Section 290]

Every person deducting, retaining or paying any tax in pursuance of this Act in respect of income belonging to another person is entitled to be indemnified for the deduction, retention or payment thereof.

27.17 Power to tender immunity from prosecution [Section 291]

The Central Government is empowered by section 291 to tender any person immunity from prosecution for any offence under this Act if it is of the opinion that it is necessary or expedient in the public interest to do so for the purpose of obtaining the evidence directly or indirectly concerned in or privy to the concealment of the income or to the evasion of payment to tax on any income taxable under the Act. A tender of immunity made to or accepted by the person concerned shall, to that extent, render him immune from prosecution for any offence in respect of which tender was made or from the imposition of any penalty under the Act.

27.18 Cognizance of offences and bar of suits in Civil Courts [Sections 292 and 293]

No suit can be brought in any Civil Court to set aside or modify any order and no prosecution, suit or other proceedings shall lie against any Government Officer for any thing done or intended to be done by him in good faith under the Act. No Court inferior to that of a Presidency Magistrate or a Magistrate of the first class shall try any offence under this Act.

27.19 Certain laws not to apply [Section 292A]

This section provides that the provisions of section 360 of the Code of Criminal Procedure, 1973 or the Probation of Offenders Act, 1958 shall not be applicable to any person who is convicted of an offence under the Income tax Act, 1961 unless that person is under 18 years of age.

27.20 Return of income etc. not to become invalid [Section 292B]

Section 292B provides that no return of income, order of assessment, notice, summons or other proceedings furnished or made or taken or purported to have been furnished or made in pursuance of any of the provisions of the Income-tax Act, 1961 shall be invalid or shall be deemed to be invalid merely by reason of any mistake, defect or omission in such return of income, assessment, notice, summons or other proceeding, if they are in substance and effect in conformity with or according to the intent and purposes of the Income-tax Act, 1961. The provision, thus, enables tax authorities to accept returns and other documents and tax payers to accept orders, notice, etc., received from tax authorities even in cases where there are a few typographical, arithmetical or other mistakes which do not materially affect the objects with which the document was submitted by the assessee or order was issued by the department [Refer also to section 139(9)].

27.21 Notice deemed to be valid in certain circumstances [Section 292BB]

This section provides that the assessee would be precluded from raising any objection in any proceeding or inquiry that the notice was not served upon him or was not served in time or was served in an improper manner if he had appeared in any proceedings or co-operated in any enquiry relating to assessment or re-assessment.

In short, if the assessee had appeared in any proceedings or co-operated in any enquiry, it shall be deemed that any notice required to be served on him has been duly served upon him in time in accordance with the provisions of the Act. However, such deeming provision would not apply where the assessee has raised an objection (regarding non-service of notice or non-service of notice in time or improper service of notice) before the completion of such assessment or reassessment.

27.22 Presumption as to assets, books of account, etc. [Section 292C]

- (i) Under section 132(4A), it is provided that the books of account, money, bullion, jewellery or other valuable article or thing found in the possession or control of any person in the course of a search under section 132 will be presumed to belong to the said person.
- (ii) It is further provided that it will be presumed that -
 - (1) the contents of such books of account and other documents are true; and
 - (2) the signature and every other part of such books of account and other documents which purport to be in handwriting of any particular person or which may reasonably be

assumed to have been signed by, or to be in the handwriting of, any particular person, are in that person's handwriting, and

- (3) in the case of a document stamped, executed or attested, that it was duly stamped and executed or attested by the person by whom it purports to have been so executed or attested.
- (iii) The Supreme Court, in *P.R. Metrani v. CIT (2006) 287 ITR 209*, held that the aforesaid presumption is not available for framing regular assessment and such presumption is available only in regard to the proceedings for search and seizure under section 132. However, this decision did not reflect the correct intent of law.
- (iv) Therefore, section 292C was inserted to clarify that presumptions provided in section 132(4A) can be made in any proceeding under this Act.
- (v) This section provides that where any books of account, other documents, money, bullion, jewellery or other valuable article or thing are or is found in the possession or control of any person in the course of a search under section 132 or survey under section 133A, it may, in any proceeding under this Act, be presumed that -
 - (1) such books of account, other documents, money, bullion, jewellery or other valuable article or thing belong or belongs to such person;
 - (2) the contents of such books of account and other documents are true; and
 - (3) the signature and every other part of such books of account and other documents which purport to be in the handwriting of any particular person or which may reasonably be assumed to have been signed by, or to be in the handwriting of, any particular person, are in that person's handwriting;
 - (4) In the case of a document stamped, executed or attested, that it was duly stamped and executed or attested by the person by whom it purports to have been so executed or attested.
- (vi) Further, this presumption has also been extended to books of account, other documents or assets which have been delivered to the requisitioning officer in accordance with the provisions of section 132A. For this purpose, sub-section (2) provides that where any books of accounts, other documents or assets have been delivered to the requisitioning officer in accordance with the provision of section 132A then, the presumption would apply as if such books of accounts, other documents or assets which had been taken into custody from the person referred to in clause (a) or clause (b) or clause(c), as the case may be, of sub- section (1) of section 132A, had been found in the possession or control of that person in the course of a search under section 132.

27.23 Concessions for encouraging participation in the business of prospecting for, extraction etc., of mineral oils [Section 293A]

With a view to encouraging the foreign companies to participate in the business of oil exploration and production, the Central Government is empowered under Section 293A to make, by a notification in the Official Gazette, an exemption, reduction in rate or other

modification in respect of income-tax in favour of any class of persons specified below, if it considers it necessary or expedient so to do in the public interest namely:

- (i) persons with whom the Central Government have entered into agreement for the association or participation of that Government or any person authorised by that Government in any business consisting of prospecting for, or extraction or production of minerals oils;
- (ii) persons providing any services or facilities or supplying any ship, aircraft, machinery or plant (whether by way of sale or hire) in connection with any business consisting of the prospecting for or extraction or production of mineral oils carried on by that Government or any person specified by it in this behalf by notification in the Official Gazette.

The Central Government also has the power to make a modification in regard to the status in which the aforesaid class of persons or members thereof are to be assessed on their income from the said business. The term 'status' has been explained to mean the category under which the assessee is assessed as 'individual', 'Hindu undivided family' and so on.

27.24 Authority empowered to grant an approval under the Income-tax Act, 1961 deemed to have power to withdraw the approval granted [Section 293C]

- (i) The Central Government, CBDT and income-tax Authorities are empowered under the various provisions of the Income-tax Act to grant approval to the assessee for availing the benefit of incentives available under the Act.
- (ii) However, only some provisions of the Income-tax Act, 1961 specifically contain provisions for withdrawal of approval. In all other cases, there is no specific power to withdraw the approval granted.
- (iii) Therefore, section 293C provides explicitly, such power to withdraw an approval granted. This section provides that an approval granting authority (i.e. the Central Government, CBDT or income-tax authority, as the case may be) shall also have the powers to withdraw the approval at any time.
- (iv) However, such withdrawal can be made only after giving a reasonable opportunity to the concerned assessee of showing cause against the proposed withdrawal. Further, the reasons for withdrawal of the approval should be recorded by the concerned authority.

27.25 Act to have effect pending legislative provision for charge of tax [Section 294]

If on the 1st April in any assessment year, provision has not yet been made by a Central Act for the charging of income-tax for that assessment year, this Act shall nevertheless have effect until such provision is so made as if the provision in force in the preceding assessment year or the provision proposed in the Bill then before Parliament, whichever is more favourable to the assessee, were actually in force.

27.26 Rules [Sections 295 and 296]

Section 295 authorises the CBDT to make rules for the whole or any part of India for carrying out the purposes and to implement the provisions of the Act. The powers of the Board in this regard are subject to the supervision and control of the Central Government. The Rules framed by the Board and approved by the Central Government are required to be placed before each House of the Parliament before enforcing the same. In exercise of the powers conferred on it by this section, the Board, with the approval and sanction of the Central Government and the Parliament, has framed the Income-tax Rules, 1962 which have been amended from time to time. This section also enumerates the important matters on which rules may be framed by the Board: the rules framed under this Act have the same force of the section of the Act. The rules must be interpreted in the light of the sections under which they have been made. But the rules should be so framed as not to adversely affect or derogate from the full operative effect of the provisions of the sections. The rules must be within the term of the mandate given to the Board and must be framed in such a way as to be consistent with and supplementary to the provisions of the Act.

27.27 Schedules to the Income-tax Act, 1961

There are fourteen Schedules to the Income-tax Act, 1961. Briefly they deal with the following matters:

Schedule I	Method of computing profits and gains of Insurance business Section 44
Schedule II	Procedure for Recovery of Tax - Sections 222 and 276.
Schedule III	Procedure for distraint by Assessing Officer or Tax Recovery Officer - Section 226(5)
Schedule IV	Recognised Provident Funds, approved superannuation funds and approved gratuity funds - Sections 2(38), 10(12), 10(25), 36(1)(iv), 87(1)(d), 111, 192(4).
Schedule VII	Containing a list of minerals and group of associated minerals in the context of section 35E.
Schedule VIII	List of Industrially backward States and Union Territories – Section 80IA(2)(iv)(b)
Schedule XIII	List of articles or things which an undertaking or enterprise should not manufacture or produce in the context of section 80-IC(2)(a)
Schedule XIV	List of articles or things which an undertaking or enterprise should manufacture or produce and list of operations which an undertaking or enterprise should commence in the context of section 80-IC(2)(b).

Note – Only the schedules currently relevant have been listed above.

Deduction, Collection and Recovery of Tax

28.1 Deduction and Collection of Tax at Source and Advance Payment [Section 190]

The total income of an assessee for the previous year is taxable in the relevant assessment year. For example, the total income for the P.Y.2013-14 is taxable in the A.Y.2014-15. However, the income-tax is recovered from the assessee in the previous year itself through –

- (1) Tax deduction at source (TDS)
- (2) Tax collection at source (TCS)
- (3) Payment of advance tax

Another mode of recovery of tax is from the employer through tax paid by him under section 192(1A) on the non-monetary perquisites provided to the employee.

These taxes are deductible from the total tax due from the assessee. The assessee, while filing his return of income, has to pay self-assessment tax under section 140A, if tax is due on the total income as per his return of income after adjusting, inter-alia, TDS and advance tax.

28.2 Direct Payment [Section 191]

Section 191 provides that in the following cases, tax is payable by the assessee directly –

- (1) in the case of income in respect of which tax is not required to be deducted at source; and
- (2) income in respect of which tax is liable to be deducted but is not actually deducted.

In view of these provisions of section 191, the proceedings for recovery of tax necessarily had to be taken against the assessee whose tax was liable to be deducted, but not deducted.

In order to overcome this difficulty, the Explanation to this section provides that if –

- (1) any person, including the principal officer of the company, who is required to deduct tax at source or
- (2) an employer paying tax on non-monetary perquisites under section 192(1A),

does not deduct the whole or part of the tax, or after deducting fails to pay such tax deducted, then such person shall be deemed to be an assessee in default.

However, if the assessee himself has paid the tax, this provision will not apply.

28.3 Deduction of Tax at Source

28.3.1 Salary [Section 192]

- (1) This section casts an obligation on every person responsible for paying any income chargeable to tax under the head 'Salaries' to deduct income-tax on the amount payable.
- (2) Such income-tax has to be calculated at the average rate of income-tax computed on the basis of the rates in force for the relevant financial year in which the payment is made, on the estimated total income of the assessee. Therefore, the liability to deduct tax at source in the case of salaries arises only at the time of payment.
- (3) Average rate of income-tax means the rate arrived at by dividing the amount of income-tax calculated on the total income, by such total income.
- (4) However, deduction at a rate lower than that prescribed may be made if a certificate has been obtained under section 197 from the Assessing Officer.
- (5) Every year, the CBDT issues a circular giving details and direction to all employers for the purpose of deduction of tax from salaries payable to the employees during the relevant financial year. These instructions should be followed.
- (6) The concept of payment of tax on non-monetary perquisites has been provided in sections 192(1A) and (1B). These sections provide that the employer may pay this tax, at his option, in lieu of deduction of tax at source from salary payable to the employee. Such tax will have to be worked out at the average rate applicable to aggregate salary income of the employee and payment of tax will have to be made every month along with tax deducted at source on monetary payment of salary, allowances etc.
- (7) Time and mode of payment to Government account of TDS or tax paid under section 192(1A) [Rule 30]
 - (a) All sums deducted in accordance with Chapter XVII-B by an office of the Government shall be paid to the credit of the Central Government on the same day where the tax is paid without production of an income-tax challan and on or before seven days from the end of the month in which the deduction is made or income-tax is due under section 192(1A), where tax is paid accompanied by an income-tax challan.
 - (b) All sums deducted in accordance with Chapter XVII-B by deductors other than a Government office shall be paid to the credit of the Central Government on or before 30th April, where the income or amount is credited or paid in the month of March. In any other case, the tax deducted should be paid on or before seven days from the end of the month in which the deduction is made or income-tax is due under section 192(1A).
 - (c) In special cases, the Assessing Officer may, with the prior approval of the Joint Commissioner, permit quarterly payment of the tax deducted under section 192/194A/194D/194H on or before 7th of the month following the quarter, in respect of first three quarters in the financial year and 30th April in respect of the quarter ending on 31st March. The dates for quarterly payment would, therefore, be 7th July, 7th October, 7th January and 30th April, for the quarters ended 30th June, 30th September, 31st December and 31st March, respectively.

(8) In cases where an assessee is simultaneously employed under more than one employer or the assessee takes up a job with another employer during the financial year after his resignation or retirement from the services of the former employer, he may furnish the details of the income under the head "Salaries" due or received by him from the other employer, the tax deducted therefrom and such other particulars to his current employer. Thereupon, the subsequent employer should take such information into consideration and then deduct the tax remaining payable in respect of the employee's remuneration from both the employers put together for the relevant financial year.

(9) For purposes of deduction of tax out of salaries payable in a foreign currency, the value of salaries in terms of rupees should be calculated at the prescribed rate of exchange as specified in Rule 26 of the Income-tax Rules, 1962.

(10) In respect of salary payments to employees of Government or to employees of companies, co-operative societies, local authorities, universities, institutions, associations or bodies, deduction of tax at source should be made after allowing relief under section 89(1), where eligible.

(11) A tax payer having salary income in addition to other income chargeable to tax for that financial year, may send to the employer, the following:

- (i) particulars of such other income;
- (ii) particulars of any tax deducted under any other provision;
- (iii) loss, if any, under the head 'Income from house property'.

The employer shall take the above particulars into account while calculating tax deductible at source.

It is also provided that except in cases where loss from house property has been adjusted against salary income, the tax deductible from salary should not be reduced as a consequence of making the above adjustments.

(12) Sub-section (2C) provides that the employer shall furnish to the employee, a statement giving correct and complete particulars of perquisites or profits in lieu of salary provided to him and the value thereof. The statement shall be in the prescribed form (Form 12BA) and manner. This requirement is applicable only where the salary paid/payable to an employee exceeds ₹ 1,50,000. For other employees, the particulars of perquisites/profits in lieu of salary shall be given in Form 16 itself.

28.3.2 Interest on securities [Section 193]

(1) This section casts responsibility on every person responsible for paying to a resident any income by way of interest on securities.

(2) Such person is vested with the responsibility to deduct income-tax at the rates in force from the amount of interest payable.

The rate at which tax is deductible under section 193 is 10%, both in the case of domestic companies and resident non-corporate assesseees.

(3) Tax should be deducted at the time of credit of such income to the account of the payee

or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

- (4) However, no tax deduction is to be made from any interest payable:
 - (i) on 4¼% National Defence Bonds 1972, where the bonds are held by an individual not being a non-resident;
 - (ii) on 4¼% National Defence Loan, 1968 or 4¾% National Defence Loan, 1972, where the interest is payable to an individual;
 - (iii) on National Development Bonds;
 - (iv) on 7-year National Savings Certificates (IV Issue);
 - (v) on debentures issued by any institution or authority or any public sector company or any co-operative society (including a co-operative land mortgage bank or a co-operative land development bank), as notified by the Central Government;
 - (vi) on 6½% Gold Bonds, 1977 or 7% Gold Bonds, 1980, where the bonds are held by an individual (other than a non-resident), provided that the holders of the bonds make a written declaration that the total nominal value of the bonds held by him or on his behalf did not in either case exceed ₹ 10,000 at any time during the period to which the interest relates;
 - (vii) on any security of the Central Government or a State Government;

Note – It may be noted that tax has to be deducted at source in respect of interest payable on 8% Savings (Taxable) Bonds, 2003, if such interest payable exceeds ₹ 10,000 during the financial year.
 - (viii) on any debentures (whether listed or not listed on a recognized stock exchange) issued by the company in which the public are substantially interested to a resident individual or HUF. However,
 - (a) the interest should be paid by the company by an account payee cheque;
 - (b) the amount of such interest or the aggregate thereof paid or likely to be paid during the financial year by the company to such resident individual or HUF should not exceed ₹ 5,000.
 - (ix) on securities to LIC, GIC, subsidiaries of GIC or any other insurer, provided –
 - (a) the securities are owned by them or
 - (b) they have full beneficial interest in such securities.
 - (x) on any security issued by a company, where such security is in dematerialised form and is listed on a recognised stock exchange in India in accordance with the Securities Contracts (Regulation) Act, 1956 and the rules made thereunder.
- (5) In all the above cases, the declaration shall be made by the recipient to the person responsible for paying such interest on securities.
- (6) If the person entitled to receive interest produces a certificate under section 197 from the Assessing Officer to the effect that his total income is either below the taxable limit or is liable to income-tax at a lower rate, the interest on securities shall be paid without any deduction of tax or after deduction of tax at such lower rate, as the case may be.

(7) Where any income by way of interest on securities is credited to any account in the books of account of the person liable to pay such income, such crediting is deemed to be credit of such income to the account of the payee and tax has to be deducted at source.

(8) The account to which such interest is credited may be called "Interest Payable account" or "Suspense account" or by any other name.

28.3.3 Dividends [Section 194]

(1) Dividends declared, distributed or paid by a domestic company are exempt in the hands of the shareholder under section 10(34). This includes deemed dividend under sections 2(22)(a) to (d). This is because such dividend attracts dividend distribution tax @ 15% in the hands of the company.

(2) The TDS provisions under this section are attracted only in respect of deemed dividend referred to in section 2(22)(e), if such dividend exceeds ₹ 2,500 in a year.

(3) The rate of deduction of tax in respect of such dividend is 10%.

(4) Individual shareholders, who are residents in India are entitled to receive their dividends from any domestic company without deduction of tax at source by the company in cases where -

- (i) the amount of dividend income received from the company does not exceed ₹ 2500 during the year; and
- (ii) the dividend is paid by an account payee cheque.

The TDS provisions will not apply to dividend receivable by LIC, GIC, its subsidiaries or any other insurer provided the shares are owned by them, or they have full beneficial interest in such shares.

28.3.4 Interest other than interest on securities [Section 194A]: This section deals with the scheme of deduction of tax at source from interest other than interest on securities. The main provisions are the following:

(1) This section applies only to interest, other than "interest on securities", credited or paid by assessee other than individuals or Hindu undivided families not subject to tax audit under section 44AB in the immediately preceding financial year. In other words, individuals and HUFs subject to tax audit in the immediately preceding financial year, companies, firms, association of persons, local authorities and artificial juridical persons are under a legal obligation to deduct tax at source in respect of the interest other than "interest on securities" paid by them.

(2) These provisions apply only to interest paid or credited to residents. In respect of payments to non-residents, the provisions are contained under section 195.

(3) The deduction of tax must be made at the time of crediting such interest to the payee or at the time of its payment in cash or by any other mode, whichever is earlier.

(4) Where any such interest is credited to any account in the books of account of the person liable to pay such income, such crediting is deemed to be credit of such income to the account of the payee and the tax has to be deducted at source.

(5) The account to which such interest is credited may be called "Interest Payable account" or "Suspense account" or by any other name.

The CBDT has, vide *Circular No.3/2010 dated 2.3.2010*, given a clarification regarding deduction of tax at source on payment of interest on time deposits under section 194A by banks following Core-branch Banking Solutions (CBS) software. It has been clarified that *Explanation* to section 194A is not meant to apply in cases of banks where credit is made to provisioning account on daily/monthly basis for the purpose of macro monitoring only by the use of CBS software. It has been further clarified that since no constructive credit to the depositor's / payee's account takes place while calculating interest on time deposits on daily or monthly basis in the CBS software used by banks, tax need not be deducted at source on such provisioning of interest by banks for the purposes of macro monitoring only. In such cases, tax shall be deducted at source on accrual of interest at the end of financial year or at periodic intervals as per practice of the bank or as per the depositor's / payee's requirement or on maturity or on encashment of time deposits, whichever event takes place earlier, whenever the aggregate of amounts of interest income credited or paid or likely to be credited or paid during the financial year by the banks exceeds the limits specified in section 194A.

(6) The deduction of tax at source is to be made in all cases where the amount of income by way of interest or, as the case may be, the aggregate of the amounts of interest credited or paid or likely to be credited or paid during the financial year to the account of or to the payee or any other person on his behalf is more than ₹ 5,000.

(7) The rate at which the deduction is to be made are given in Part II of the First Schedule to the Annual Finance Act. The rate at which tax is to be deducted is 10% both in the case of resident non-corporate assesseees and domestic companies.

(8) No deduction of tax shall be made in the following cases:

(a) If the aggregate amount of interest paid or credited during the financial year does not exceed ₹ 5,000.

This limit is increased to ₹ 10,000 in respect of interest paid on –

- (i) time deposits with a banking company;
- (ii) time deposits with a co-operative society engaged in banking business; and
- (iii) deposits with post office under notified schemes.

In all other cases, the limit would continue to be ₹ 5,000.

The limit will be calculated with respect to income credited or paid by a branch of a bank or a co-operative society or a public company in case of:

- (i) time deposits with a bank
- (ii) time deposits with a co-operative society carrying on the business of banking; and
- (iii) deposits with housing finance companies, provided:
 - they are public companies formed and registered in India
 - their main object is to carry on the business of providing long-term finance for construction or purchase of houses in India for residential purposes.

The above ceiling will operate:

- (i) on a branch of a bank;
- (ii) with reference to only time deposits.

Hence, the interest on all other types of account such as savings account, recurring deposits etc., payable by a branch will have to be excluded to determine whether the interest exceeds ₹ 10,000 or not. However, in respect of time deposits, interest on all such time deposits maintained with a branch has to be aggregated.

- (b) Interest paid or credited by a firm to any of its partners;
- (c) Interest paid or credited by a co-operative society to a member thereof or any other co-operative society;
- (d) Interest paid or credited in respect of deposits under any scheme framed by the Central Government and notified by it in this behalf;
- (e) Interest income credited or paid in respect of deposits (other than time deposits made on or after 1.7.1995) with
 - (i) a bank to which the Banking Regulation Act, 1949 applies; or
 - (ii) a co-operative society engaged in carrying on the business of banking.
- (f) Interest credited or paid in respect of deposits with primary agricultural credit society or a primary credit society or a co-operative land mortgage bank or a co-operative land development bank.
- (g) Interest income credited or paid by the Central Government under any provisions of the Income-tax Act, 1961, the Estate Duty Act, the Wealth-tax Act, 1957, the Gift-tax Act, the Companies (Profits) Surtax Act or the Interest Tax Act.
- (h) Interest paid or credited to the following entities:
 - (1) banking companies, or co-operative societies engaged in the business of banking, including co-operative land mortgage banks;
 - (2) financial corporations established under any Central, State or Provincial Act.
 - (3) the Life Insurance Corporation of India.
 - (4) companies and co-operative societies carrying on the business of insurance.
 - (5) the Unit Trust of India; and
 - (6) notified institution, association, body or class of institutions, associations or bodies.
(National Skill Development Fund has been notified by the Central Government for this purpose)
- (i) income credited or paid by way of interest on the compensation amount awarded by the Motor Accidents Claims Tribunal where the amount of such income or, as the case may be, the aggregate of the amounts of such income credited or paid during the financial year does not exceed ₹ 50,000.

- (j) income paid or payable by an infrastructure capital company or infrastructure capital fund or public sector company in relation to a zero coupon bond issued on or after 1.6.2005 [Refer Chapter 1 for definitions of "infrastructure capital company" and "infrastructure capital fund" as per sections 2(26A) and 2(26B), respectively].
- (9) The expression "time deposits" [for the purpose of (8)(a) above] means the deposits, excluding recurring deposits, repayable on the expiry of fixed periods.
- (10) The time for making the payment of tax deducted at source would reckon from the date of credit of interest made constructively to the account of the payee.

28.3.5 Winnings from lotteries, crossword puzzles and horse races [Sections 194B and 194BB]

- (1) Any income of a casual and non-recurring nature of the type of winnings from lotteries, crossword puzzles, card game and other game of any sort, races including horse races, etc. will be charged to income-tax at a flat rate of 30% [Section 115BB].
- (2) According to the provisions of section 194B, every person responsible for paying to any person, whether resident or non-resident, any income by way of winnings from lottery or crossword puzzle or card game and other game of any sort, is required to deduct income-tax therefrom at the rate of 30% if the amount of payment exceeds ₹ 10,000.
- (3) Further, in a case where the winnings are wholly in kind or partly in cash and partly in kind but the part in cash is not sufficient to meet the liability of deduction of tax in respect of whole of the winnings, the person responsible for paying shall, before releasing the winnings, ensure that tax has been paid in respect of the winnings.
- (4) Section 194BB casts responsibility on the following persons to deduct tax at source -
 - (i) a bookmaker; or
 - (ii) a person to whom a license has been granted by the Government under any law for the time being in force -
 - (a) for horse racing in any race course; or
 - (b) for arranging for wagering or betting in any race course.
- (5) The obligation to deduct tax at source under section 194BB arises when the abovementioned persons make payment of any income by way of winnings from any horse race in excess of ₹ 5,000. The rate applicable for deduction of tax at source is 30%.
- (6) Tax will have to be deducted at source from winnings from horse races even though the winnings may be paid to the person concerned in installments of less than ₹ 5,000. Similarly, in cases where the book-maker or other person responsible for paying the winnings, credits such winnings and debits the losses to the individual account of the punter, the set off of the loss against the income would be treated for this purpose as a constructive payment of the income.
- (7) In the context of the provisions of section 194BB, the expression 'any horse race' used therein must be taken to include, wherever the circumstances so necessitate, more than one horse race. Therefore, winnings by way of jack pot would also fall within the scope of section 194BB.

28.3.6 Payments to contractors and sub-contractors [Section 194C]

(1) Section 194C provides for deduction of tax at source from the payment made to resident contractors and sub-contractors.

(2) Any person responsible for paying any sum to a resident contractor for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract between the contractor and the Central Government, a State Government, local authority, statutory corporation, a company, co-operative society, any statutory authority dealing with housing accommodation, any society registered under the Societies Registration Act, 1860, any trust or any university or any firm or any Government of a foreign State or foreign enterprise or any association or body established outside India or an individual, HUF, AOP or BOI subject to tax audit under section 44AB in the immediately preceding financial year must deduct income-tax at the prescribed rate from such sum at the time of credit or payment, whichever is earlier.

Payments made by Individuals, HUFs, AOPs and BOIs to a contractor would attract TDS if their total sales/turnover exceeds ₹ 100 lakh (in case of business) and gross receipts exceed ₹ 25 lakh (in case of profession) in the immediately preceding financial year. However, relief has been provided in respect of payments made by individuals/HUFs to a contractor exclusively for personal purposes.

(3) The rate of TDS under section 194C on payments to contractors would be 1%, where the payee is an individual or HUF and 2% in respect of other payees. The same rates of TDS would apply for both contractors and sub-contractors.

(4) Further, in respect of payment to transport contractors and sub-contractors engaged in the business of plying, leasing and hiring goods carriages, TDS provisions would not apply if they furnish their PAN to the deductor.

(5) The applicable rates of TDS under section 194C are as follows –

Payee	TDS rate
Individual / HUF contractor/sub-contractor	1%
Other than individual / HUF contractor/sub-contractor	2%
Contractor in transport business (if PAN is furnished)	Nil
Sub-contractor in transport business (if PAN is furnished)	Nil

(6) No deduction will be required to be made if the consideration for the contract does not exceed ₹ 30,000. However, to prevent the practice of composite contracts being split up into contracts valued at less than ₹ 30,000 to avoid tax deduction, it has been provided that tax will be required to be deducted at source where the amount credited or paid or likely to be credited or paid to a contractor or sub-contractor exceeds ₹ 30,000 in a single payment or ₹ 75,000 in the aggregate during a financial year.

Therefore, even if a single payment to a contractor does not exceed ₹ 30,000, TDS provisions under section 194C would be attracted where the aggregate of the amounts of such sums credited or paid or likely to be credited or paid to the contractor during the financial year exceeds ₹ 75,000.

Illustration 1

ABC Ltd. makes the following payments to Mr. X, a contractor, for contract work during the P.Y.2013-14 –

₹ 15,000 on 1.5.2013

₹ 25,000 on 1.8.2013

₹ 30,000 on 1.12.2013

On 1.3.2014, a payment of ₹ 28,000 is due to Mr.X on account of a contract work.

Discuss whether ABC Ltd. is liable to deduct tax at source under section 194C from payments made to Mr.X.

Solution

In this case, the individual contract payments made to Mr. X does not exceed ₹ 30,000. However, since the aggregate amount paid to Mr. X during the P.Y.2013-14 exceeds ₹ 75,000 (on account of the last payment of ₹ 28,000, due on 1.3.2014, taking the total from ₹ 70,000 to ₹ 98,000), the TDS provisions under section 194C would get attracted. Tax has to be deducted@1% on the entire amount of 98,000 from the last payment of ₹ 28,000 and the balance of ₹ 27,020 (i.e. ₹ 28,000 – ₹ 980) has to be paid to Mr. X.

(7) Work includes –

- (a) advertising;
- (b) broadcasting and telecasting including production of programmes for such broadcasting or telecasting;
- (c) carriage of goods or passengers by any mode of transport other than by railways;
- (d) catering;
- (e) manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer.

However, “work” shall not include manufacturing or supplying a product according to the requirement or specification of a customer by using raw material purchased from a person, other than such customer, as such a contract is a contract for ‘sale’. However, this will not be applicable to a contract which does not entail manufacture or supply of an article or thing (e.g. a construction contract).

It may be noted that the term “work” would include manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer. In such a case, tax shall be deducted on the invoice value excluding the value of material purchased from such customer if such value is mentioned separately in the invoice. Where the material component has not been separately mentioned in the invoice, tax shall be deducted on the whole of the invoice value.

(8) No deduction is required to be made from the sum credited or paid or likely to be credited or paid during the previous year to the account of a contractor, during the course of the

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business of plying, hiring or leasing goods carriages, if he furnishes his PAN to the deductor.

(9) However, for this purpose, it is necessary to produce a declaration within the prescribed time to the concerned person paying or crediting such sum. Such declaration should be in the prescribed form and manner.

(10) Goods carriage means -

- (i) any motor vehicle constructed or adapted for use solely for the carriage of goods; or
- (ii) any motor vehicle not so constructed or adapted, when used for the carriage of goods.

The term "motor vehicle" does not include vehicles having less than four wheels and with engine capacity not exceeding 25cc as well as vehicles running on rails or vehicles adapted for use in a factory or in enclosed premises.

(11) The substance of the provisions is explained hereunder:

- (i) The deduction of income-tax at source from payments made to non-resident contractors will be governed by the provisions of section 195.
- (ii) The deduction of income-tax will be made from sums paid for carrying out any work or for supplying labour for carrying out any work. In other words, the section will apply only in relation to 'works contracts' and 'labour contracts' and will not cover contracts for sale of goods.
- (iii) Contracts for rendering professional services by lawyers, physicians, surgeons, engineers, accountants, architects, consultants etc., cannot be regarded as contracts for carrying out any "work" and, accordingly, no deduction of income-tax is to be made from payments relating to such contracts under this section. Separate provisions for fees for professional services have been made under section 194J.
- (iv) The deduction of income-tax must be made at the time of credit of the sum to the account of the contractor, or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

(12) **Deduction of tax at source on payment of gas transportation charges by the purchaser of natural gas to the seller of gas [Circular No. 9/2012 dated 17.10.2012]**

In response to the representations received by CBDT, on the difficulties being faced in the matter of tax deduction at source on Gas Transportation Charges paid by the purchasers of Natural gas to the owners/sellers of gas, CBDT has, through this Circular, clarified that in case the Owner/Seller of the gas sells as well as transports the gas to the purchaser till the point of delivery, where the ownership of gas to the purchaser is simultaneously transferred, the manner of raising the sale bill (whether the transportation charges are embedded in the cost of gas or shown separately) does not alter the basic nature of such contract which remains essentially a 'contract for sale' and not a 'works contract' as envisaged in Section 194C. Therefore, in such circumstances, the provisions of Chapter XVIIIB are not applicable on the component of Gas Transportation Charges paid by the purchaser to the Owner/Seller of the gas. Further, the use of different modes of transportation of gas by Owner/Seller will not alter the position.

However, transportation charges paid to a third party transporter of gas, either by the Owner/Seller of the gas or purchaser of the gas or any other person, shall continue to be governed by the appropriate provisions of the Act and tax shall be deductible at source on such payment to the third party at the applicable rates.

28.3.7 Insurance Commission [Section 194D]

- (1) Section 194D casts responsibility on any person responsible for paying to a resident any income by way of remuneration or reward.
- (2) Such income may be by way of insurance commission or other remuneration in consideration for soliciting or procuring insurance business (including the business relating to the continuance, renewal or revival of policies of insurance).
- (3) Such person is required to deduct income-tax at the rate of 10%, both in the case of resident non-corporate assessees and domestic companies.
- (4) The deduction is to be made at the time of the credit of the income to the account of the payee or at the time of making the payment (by whatever mode) to the payee, whichever is earlier.
- (5) The tax under this section has to be deducted at source only if the amount of such income or the aggregate of the amounts of such income credited or paid during the financial year to the account of the payee exceeds ₹ 20,000.

28.3.8 Payments to non-resident sportsmen or sports association [Section 194E]

- (1) This section provides for deduction of tax at source in respect of any income referred to in section 115BBA payable to a non-resident sportsman (including an athlete) or an entertainer who is not a citizen of India or a non-resident sports association or institution.
- (2) Deduction of tax at source @20% should be made by the person responsible for making the payment.
- (3) Such tax deduction should be at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.
- (4) The following are the income referred to in section 115BBA -
 - (i) income received or receivable by a non-resident sportsman (including an athlete) by way of -
 - (a) participation in any game or sport in India (However, games like crossword puzzles, horse races etc. taxable under section 115BB are not included herein); or
 - (b) advertisement; or
 - (c) contribution of articles relating to any game or sport in India in newspapers, magazines or journals.
 - (ii) Guarantee amount paid or payable to a non-resident sports association or institution in relation to any game or sport played in India. However, games like crossword puzzles, horse races etc. taxable under section 115BB are not included herein.

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- (iii) income received or receivable by a non-resident entertainer (who is not a citizen of India) from his performance in India.

28.3.9 Payments in respect of deposits under National Savings Scheme etc. [Section 194EE]

- (1) The person responsible for paying any amount from National Savings Scheme Account under section 80CCA shall deduct income-tax thereon at the rate of 20% at the time of payment.
- (2) However, no such deduction shall be made where the amount of payment or the aggregate amount of payments in a financial year is less than ₹ 2,500.
- (3) The provisions of this section shall not apply to the payments made to the heirs of the assessee.

28.3.10 Repurchase of units by Mutual Fund or Unit Trust of India [Section 194F]

A person responsible for paying to any person any amount on account of repurchase of units covered under section 80CCB(2) shall deduct tax at source at the rate of 20% at the time of payment of such amount.

28.3.11 Commission etc. on the sale of lottery tickets [Section 194G]

- (1) Under section 194G, the person responsible for paying any income by way of commission, remuneration or prize (by whatever name called) on lottery tickets in an amount exceeding ₹ 1,000 shall deduct income-tax thereon at the rate of 10%.
- (2) Such deduction should be made at the time of credit of such income to the account of the payee or at the time of payment of such income by cash, cheque, draft or any other mode, whichever is earlier.
- (3) Where any such income is credited to any account, whether called "Suspense Account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section shall apply accordingly.

28.3.12 Commission or brokerage [Section 194H]

- (1) Any person, not being an individual or a Hindu undivided family not subject to tax audit under section 44AB in the immediately preceding financial year, who is responsible for paying any income by way of commission (other than insurance commission) or brokerage to a resident shall deduct income tax at the rate of 10%.
- (2) The deduction shall be made at the time such income is credited to the account of the payee or at the time of payment in cash or by issue of cheque or draft or by any other mode, whichever is earlier.
- (3) Even where income is credited to some other account, whether called "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit to the account of the payee for the purposes of this section.
- (4) No deduction is required if the amount of such income or the aggregate of such amount

does not exceed ₹ 5,000 during the financial year.

(5) "Commission or brokerage" includes any payment received or receivable, directly or indirectly, by a person acting on behalf of another person for services rendered, or for any services in the course of buying or selling of goods, or in relation to any transaction relating to any asset, valuable article or thing, other than securities.

(6) However, this section is not applicable to professional services. "Professional Services" means services rendered by a person in the course of carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or such other profession as notified by the CBDT for the purpose of compulsory maintenance of books of account under section 44AA.

(7) Further, there would be no requirement to deduct tax at source on commission or brokerage payments by BSNL or MTNL to their public call office (PCO) franchisees.

28.3.13 Rent [Section 194-I]

(1) Any person, other than an individual or a HUF not subject to tax audit under section 44AB in the immediately preceding year, who is responsible for paying to a resident any income by way of rent shall deduct income tax at the rate of:

- (i) 2% in respect of rent for plant, machinery or equipment;
- (ii) 10% in respect of other rental payments (i.e., rent for use of any land or building, including factory building, or land appurtenant to a building, including factory building, or furniture or fixtures).

(2) This deduction is to be made at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of cheque or draft or by any other mode, whichever is earlier.

(3) No deduction need be made where the amount of such income or the aggregate of the amounts of such income credited or paid or likely to be credited or paid during the financial year to the account of the payee does not exceed ₹ 1,80,000.

(4) "Rent" means any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of (either separately or together) any –

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

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

(5) Where any such income is credited to any account, whether called "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section will apply accordingly.

Applicability of TDS provisions under section 194-I to payments made by the customers on account of cooling charges to the cold storage owners.

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

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

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

Applicability of TDS provisions under section 194-I to service tax component of rental income

CBDT Circular No.4/2008 dated 28.4.2008 provides clarification on deduction of tax at source (TDS) on service tax component of rental income under section 194-I.

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

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

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

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

28.3.14 Payment on transfer of certain immovable property other than agricultural land [New Section 194-IA]

(1) Under section 139A read with Rule 114B, quoting of Permanent Account Number (PAN) in documents pertaining to purchase or sale of immovable property for value of ₹5 lakh or more is mandatory.

(2) However, the information furnished in Annual Information Returns by the Registrar/Sub-Registrar reveal non-quoting or quoting of invalid PAN in the documents relating to transfer of property by a sizable number of the purchasers or sellers of immovable properties, valued at ₹30 lakh or more, during the financial year 2011-12.

(3) Chapter XVII-B of the Income-tax Act, 1961 requires tax to be deducted at source on certain specified payments made to residents by way of salary, interest, rent, commission, brokerage, fees for professional and technical services, royalty etc.

In case of transfer of immovable property by a non-resident, the TDS provisions under section 195 are attracted in the hands of the transferee. However, in case of transfer of immovable property by residents, there is no requirement to deduct tax at source, the only exception being a case of compulsory acquisition of immovable property (other than agricultural land) in respect of which tax deduction is required under section 194LA.

(4) For the twin purposes of having a reporting mechanism of transactions in the real estate sector and also collecting tax at the earliest point of time, new section 194-IA has been inserted to require every transferee responsible for paying any sum as consideration for transfer of immovable property (land, other than agricultural land, or building or part of building) to deduct tax, at the rate of 1% of such sum, at the time of credit of such sum to the account of the resident transferor or at the time of payment of such sum to a resident transferor, whichever is earlier.

(5) However, tax is not required to be deducted at source where the total amount of consideration for the transfer of immovable property is less than ₹50 lakh.

(6) Further, since tax deduction at source for compulsory acquisition of immovable property is covered under section 194LA, the provisions of section 194-IA do not get attracted in the hands of the transferee in such cases.

(7) The provisions of section 203A containing the requirement of obtaining Tax deduction account number (TAN) shall not apply to the person required to deduct tax in accordance with the provisions of section 194-IA.

Illustration 2

Mr. X sold his house property in Bangalore as well as his rural agricultural land for a consideration of ₹ 60 lakh and ₹ 15 lakh, respectively, to Mr. Y on 1.8.2013. He has purchased the house property and the land in the year 2011 for ₹ 40 lakh and ₹ 10 lakh, respectively. The stamp duty value on the date of transfer, i.e., 1.8.2013, is ₹ 85 lakh and ₹ 20 lakh for the house property and rural agricultural land, respectively. Determine the tax implications in the hands of Mr. X and Mr. Y and the TDS implications, if any, in the hands of Mr. Y, assuming that both Mr. X and Mr. Y are resident Indians.

Solution

(i)	<u>Tax implications in the hands of Mr.X</u>
	As per section 50C, the stamp duty value of house property (i.e. ₹ 85 lakh) would be deemed to be the full value of consideration arising on transfer of property. Therefore, ₹ 45 lakh (i.e., ₹ 85 lakh – ₹ 40 lakh, being the purchase price) would be taxable as short-term capital gains in the A.Y.2014-15. Since rural agricultural land is not a capital asset, the gains arising on sale of such land is not taxable in the hands of Mr. X.
(ii)	<u>Tax implications in the hands of Mr.Y</u>
	In case immovable property is received for inadequate consideration, the difference between the stamp value and actual consideration would be taxable under section 56(2)(vii), if such difference exceeds ₹ 50,000. Therefore, in this case ₹ 25 lakh (₹ 85 lakh – ₹ 60 lakh) would be taxable in the hands of Mr.Y under section 56(2)(vii). Since agricultural land is not a capital asset, the provisions of section 56(2)(vii) are not attracted in respect of receipt of agricultural land for inadequate consideration, since the definition of “property” under section 56(2)(vii) includes only capital assets specified thereunder.
(iii)	<u>TDS implications in the hands of Mr.Y</u>
	Since the sale consideration of house property exceeds ₹ 50 lakh, Mr.Y is required to deduct tax at source under section 194-IA. The tax to be deducted under section 194-IA would be ₹ 60,000, being 1% of ₹ 60 lakh. TDS provisions under section 194-IA are not attracted in respect of transfer of rural agricultural land.

28.3.15 Fees for professional or technical services [Section 194J]

(1) Every person, other than an individual or Hindu undivided family not subject to tax audit under section 44AB in the immediately preceding financial year, who is responsible for paying to a resident any sum by way of –

- (i) fees for professional services; or
 - (ii) fees for technical services; or
 - (iii) any remuneration or fees or commission, by whatever name called, other than those on which tax is deductible under section 192, to a director of a company; or
 - (iv) royalty, or
 - (v) non-compete fees referred to in section 28(va)
shall deduct tax at source at the rate of 10%.
- (2) The deduction is to be made at the time of credit of such sum to the account of the payee

or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

(3) No tax deduction is required if the amount of fees or the aggregate of the amounts of fees credited or paid or likely to be credited or paid during a financial year does not exceed ₹ 30,000 in the case of fees for professional services, ₹ 30,000 in the case of fees for technical services, ₹ 30,000 in the case of royalty and ₹ 30,000 in the case of non-compete fees.

The limit of ₹ 30,000 under section 194J is applicable separately for fees for professional services, fees for technical services, royalty and non-compete fees referred to in section 28(va). It implies that if the payment to a person towards each of the above is less than ₹ 30,000, no tax is required to be deducted at source, even though the aggregate payment or credit exceeds ₹ 30,000. However, there is no such exemption limit for deduction of tax on any remuneration or fees or commission payable to director of a company.

Illustration 3

XYZ Ltd. makes a payment of ₹ 28,000 to Mr. Ganesh on 2.8.2013 towards fees for professional services and another payment of ₹ 25,000 to him on the same date towards fees for technical services. Discuss whether TDS provisions under section 194J are attracted.

Answer

TDS provisions under section 194J would not get attracted, since the limit of ₹ 30,000 is applicable for fees for professional services and fees for technical services, separately. It is assumed that there is no other payment to Mr. Ganesh towards fees for professional services and fees for technical services during the P.Y.2013-14.

(4) An individual or a Hindu undivided family, whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits specified under clause (a) or clause (b) of section 44AB during the financial year immediately preceding the financial year in which such sum by way of fees for professional or technical services is credited or paid shall be liable to deduct income-tax under this sub-section.

(5) However, such individual or Hindu Undivided family, shall not be liable to deduct income-tax on the sum payable by way of fees for professional services, in case such sum is credited or paid exclusively for personal purposes.

(6) Where any fees for professional or technical services is credited to any account, whether called suspense account or by any other name, in the books of accounts of the person liable to pay such sum, such crediting shall be deemed to be credit of such sum to the account of the payee and tax has to be deducted accordingly.

(7) "Professional services" means services rendered by a person in the course of carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or advertising or such other profession as is notified by the CBDT for the purposes of section 44AA or of this section.

(8) Other professions notified for the purposes of section 44AA are as follows:

(a) Profession of "authorised representatives";

- (b) Profession of “film artist”;
- (c) Profession of “company secretary”.
- (9) The CBDT has notified the services rendered by following persons in relation to the sports activities as Professional Services for the purpose of the section 194J:
 - (a) Sports Persons,
 - (b) Umpires and Referees,
 - (c) Coaches and Trainers,
 - (d) Team Physicians and Physiotherapists,
 - (e) Event Managers,
 - (f) Commentators,
 - (g) Anchors and
 - (h) Sports Columnists.

(10) Accordingly, the requirement of TDS as per section 194J would apply to all the aforesaid professions. The term “profession”, as such, is of a very wide import. However, the term has been defined in this section exhaustively. For the purposes of TDS, therefore, all other professions would be outside the scope of section 194J. For example, this section will not apply to professions of teaching, sculpture, painting etc. unless they are notified.

(11) *Explanation (b)* to section 194J provides that the term ‘fees for technical services’ shall have the same meaning as in *Explanation 2* to section 9(1)(vii). The term ‘fees for technical services’ as defined in *Explanation 2* to section 9(i)(vii) means any consideration (including any lump sum consideration) for rendering of any of the following services:

- (i) Managerial services;
- (ii) Technical services;
- (iii) Consultancy services;
- (iv) Provision of services of technical or other personnel.

It is expressly provided that the term ‘fees for technical services’ will not include following types of consideration:

- (i) Consideration for any construction, assembly, mining or like project, or
- (ii) Consideration which is chargeable under the head ‘Salaries’.

(12) The CBDT has, through *Circular No.8/2009 dated 24.11.2009*, clarified that TPAs (Third Party Administrator’s) who are making payment on behalf of insurance companies to hospitals for settlement of medical/insurance claims etc. under various schemes including cashless schemes are liable to deduct tax at source under section 194J on all such payments to hospitals etc. This is because the services rendered by hospitals to various patients are primarily medical services and, therefore, the provisions of section 194J are applicable to payments made by TPAs to hospitals etc.

Consequently, all such past transactions between TPAs and hospitals would fall within the provisions of section 194J and consequence of failure to deduct tax or after deducting tax failure to pay on all such transactions would make the deductor (TPAs) deemed to be an assessee-in-default in respect of such tax and also liable for charging of interest under section 201(1A).

However, no proceedings under section 201 may be initiated after the expiry of six years from the end of the financial year in which payments have been made without deducting tax at source etc. by the TPA's. Further, the tax demand arising out of section 201(1) in situations arising above, may not be enforced if the deductor (TPA) satisfies the officer in charge of TDS that the relevant taxes have been paid by the deductee-assessee (hospitals etc.). A certificate from the auditor of the deductee-assessee stating that the tax and interest due from deductee-assessee has been paid for the assessment year concerned would be sufficient compliance for the above purpose. However, this will not alter the liability to charge interest under section 201(1A) till payment of taxes by the deductee-assessee or liability for penalty under section 271C, as the case may be.

(13) Consideration for use or right to use of computer software is royalty within the meaning of section 9(1)(vi)

As per section 9(1)(vi), any income payable by way of royalty in respect of any right, property or information is deemed to accrue or arise in India. The term "royalty" means consideration for transfer of all or any right in respect of certain rights, property or information. There have been conflicting court rulings on the interpretation of the definition of royalty, on account of which there was a need to resolve the following issues –

Does consideration for use of computer software constitute royalty?

- (i) Is it necessary that the right, property or information has to be used directly by the payer?
- (ii) Is it necessary that the right, property or information has to be located in India or control or possession of it has to be with the payer?
- (iii) What is the meaning of the term "process"?

In order to resolve the above issues arising on account of conflicting judicial decisions and to clarify the true legislative intent, *Explanations 4, 5 & 6* have been inserted with retrospective effect from 1st June, 1976.

Explanation 4 clarifies that the consideration for use or right to use of computer software is royalty by clarifying that, transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

Consequently, the provisions of tax deduction at source under section 194J and section 195 would be attracted in respect of consideration for use or right to use computer software since the same falls within the definition of royalty.

28.21 Income tax

Note - The Central Government has, vide *Notification No.21/2012 dated 13.6.2012*, effective from 1st July, 2012, exempted certain software payments from the applicability of tax deduction under section 194J. Accordingly, where payment is made by the transferee for acquisition of software from a resident-transferor, the provisions of section 194J would not be attracted if -

- (1) the software is acquired in a subsequent transfer without any modification by the transferor;
- (2) tax has been deducted either under section 194J or under section 195 on payment for any previous transfer of such software; and
- (3) the transferee obtains a declaration from the transferor that tax has been so deducted along with the PAN of the transferor.

28.3.16 Payment of compensation on acquisition of certain immovable property [Section 194LA]

(1) Section 194LA provides for deduction of tax at source by a person responsible for paying to a resident any sum in the nature of –

- (i) compensation or the enhanced compensation or
- (ii) the consideration or the enhanced consideration

on account of compulsory acquisition, under any law for the time being in force, of any immovable property (other than agricultural land).

(2) Immovable property means any land (other than agricultural land) or any building or part of a building.

(3) The amount of tax to be deducted is 10% of such sum mentioned in (1) above.

(4) The tax should be deducted at the time of payment of such sum in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

(5) No tax is required to be deducted where the amount of such payment or, as the case may be, the aggregate amount of such payments to a resident during the financial year does not exceed ₹ 2 lakh.

28.3.17 Income by way of interest from Infrastructure Debt Fund [Section 194LB]

(1) Interest income received by a non-resident or a foreign company from notified infrastructure debt funds set up in accordance with the prescribed guidelines would be subject to tax at a concessional rate of 5% under section 115A on the gross amount of such interest income as compared to tax @ 20% on other interest income of non-resident. The concessional rate of tax is expected to give a fillip to infrastructure and encourage inflow of long-term foreign funds to the infrastructure sector

(2) Accordingly, tax would be deductible @ 5% on interest paid/credited by such fund to a non-resident/foreign company. The person responsible for making the payment shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax @5%.

28.3.18 Income by way of interest from an Indian company [Section 194LC]

(1) Interest paid by an Indian company to a foreign company or a non-corporate non-resident in respect of borrowing made in foreign currency from sources outside India between 1.7.2012 and 30.6.2015 would be subject to tax at a concessional rate of 5% on gross interest (as against the rate of 20% of gross interest applicable in respect of other interest received by a non-corporate non-resident or foreign company from Government or an Indian concern on money borrowed or debt incurred by it in foreign currency).

(2) To avail this concessional rate, the borrowing should be from a source outside India under a loan agreement or by way of issue of long-term infrastructure bonds approved by the Central Government.

(3) The interest to the extent the same does not exceed the interest calculated at the rate approved by the Central Government, taking into consideration the terms of the loan or the bond and its repayment, will be subject to tax at a concessional rate of 5%.

(4) Such interest paid by an Indian company to a non-corporate non-resident or a foreign company would be subject to TDS@5% under section 194LC.

(5) Further, levy of higher rate of TDS@20% under section 206AA in the absence of PAN would not be attracted in respect of payment of interest on long-term infrastructure bonds, as referred to in section 194LC, to a non-corporate non-resident or to a foreign company.

28.3.19 Interest on Government securities or rupee-denominated bonds of an Indian company payable to a Foreign Institutional Investor (FII) or a Qualified Foreign Investor (QFI) [New section 194LD]

(1) New section 194LD provides that any income by way of interest payable during the period between 1.6.2013 and 31.5.2015 in respect of investment made by an FII or QFI in a rupee denominated bond of an Indian company or a Government security, shall be subject to tax deduction at source at a concessional rate of 5% (as against the rate of 20% of interest applicable in respect of other interest received by a QFI or FII).

(2) The interest to the extent the same does not exceed the interest calculated at the rate notified by the Central Government in this behalf will be subject to tax deduction at a concessional rate of 5%.

(3) Any person who is responsible for paying to a person being a FII or a QFI, any such interest shall, at the time of credit of such income to the account of the payee or at the time of payment of such income in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon@5%.

(4) FII refers to Foreign Institutional Investors specified by the Central Government by notification in the Official Gazette.

(5) QFI refers to Qualified Foreign Investors i.e. Foreign Investors, being non-residents, who meet certain KYC requirements under SEBI laws and are hence permitted to invest in equity and debt schemes of Mutual Funds, thereby enabling Indian Mutual Funds to have direct access to foreign investors and widen the class of foreign investors in Indian equity and debt market. QFI does not include FIIs.

28.3.20 Other sums (payable to non-residents) [Section 195]

(1) Any person responsible for paying interest (other than interest referred to in section 194LB or section 194LC or *section 194LD*) or any other sum chargeable to tax (other than salaries) to a non-resident or to a foreign company is liable to deduct tax at source at the rates prescribed by the relevant Finance Act. Such persons are also required to furnish the information relating to payment of any sum in such form and manner as may be prescribed by the CBDT.

Under section 195(1), the obligation to deduct tax at source from interest and other payments to a non-resident, which are chargeable to tax in India, is on “any person responsible for paying to a non-resident or to a foreign company”. The words “any person” used in section 195(1) is intended to include both residents and non-residents. Therefore, a non-resident person is also required to deduct tax at source before making payment to another non-resident, if the payment represents income of the payee non-resident, chargeable to tax in India. Therefore, if the income of the payee non-resident is chargeable to tax, then tax has to be deducted at source, whether the payment is made by a resident or a non-resident.

Explanation 2 clarifies that the obligation to comply with section 195(1) and to make deduction thereunder applies and shall be deemed to have always applied and extends and shall be deemed to have always extended to all persons, resident or non-resident, whether or not the non-resident has :-

- (a) a residence or place of business or business connection in India; or
 - (b) any other presence in any manner whatsoever in India.
- (2) In order to subject an item of income to deduction of tax under this section the payee must be a non-resident or a foreign company.
- (3) The tax is to be deducted at source at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier.
- (4) Where any interest or other sum as aforesaid is credited to any account, whether called “Interest payable account” or “Suspense account” or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee.
- (5) The statutory obligation imposed under this section would apply for the purpose of deduction of tax at source from any sum being income assessable to tax (other than salary income) in the hands of the non-resident/foreign company. However, no deduction shall be made in respect of any dividends declared/distributed/paid by a domestic company, which is exempt in the hands of the shareholders under section 10(34).
- (6) Payment to a non-resident by way of royalties and payments for technical services rendered in India are common examples of sums chargeable under the provisions of the Act to which the liability for deduction of tax at source would apply.
- (7) In the case of interest payable by the Government or a public sector bank within the meaning of section 10(23D) or a public financial institution within the meaning of section

10(23D), deduction of tax shall be made only at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode.

(8) Specified class or classes of persons, making payment to the non-resident, to mandatorily make application to Assessing Officer to determine the appropriate proportion of sum chargeable to tax [Section 195(7)]

- (i) Under section 195(1), any person responsible for paying to a non-corporate non-resident or to a foreign company, any interest or any other sum chargeable under the provisions of the Act (other than salary), has to deduct tax at source at the rates in force.
- (ii) Under section 195(2), where the person responsible for paying any such sum chargeable to tax under the Act (other than salary) to a non-resident, considers that the whole of such sum would not be income chargeable in the hands of the recipient, he may make an application to the Assessing Officer to determine, by general or special order, the appropriate proportion of such sum so chargeable. When the Assessing Officer so determines, the appropriate proportion, tax shall be deducted under section 195(1) only on that proportion of the sum which is so chargeable.
- (iii) Consequent to the retrospective amendments in section 2(47), section 2(14) and section 9(1), sub-section (7) in section 195 provides that, notwithstanding anything contained in sections 195(1) and 195(2), the CBDT may, by notification in the Official Gazette, specify a class of persons or cases, where the person responsible for paying to a non-corporate non-resident or to a foreign company, any sum, whether or not chargeable under the provisions of this Act, shall make an application to the Assessing Officer to determine, by general or special order, the appropriate proportion of sum chargeable to tax. Where the Assessing Officer determines the appropriate proportion of the sum chargeable, tax shall be deducted under sub-section (1) on that proportion of the sum which is so chargeable.
- (iv) Consequently, where the CBDT specifies a class of persons or cases, the person responsible for making payment to a non-corporate non-resident or a foreign company in such cases has to mandatorily make an application to the Assessing Officer, whether or not such payment is chargeable under the provisions of the Act.

(9) Procedure for refund of TDS under section 195 to the person deducting tax in cases where tax is deducted at a higher rate prescribed in the DTAA

The CBDT has, through Circular No.7/2011 dated 27.9.2011, modified Circular No.07/2007, dated 23.10.2007 which laid down the procedure for refund of tax deducted at source under section 195 of the Income-tax Act, 1961 to the person deducting tax at source from the payment to a non-resident. The said Circular allowed refund to the person making payment under section 195 in the circumstances indicated therein as the income does not accrue to the non-resident or if the income is accruing, no tax is due or tax is due at a lesser rate. The amount paid to the Government in such cases to that extent does not constitute tax.

The said Circular, however, did not cover a situation where the tax is deducted at a rate prescribed in the relevant DTAA which is higher than the rate prescribed in the Income-tax Act, 1961. Since the law requires deduction of tax at a rate prescribed in the relevant DTAA

or under the Income-tax Act, 1961 whichever is lower, there is a possibility that in such cases excess tax is deducted relying on the provisions of relevant DTAA.

Accordingly, in order to remove the genuine hardship faced by the resident deductor, the Board has modified Circular No. 07/2007, dated 23-10-2007 to the effect that the beneficial provisions under the said Circular allowing refund of tax deducted at source under section 195 to the person deducting tax at source shall also apply to those cases where deduction of tax at a higher rate under the relevant DTAA has been made while a lower rate is prescribed under the domestic law.

28.3.21 TDS on income from Deep Discount Bonds

(1) The tax treatment of income from Deep Discount Bonds has been explained in the CBDT's *Circular No.2/2002 dated 15.2.2002*.

(2) *Circular No.4/2004 dated 13.5.2004* issued by the CBDT clarifies that tax is required to be deducted at source under section 193 or 195, as the case may be, only at the time of redemption of such bonds, irrespective of whether the income from the bonds has been declared by the bond-holder on accrual basis from year to year or is declared only in the year of redemption.

(3) A person, who has declared the income from a Deep Discount Bond on annual accrual basis during the term of the bond, is entitled to make an application under section 197, requesting the Assessing Officer to issue a certificate for no deduction of tax or deduction at a lower rate. In such a case, the assessee should furnish, along with the prescribed Form No.13, details of the income offered for tax by him from year to year.

(4) In case the assessee is not the original subscriber, and has acquired the bonds from some other person, he shall furnish the relevant particulars including the name, address and PAN of such other person.

(5) If the Assessing Officer is satisfied that the applicant assessee has declared his income from the bonds from year to year on accrual basis during the period the bond was held by him, he shall issue a certificate allowing the tax deduction at source at such reduced rate as is justified by the total income of the applicant in the year of redemption.

(6) An assessee, being a resident individual, who is the original subscriber of a Deep Discount Bond, may furnish a declaration in Form No.15H in the year of redemption in accordance with section 197A, if he has been declaring income on the bond from year to year on accrual basis, and no tax is payable on his total income, including the interest accruing during that year.

(7) However, such a declaration cannot be filed by an individual, other than a senior citizen being a resident individual of the age of 65 years or more during the relevant previous year, if the amount of accumulated interest, being paid on redemption, exceeds the maximum amount not chargeable to tax in his case.

28.3.22 Income payable net of tax [Section 195A]

(1) Where, under an agreement or other arrangement, the tax chargeable on any income referred to in the foregoing provisions of this Chapter is to be borne by the person by whom the income is payable, then, for the purposes of deduction of tax under those provisions such

income shall be increased to such amount as would, after deduction of tax thereon, be equal to the net amount payable under such agreement or arrangement.

(2) However, no grossing up is required in the case of tax paid [under section 192(1A)] by an employer on the non-monetary perquisites provided to the employee.

28.3.23 Interest or dividend or other sums payable to Government, Reserve Bank or certain corporations [Section 196]

- (1) No deduction of tax shall be made by any person from any sums payable to -
- (i) the Government; or
 - (ii) the Reserve Bank of India; or
 - (iii) a corporation established by or under a Central Act, which is, under any law for the time being in force, exempt from income-tax on its income; or
 - (iv) a Mutual Fund specified under section 10(23D).
- (2) This provision for non-deduction is when such sum is payable to the above entities by way of -
- (i) interest or dividend in respect of securities or shares -
 - (a) owned by the above entities; or
 - (b) in which they have full beneficial interest or
 - (ii) any income accruing or arising to them.

28.4 Certificate for deduction of tax at a lower rate [Section 197]

- (1) This section applies where, in the case of any income of any person or sum payable to any person, income-tax is required to be deducted at the time of credit or payment, as the case may be at the rates in force as per the provisions of sections 192, 193, 194, 194A, 194C, 194D, 194G, 194H, 194I, 194J, 194K, 194LA and 195.
- (2) In such cases, the assessee can make an application to the Assessing Officer for deduction of tax at a lower rate or for non-deduction of tax.
- (3) If the Assessing Officer is satisfied that the total income of the recipient justifies the deduction of income-tax at lower rates or no deduction of income-tax, as the case may be, he may give to the assessee such certificate, as may be appropriate.
- (4) Where the Assessing Officer issues such a certificate, then the person responsible for paying the income shall deduct income-tax at such lower rates specified in the certificate or deduct no tax, as the case may be, until such certificate is cancelled by the Assessing Officer.
- (5) Enabling powers have been conferred upon the CBDT to make rules for prescribing the procedure in this regard.

28.5 No Deduction in Certain Cases [Section 197A]

- (1) This section enables an individual, who is resident in India and whose estimated total income of the previous year is less than the basic exemption limit, to receive dividends and

any sum out of National Savings Scheme Account, without deduction of tax at source under sections 194 and 194EE, on furnishing a declaration in duplicate in the prescribed form and verified in the prescribed manner [Sub-section (1)].

(2) The declaration in the above form is to be furnished by the declarant to the person responsible for paying any income of the nature referred to in sections 194 or 194EE. The declaration will have to be to the effect that the tax on the estimated total income of the declarant of the previous year in which such income is to be included in computing his total income will be nil [Sub-section (1)].

(3) No deduction of tax shall be made under sections 193 or 194A or 194K, where a person, who is not a company or a firm, furnishes to the person responsible for paying any income of the nature referred to in section 193 or 194A or 194K, a declaration in writing in duplicate in the prescribed form to the effect that the tax on his estimated total income of the previous year in which such income is to be included in computing his total income will be nil [Sub-section (1A)].

(4) The provisions of this section will, however, not apply where -

- (i) the amount of any income from dividends,
- (ii) payments in respect of deposits under National Savings Schemes, etc. or
- (iii) income from interest on securities or interest other than "interest on securities" or units or
- (iv) the aggregate of the amounts of such incomes in (1), (2) and (3) above credited or paid or likely to be credited or paid during the previous year in which such income is to be included exceeds the maximum amount which is not chargeable to income-tax [Sub-section (1B)].

(5) For a senior citizen, who is of the age of 60 years or more at any time during the previous year, no deduction of tax shall be made under section 193 or section 194 or section 194A or section 194EE or section 194K, if they furnish a declaration in writing to the payer, of any amount or income mentioned in the above sections [Sub-section (1C)].

(6) Such declaration should be in duplicate in the prescribed form and verified in the prescribed manner to the effect that the tax on his estimated total income of the previous year in which such income is to be included in computing his total income will be nil. The restriction contained in sub-section (1B) will not apply to senior citizens [Sub-section (1C)].

(7) No deduction of tax shall be made by an Offshore Banking Unit from the interest paid on-

- (i) deposit made by a non-resident/not-ordinarily resident on or after 1.4.2005; or
- (ii) borrowing from a non-resident/not-ordinarily resident on or after 1.4.2005.

This provision is contained in sub-section (1D).

(8) No deduction of tax at source shall be made from any payment to any person for, or on behalf of, the New Pension System Trust referred in section 10(44).

(9) No deduction of tax shall be made from specified payments to such institution, association or body or class of institutions or associations or bodies as may be notified by the Central Government in the Official Gazette in this behalf. Therefore, in respect of such specified payments made to notified bodies, no tax is to be deducted at source.

Accordingly, the Central Government has notified that no deduction of tax shall be made from the payments of the nature specified below, in case such payment is made

by a person to a bank listed in the Second Schedule to the Reserve Bank of India Act, 1934, excluding a foreign bank –

- (i) bank guarantee commission,*
- (ii) cash management service charges,*
- (iii) depository charges on maintenance of DEMAT accounts ,*
- (iv) charges for warehousing services for commodities,*
- (v) underwriting service charges,*
- (vi) clearing charges (MICR charges) and*
- (vii) credit card or debit card commission for transaction between the merchant establishment and acquirer bank,*

(10) On receipt of the declaration referred to in sub-section (1), (1A) or (1C), the person responsible for making the payment will be required to deliver or cause to be delivered to the Chief Commissioner or Commissioner, one copy of the declaration on or before the 7th day of the month following the month in which the declaration is furnished to him [Section 197A(2)].

28.6 Miscellaneous Provisions

28.6.1 Tax deducted is income received [Section 198]

(1) All sums deducted in accordance with the foregoing provisions shall, for the purpose of computing the income of an assessee, be deemed to be income received.

(2) However, the tax paid by an employer under sub-section (1A) of section 192 on non-monetary perquisites provided to the employees, shall not be deemed to be income received by the assessee.

28.6.2 Credit for tax deducted at source [Section 199]

(1) Tax deducted at source in accordance with the above provisions and paid to the credit of the Central Government shall be treated as payment of tax on behalf of the-

- (i) person from whose income the deduction was made; or
- (ii) owner of the security; or
- (iii) depositor; or
- (iv) owner of property; or
- (v) unit-holder; or
- (vi) shareholder.

(2) Any sum referred to in sub-section (1A) of section 192 and paid to the Central Government, shall be treated as the tax paid on behalf of the person in respect of whose income, such payment of tax has been made.

(3) The CBDT is empowered to frame rules for the purpose of giving credit in respect of tax

deducted or tax paid under Chapter XVII. The CBDT also has the power to make rules for giving credit to a person other than the persons mentioned in (1) and (2) above. Further, the CBDT can specify the assessment year for which such credit may be given.

(4) Rule 37BA – Credit for tax deducted at source for the purposes of section 199

Rule 37BA(1) provides that credit for tax deducted at source and paid to the Central Government shall be given to the person to whom the payment has been made or credit has been given (i.e., the deductee) on the basis of information relating to deduction of tax furnished by the deductor to the income-tax authority or the person authorized by such authority.

Clause (i) of Rule 37BA(2) provides that where under any provisions of the Act, the whole or any part of the income on which tax has been deducted at source is assessable in the hands of a person other than the deductee, credit for the whole or any part of the tax deducted at source, as the case may be, shall be given to the other person and not to the deductee.

However, the deductee should file a declaration with the deductor and the deductor should report the tax deduction in the name of the other person in the information relating to deduction of tax referred to in sub-rule (1) of Rule 37BA.

28.6.3 Duty of person deducting tax [Section 200]

(1) The persons responsible for deducting the tax at source should deposit the sum so deducted to the credit of the Central Government within the prescribed time [Sub-section (1)].

(2) Further, an employer paying tax on non-monetary perquisites provided to employees in accordance with section 192(1A), should deposit within the prescribed time, the tax to the credit of the Central Government or as the Board directs [Sub-section (2)].

Rule 30 – Prescribed time and mode of payment to Government account of TDS or tax paid under section 192(1A)

(a) All sums deducted in accordance with Chapter XVII-B by an office of the Government shall be paid to the credit of the Central Government on the same day where the tax is paid without production of an income-tax challan and on or before seven days from the end of the month in which the deduction is made or income-tax is due under section 192(1A), where tax is paid accompanied by an income-tax challan.

(b) All sums deducted in accordance with Chapter XVII-B by deductors other than a Government office shall be paid to the credit of the Central Government on or before 30th April, where the income or amount is credited or paid in the month of March. In any other case, the tax deducted should be paid on or before seven days from the end of the month in which the deduction is made or income-tax is due under section 192(1A).

(c) In special cases, the Assessing Officer may, with the prior approval of the Joint Commissioner, permit quarterly payment of the tax deducted under section 192/194A/194D/194H on or before 7th of the month following the quarter, in respect of first three quarters in the financial year and 30th April in respect of the quarter ending on 31st March. The dates for quarterly payment would, therefore, be 7th July, 7th October, 7th January and 30th April, for the quarters ended 30th June, 30th September, 31st December and 31st March, respectively.

- (3) Sub-section (3) casts responsibility on the following persons –
- (i) any person deducting any sum on or after 1st April, 2005 in accordance with the foregoing provisions of this chapter; or,
 - (ii) any person being an employer referred to in section 192(1A).
- (4) These persons are responsible for preparing such statements for such periods as may be prescribed, after paying the tax deducted to the credit of the Central Government within the prescribed time.
- (5) Such statements have to be delivered or caused to be delivered to the prescribed income-tax authority or the person authorised by such authority.
- (6) Such statements should be in the prescribed form and verified in the prescribed manner.
- (7) It should set forth such particulars and should be delivered within such time as may be prescribed.
- (8) Every person responsible for deduction of tax under Chapter XVII-B shall deliver, or cause to be delivered, the following quarterly statements to the DGIT (Systems) or any person authorized by him, in accordance with section 200(3):
- (i) Statement of TDS under section 192 in Form No.24Q;
 - (ii) Statement of TDS under sections 193 to 196D in Form No.26Q in respect of all deductees other than a deductee being a non-resident not being a company or a foreign company or resident but not ordinarily resident in which case the relevant form would be Form No.27Q.

Rule 31A - Time limit for submission of quarterly statements

Date of ending of the quarter of the financial year	Due date in the case of a deductor, being an office of Government	Due date in case of other deductors
30th June	31st July of the financial year	15th July of the financial year
30th September	31st October of the financial year	15th October of the financial year
31st December	31st January of the financial year	15th January of the financial year
31st March	15th May of the financial year immediately following the financial year in which deduction is made	15th May of the financial year immediately following the financial year in which deduction is made

28.6.4 Correction of arithmetic mistakes and adjustment of incorrect claim during computerized processing of TDS statements [Section 200A]

- (1) At present, all statements of tax deducted at source are filed in an electronic mode, thereby facilitating computerised processing of these statements.
- (2) Therefore, in order to process TDS statements on computer, electronic processing on the same lines as processing of income-tax returns has been provided in section 200A with effect from 1st April, 2010.

(3) The following adjustments can be made during the computerized processing of statements of tax deducted at source –

- (i) any arithmetical error in the statement; or
- (ii) an incorrect claim, if such incorrect claim is apparent from any information in the statement.

The term “an incorrect claim apparent from any information in the statement” shall mean such claim on the basis of an entry, in the statement, –

- (a) of an item, which is inconsistent with another entry of the same or some other item in such statement;
- (b) in respect of rate of deduction of tax at source, where such rate is not in accordance with the provisions of the Act.

(4) After making such adjustments, tax and interest [say, under section 201(1A)] would be calculated and sum payable by the deductor or refund due to the deductor will be determined.

(5) An intimation will be sent to the deductor, informing him of his tax liability or the refund due, within one year from the end of the financial year in which the statement is filed. The refund due shall be granted to the deductor.

(6) For this purpose, the CBDT is empowered to make a scheme for centralized processing of statements of TDS to determine the tax payable by, or refund due to, the deductor.

28.6.5 Consequences of failure to deduct or pay [Section 201]

(1) The following persons shall be deemed to be an assessee in default if they do not deduct the whole or any part of the tax or after deducting fails to pay the tax -

- (i) any person including the principal officer of a company, who is required to deduct any sum in accordance with the provisions of the Act; and
- (ii) an employer paying tax on non-monetary perquisites under section 192(1A).

(2) However, any person (including the principal officer of the company) who fails to deduct the whole or any part of the tax on the amount credited or payment made to a resident payee shall not be deemed to be an assessee-in-default in respect of such tax if such resident payee –

- (i) has furnished his return of income under section 139;
- (ii) has taken into account such sum for computing income in such return of income; and
- (iii) has paid the tax due on the income declared by him in such return of income,

and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed.

(3) Further, no penalty shall be charged under section 221 from such person unless the Assessing Officer is satisfied that such person has failed to deduct and pay the tax without good and sufficient reasons.

(4) A person deemed to be an assessee-in-default under section 201(1), for failure to deduct tax or to pay the tax after deduction, is liable to pay simple interest @ 1% for every month or part of month on the amount of such tax from the date on which tax was deductible to the date on which such tax was actually deducted and simple interest @ 1½% for every month or part

of month from the date on which tax was deducted to the date on which such tax is actually paid [Section 201(1A)].

Illustration 4

An amount of ₹ 40,000 was paid to Mr. X on 1.7.2013 towards fees for professional services without deduction of tax at source. Subsequently, another payment of ₹ 50,000 was due to Mr. X on 28.2.2013, from which tax@10% (amounting to ₹ 9,000) on the entire amount of ₹ 90,000 was deducted. However, this tax of ₹ 9,000 was deposited only on 22.6.2013. Compute the interest chargeable under section 201(1A).

Solution

Interest under section 201(1A) would be computed as follows –

Particulars	₹
1% on tax deductible but not deducted i.e., 1% on ₹ 4,000 for 8 months	320
1½% on tax deducted but not deposited i.e. 1½% on ₹ 9,000 for 4 months	540
	860

(5) Such interest should be paid before furnishing the statements in accordance with section 200(3).

(6) Where the payer fails to deduct the whole or any part of the tax on the amount credited or payment made to a resident and is not deemed to be an assessee-in-default under section 201(1) on account of payment of taxes by such resident payee, interest under section 201(1A)(i) i.e., @1% p.m. or part of month, shall be payable by the payer from the date on which such tax was deductible to the date of furnishing of return of income by such resident payee. The date of deduction and payment of taxes by the payer shall be deemed to be the date on which return of income has been furnished by the resident payee.

(7) Where the tax has not been paid after it is deducted, the amount of the tax together with the amount of simple interest thereon shall be a charge upon all the assets of the person or the company, as the case may be.

(8) An order under section 201(1) deeming a person to be an assessee-in-default for failure to deduct the whole or any part of the tax from a person resident in India has to be passed within two years from the end of the financial year in which the statement of TDS is filed by the deductor. Where no such statement is filed, such order can be passed up till six years from the end of the financial year in which the payment is made or credit is given.

(9) Further, the exclusions from the time limit, as specified in *Explanation 1* to section 153, would also apply to the above time limit for passing an order deeming a person to be an assessee-in-default. Also, the time limit would not apply to an order passed consequent to the direction contained in an order of the Commissioner under sections 263 and 264, Commissioner (Appeals) under section 250, Appellate Tribunal under section 254, Supreme Court/National Tax Tribunal under section 260 and Supreme Court under section 262. Thus, the time limit would be extended where effect is to be given to various appellate proceedings

or where proceedings are stayed.

(10) Section 201(1) deems a person to be an assessee-in-default if he –

- (i) does not deduct tax; or
- (ii) does not pay; or
- (iii) after so deducting fails to pay

the whole or any part of the tax, as required by or under this Act.

Thus, section 201(1) contemplates three types of defaults. The default contemplated in (ii) is covered by the default contemplated in (iii). However, the time limit has been specified only for passing of orders relating to default contemplated in (i) above. There is no time limit specified in respect of the other defaults.

(11) Therefore, no time-limits have been prescribed for the order under section 201(1) where –

- (i) the deductor has deducted but not deposited the tax deducted at source, as this would be a case of defalcation of government dues,
- (ii) the employer has failed to pay the tax wholly or partly, under sub-section (1A) of section 192, as the employee would not have paid tax on such perquisites,
- (iii) the deductee is a non-resident as it may not be administratively possible to recover the tax from the non-resident.

28.6.6 Deduction only one mode of recovery [Section 202]

(1) Recovery of tax through deduction at source is only one method of recovery.

(2) The Assessing Officer can use any other prescribed methods of recovery in addition to tax deducted at source.

28.6.7 Certificate for tax deducted [Section 203]

(1) Every person deducting tax at source shall issue a certificate to the effect that tax has been deducted and specify the amount so deducted, the rate at which tax has been deducted and such other particulars as may be prescribed.

(2) Every person, being an employer, referred to in sub-section (1A) of section 192 shall, within such period, as may be prescribed, furnish to the person in respect of whose income such payment of tax has been made, a certificate to the effect that tax has been paid to the Central Government, and specify the amount so paid, the rate at which the tax has been paid and such other particulars as may be prescribed.

Certificate of TDS to be furnished under section 203 [Rule 31]

The certificate of deduction of tax at source to be furnished under section 203 shall be in Form 16 in respect of tax deducted or paid under section 192 and in any other case, Form 16A.

Form No.16 shall be issued to the employee annually by 31st May of the financial year immediately following the financial year in which the income was paid and tax deducted. Form No.16A shall be issued quarterly within 15 days from the due date for furnishing the statement of TDS under Rule 31A.

28.6.8 Common number for TDS and TCS [Section 203A]

- (1) Persons responsible for deducting tax or collecting tax at source should apply to the Assessing Officer for the allotment of a “tax-deduction and collection-account number”.
- (2) Section 203A(2) enlists the documents/certificates/returns/challans in which the “tax deduction account number” or “tax collection account number” or “tax deduction and collection account number” has to be compulsorily quoted. They are -
- challans for payment of any sum in accordance with the provisions of section 200 or section 206C(3);
 - certificates furnished under section 203 or section 206C(5);
 - statements prepared and delivered or caused to be delivered in accordance with the provisions of section 200(3) or section 206C(3).
 - returns delivered in accordance with the provisions of section 206 or section 206C(5A)/(5B); and
 - in all other documents pertaining to such transactions as may be prescribed in the interests of revenue.

28.6.9 Furnishing of statement of tax deducted [Section 203AA]

- (1) This section provides for furnishing of a statement of the tax deducted on or after 1st April, 2008 by the prescribed income-tax authority or the person authorised by such authority referred to in section 200(3)
- (2) Such statement should be prepared and delivered to every person -
- from whose income, tax has been deducted or
 - in respect of whose income, tax has been paid.
- (3) Such statement should be in the prescribed form specifying the amount of tax deducted or paid and other prescribed particulars.

28.6.10 Person responsible for paying taxes deducted at source [Section 204]

For purposes of deduction of tax at source the expression “person responsible for paying” means:

	Nature of income/payment	Person responsible for paying tax
(1)	Salary (other than payment of salaries by the Central or State Government)	(i) the employer himself; or (ii) if the employer is a company, the company itself, including the principal officer thereof.
(2)	Interest on securities (other than payments by or on behalf of the Central or State Government)	the local authority, corporation or company, including the principal officer thereof.
(3)	Any sum payable to a non-resident Indian, representing consideration for the transfer by him of any foreign exchange	the “ <i>Authorised Person</i> ” responsible for remitting such sum to the non-resident Indian or for crediting such sum to his Non-resident (External) Account maintained in accordance

	asset, which is not a short term capital asset	with the <i>Foreign Exchange Management Act, 1999</i> and any rules made thereunder.
(4)	Credit / payment of any other sum chargeable under the provisions of the Act	(i) the payer himself; or (ii) if the payer is a company, the company itself including the principal officer thereof.
(5)	Credit / payment of any sum chargeable under the provisions of the Act made by or on behalf of the Central Government or the Government of a State.	(i) the drawing and disbursing officer; or (ii) any other person, by whatever name called, responsible for crediting, or as the case may be, paying such sum.

28.6.11 Bar against direct demand on assessee [Section 205]

Where tax is deductible at source under any of the aforesaid sections, the assessee shall not be called upon to pay the tax himself to the extent to which tax has been deducted from that income.

28.6.12 Furnishing of statements in respect of payment of interest to residents without deduction of tax [Section 206A]

(1) This section casts responsibility on every banking company or co-operative society or public company referred to in the proviso to section 194A(3)(i) to prepare such statements for such period as may be prescribed –

- if they are responsible for paying to a resident,
- the payment should be of any income not exceeding ₹ 10,000, where the payer is a banking company or a co-operative society, and ₹ 5,000 in any other case.
- such income should be by way of interest (other than interest on securities)

(2) The statements have to be delivered or caused to be delivered to the prescribed income-tax authority or the person authorised by such authority.

(3) The statements have to be in the prescribed form, verified in the prescribed manner and to be filed within the prescribed time, on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media.

(4) The Central Government may, by notification in the Official Gazette, cast responsibility on any person other than a person mentioned in (1) above.

(5) Such persons would be persons responsible for paying to a resident any income liable for deduction of tax at source.

(6) Such persons are vested with the responsibility to prepare and deliver or cause to be delivered statements within the prescribed time to the prescribed income-tax authority or the person authorized by such authority.

(7) Such statements should be in the prescribed form and verified in the prescribed manner.

(8) Such statements should be on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media.

28.6.13 Mandatory requirement of furnishing PAN in all TDS statements, bills, vouchers and correspondence between deductor and deductee [Section 206AA]

(1) The non-quoting of PAN by deductees in many cases have led to delay in issue of refund on account of problems in the processing of returns of income and in granting credit for tax deducted at source.

(2) With a view to strengthening the PAN mechanism, section 206AA provides that any person whose receipts are subject to deduction of tax at source i.e. the deductee, shall mandatorily furnish his PAN to the deductor failing which the deductor shall deduct tax at source at higher of the following rates –

- (i) the rate prescribed in the Act;
- (ii) at the rate in force i.e., the rate mentioned in the Finance Act; or
- (iii) at the rate of 20%.

For instance, in case of rental payment for plant and machinery, where the payee does not furnish his PAN to the payer, tax would be deductible @20% instead of @2% prescribed under section 194I. However, non-furnishing of PAN by the deductee in case of income by way of winnings from lotteries, card games etc., would result in tax being deducted at the existing rate of 30% under section 194B. Therefore, wherever tax is deductible at a rate higher than 20%, this provision would not have any impact.

(3) Tax would be deductible at the rates mentioned above also in cases where the taxpayer files a declaration in Form 15G or 15H (under section 197A) but does not provide his PAN.

(4) Further, no certificate under section 197 will be granted by the Assessing Officer unless the application contains the PAN of the applicant.

(5) If the PAN provided to the deductor is invalid or it does not belong to the deductee, it shall be deemed that the deductee has not furnished his PAN to the deductor. Accordingly, tax would be deductible at the rate specified in (ii) above.

(6) These provisions will also apply to non-residents where tax is deductible on payments or credits made to them. *However, the provisions of section 206AA shall not apply in respect of payment of interest on long-term infrastructure bonds, as referred to in section 194LC, to a non-corporate non-resident or to a foreign company.*

(7) Both the deductor and the deductee have to compulsorily quote the PAN of the deductee in all correspondence, bills, vouchers and other documents exchanged between them.

28.7 Tax collection at source [Section 206C]

Under section 206C(1), sellers of certain goods are required to collect tax from the buyers at the specified rates. The specified percentage for collection of tax at source is as follows:

Nature of Goods	Percentage
(i) Alcoholic liquor for human consumption	1%
(ii) Tendu leaves	5%

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(iii)	Timber obtained under a forest lease	2.5%
(iv)	Timber obtained by any mode other than (iii)	2.5%
(v)	Any other forest produce not being timber or tendu leaves	2.5%
(vi)	Scrap	1%
(vii)	Minerals, being coal or lignite or iron ore	1%

However, no collection of tax shall be made in the case of a resident buyer, if such buyer furnishes to the person responsible for collecting tax, a declaration in writing in duplicate in the prescribed form and verified in the prescribed manner to the effect that goods referred to in column (2) of the above Table are to be utilised for the purpose of manufacturing, processing or producing articles or things or for the purposes of generation of power and not for trading purposes. [Sub-section (1A)]

“Buyer” means a person who obtains in any sale, by way of auction, tender, or any other mode, goods of the nature specified in the Table in sub-section (1) or the right to receive any such goods but does not include –

- (i) a public sector company, the Central Government, a State Government, and an embassy, a high commission, legation, commission, consulate and the trade representation, of a foreign State and a club, or
- (ii) a buyer in the retail sale of such goods purchased by him for personal consumption.

“Seller” means the Central Government, a State Government or any local authority or corporation or authority established by or under a Central, State or Provincial Act, or any company or firm or co-operative society and also includes an individual or a HUF whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits specified under clause (a) or clause (b) of section 44AB during the financial year immediately preceding the financial year in which the goods of the nature specified in the Table in sub-section (1) or sub-section (1D) are sold.

“Scrap” means waste and scrap from the manufacture or mechanical working of materials which is definitely not usable as such because of breakage, cutting up, wear and other reasons;

The person responsible for collecting tax under this section shall deliver or cause to be delivered to the Chief Commissioner or Commissioner one copy of the declaration referred to in sub-section (1A) on or before 7th of the month next following the month in which the declaration is furnished to him [Sub-section (1B)].

Sub-section (1C) provides for collection of tax by every person who grants a lease or a licence or enters into a contract or otherwise transfers any right or interest in any parking lot or toll plaza or a mine or a quarry to another person (other than a public sector company) for the use of such parking lot or toll plaza or mine or quarry for the purposes of business. The tax shall be collected as provided, from the licensee or lessee of any such licence, contract or lease of the specified nature, at the rate of 2% at the time of –

- (1) debiting of the amount payable by the licensee or lessee to his account or

- (2) at the time of receipt of such amount from the licensee or lessee –
- (a) in cash or
 - (b) by the issue of a cheque or draft or
 - (c) by any other mode,
- whichever is earlier.

Two Explanations have been inserted w.e.f. 1.6.2007 to clarify the scope of the term 'mining and quarrying'. Explanation 1 excludes mining and quarrying of mineral oil from the scope of 'mining and quarrying'. Explanation 2 clarifies that 'mineral oil' includes petroleum and natural gas.

These Explanations seek to relieve the oil exploration and incidental services from the applicability of TCS provisions, since these services are in the organised sector.

Section 206C(1D) provides that tax is to be collected at source@1% of sale consideration by the seller from the buyer, where the sale of jewellery or bullion (excluding any coin or any other article weighing 10 grams or less) is in cash and the sale consideration –

- (1) for jewellery exceeds ₹ 5 lakh,
- (2) for bullion exceeds ₹ 2 lakh

In such cases, tax has to be collected at source by the seller from the buyer irrespective of the purpose of its use, whether for manufacturing or trading or for personal use.

The purpose of this requirement is to reduce the quantum of cash transaction in bullion and jewellery sector and curb the flow of unaccounted money in the trading system of bullion and jewellery. Buyer for the purpose of this transaction shall mean a person who obtains in any sale, goods of the nature specified therein.

With effect from 1st June, 2013, the provisions of tax collection at source under section 206C@1% of sale consideration would be attracted even in respect of cash sale of any coin or article weighing 10 grams or less, if the sale consideration exceeds ₹ 2 lakh.

The power to recover tax by collection under sub-section (1) or (1C) or (1D) shall be without prejudice to any other mode of recovery [Sub-section (2)].

Any amount collected under sub-section (1) or (1C) or (1D) shall be paid within the prescribed time to the credit of the Central Government or as the Board directs [Sub-section (3)].

All sums collected in accordance with section 206C(1)/(1C)/(1D) by an office of the Government, shall be paid to the credit of the Central Government on the same day where the tax is paid without production of an income-tax challan and on or before 7 days from the end of the month in which the collection is made, where tax is paid accompanied by an income-tax challan; and all sums collected in accordance with the provisions of section 206C(1)/(1C)/(1D) by collectors other than an office of the Government, shall be paid to the credit of the Central Government within one week from the last day of the month in which the collection is made [Rule 37CA].

A person collecting tax in accordance with the provisions of the section is vested with the responsibility of preparing such statements for such periods as may be prescribed after paying

the tax collected to the credit of the Central Government within the prescribed time. The statement should be delivered or caused to be delivered to the prescribed income-tax authority or the person authorised by such authority. The statement should be in the prescribed form and verified in the prescribed manner. The statement should set forth the prescribed particulars and should be filed within such time as may be prescribed.

Quarterly statement in Form No.27EQ shall be delivered, or cause to be delivered, to the DGIT (Systems) or any person authorized by him in accordance with the proviso to section 206C(3). The time limit for furnishing such quarterly statements shall be 15th of the month following each quarter in respect of the first three quarters and 15th May for the last quarter ending on 31st March. The due dates would therefore be 15th July, 15th October, 15th January and 15th May for the quarters ending 30th June, 30th September, 31st December and 31st March, respectively [Rule 31AA].

Any amount collected in accordance with the provisions of this section and paid to the credit of the Central Government shall be deemed to be payment of tax on behalf of the person from whom the amount has been collected. The CBDT may prescribe the rules based on which credit shall be given to such person for the amount so collected in a particular assessment year [Sub-section (4)].

Every person collecting tax in accordance with the provisions of this section shall, within such period as may be prescribed from the date of debit or receipt of the amount, furnish to the buyer or licensee or lessee to whose account such amount is debited or from whom such payment is received, a certificate to the effect that tax has been collected specifying the sum so collected, the rate at which the tax has been collected and such other particulars as may be prescribed [Sub-section (5)].

Certificate of tax collected at source under section 206C(5) in Form No.27D shall be furnished by the collector within 15 days from the due date for furnishing the quarterly statement of TCS under Rule 31AA [Rule 37D].

The prescribed income-tax authority or the person authorized by such authority have now been vested with the responsibility to prepare and deliver a statement in the prescribed form specifying the amount of tax collected and such other particulars as may be prescribed, within the prescribed time after the end of each financial year beginning on or after 1.4.2008.

The CBDT is empowered to frame a scheme for the purpose of filing of returns with such other authority or agency, if it considers necessary or expedient to do so.

Sub-section (5B) provides that the person responsible for collecting tax (other than a company/Central Government/State Governments) has the option to deliver or cause to be delivered such return on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media to the prescribed income-tax authority in accordance with such scheme as may be specified by the Board in this behalf.

The proviso to the said sub-section provides that where the person collecting tax is a company or the Central Government or a State Government, then such person is responsible to deliver or cause to be delivered, within the prescribed time after the end of each financial year, such returns on computer media under the said scheme.

Thus, filing of returns on computer media is compulsory where the seller is a company or the

Central Government or a State Government. In every other case, the filing of returns on computer media is optional.

As per sub-section (5C), a return filed on computer media is deemed to be a return for the purposes of sub-section (5A) and the rules made thereunder. Such a return is also admissible as evidence in any proceedings made thereunder, without further proof of production of the original.

Rectification of defective TCS return [Section 206C(5D)]

Sub-section (5D) empowers the Assessing Officer, in case he considers that the return delivered or cause to be delivered under sub-section (5B) is defective, to -

- (i) intimate the defect to the person collecting tax and
- (ii) give him an opportunity of rectifying the defect within a period of -
 - (1) fifteen days from the date of such intimation or
 - (2) within such further period which the Assessing Officer may, in his discretion, allow on an application made in this behalf and

if the defect is not rectified within the said period of fifteen days or within such further period so allowed, then, such return would be treated as an invalid return. The provisions of the Income-tax Act, 1961 would apply as if such person had failed to deliver the return.

A person who is responsible for collecting the tax in accordance with the provisions of this section shall be liable to pay the tax to the credit of the Central Government, even if he has failed to collect the tax [Sub-section (6)].

Sub-section (6A) provides that any person responsible for collecting tax shall be deemed to be an assessee in default in respect of the tax if such person -

- (1) does not collect the whole or any part of the tax or
- (2) fails to pay such tax after having collected the tax.

Any person responsible for collecting tax at source, other than a seller of jewellery or bullion, would not be deemed to be an assessee-in-default for failure to collect tax on the amount received from a buyer or licensee or lessee or on the amount debited to the account of the buyer or licensee or lessee, if such buyer or licensee or lessee has furnished his return of income under section 139, taking into account such amount for computing income and paid the tax due on the income declared by him in such return of income. Further, the person should also furnish a certificate to this effect from an accountant in the prescribed form.

Further, no penalty shall be charged under section 221 from such person unless the Assessing Officer is satisfied that the person has without good and sufficient reasons failed to collect and pay the tax.

If the person responsible for collecting tax does not collect the tax or after collecting the tax fails to pay it as required under this section, he shall be liable to pay simple interest at the rate of 1% p.m. or part thereof on the amount of such tax from the date on which such tax was collectible to the date on which the tax was actually paid and such interest shall be paid before furnishing the quarterly statement for each quarter in accordance with the provisions of sub-section (3) [Sub-section (7)].

In such cases where a person is not deemed to be an assessee-in-default on account of the tax being paid by the buyer/licensee/lessee, interest shall be payable by the collector from the date on which tax was collectible to the date of furnishing return of income by such buyer or licensee or lessee.

Where the tax has not been paid as aforesaid, after it is collected, the amount of tax together with the amount of simple interest thereon referred to in sub-section (7) shall be a charge upon all the assets of the person responsible for collecting tax [Sub-section (8)].

Further, sub-section (9) provides for issue of certificates by Assessing Officer for collection of tax at a lower rate than those specified in sub-section (1)/(1C)/(1D). Such certificate shall be issued on an application made by the buyer or licensee or lessee in this behalf.

Sub-section (10) provides that the person responsible for collecting tax shall collect the same at the rate specified in such certificate until such certificate is cancelled by the Assessing Officer.

Sub-section (11) empowers the Board to make rules specifying the cases in which and the circumstances under which an application may be made for the grant of such certificate and the conditions subject to which certificate may be granted.

28.8 Advance Payment of Tax [Section 207 to 219]

1. Advance tax is payable in respect of all income including capital gains and casual income.

2. Under section 208, obligation to pay advance tax arises in every case where the advance tax payable is ₹ 10,000 or more.

In case of senior citizens who have passive source of income like interest, rent, etc., the requirement of payment of advance tax causes genuine compliance hardship. Therefore, in order to reduce the compliance burden on such senior citizens, exemption from payment of advance tax has now been provided to a resident individual-

- (i) not having any income chargeable under the head "Profits and gains of business or profession"; and
- (ii) of the age of 60 years or more.

Such senior citizens need not pay advance tax and are allowed to discharge their tax liability (other than TDS) by payment of self-assessment tax.

Limit for payment of advance tax: An assessee who is liable to pay advance tax of less than ₹ 10,000 will not be saddled with interest under sections 234B and 234C for defaults in payment of advance tax. However, the consequences under section 234A regarding interest for belated return shall continue.

No need for filing estimate: An assessee has to estimate his current income and pay advance tax thereon. He need not submit any estimate or statement of income to the Assessing Officer, except where he has been served with notice by the Assessing Officer.

Where obligation to advance tax has arisen, the assessee shall himself compute the advance tax payable on his current income at the rates in force in the financial year and deposit the same whether or not he has been earlier assessed to tax.

In the case of a person who has been already assessed by way of a regular assessment in respect of the total income of any previous year, the Assessing Officer, if he is of the opinion that such person is liable to pay advance tax, can serve an order under section 210(3) requiring the assessee to pay advance tax. For this purpose, the total income of the latest previous year in respect of which the assessee has been assessed or the total income returned by the assessee for any subsequent previous year, whichever is higher, shall be taken as the basis for computation of advance tax payable.

The above order can be served by the Assessing Officer at any time during the financial year but not later than the last date of February.

If, after sending the above order, but before 1st March of the financial year, the assessee furnishes a return relating to any later previous year or an assessment is completed in respect of a later return of income, the Assessing Officer can amend computation on the income to returned or assessed.

If assessee feels that his own estimate of advance tax payable would be less than the one sent by the Assessing Officer, he can file estimate of his current income and advance tax payable thereon. Where the advance tax payable or assessee's estimation would be higher than the tax computed by the Assessing Officer, then the advance tax shall be paid based upon such higher amount.

No reduction of 'tax deductible but not deducted' and 'tax collectible but not collected', while computing advance tax liability

- (i) As per section 209, the amount of advance tax payable by a person is computed by reducing the amount of income-tax which would be deductible or collectible at source during the financial year from any income which has been taken into account in computing the total income.
- (ii) Some courts had opined that in case where the payer pays any amount (on which tax is deductible at source) without deduction of tax at source, the payee shall not be liable to pay advance tax to the extent tax is deductible from such amount.
- (iii) With a view to make such a person (payee) liable to pay advance tax, the proviso has to section 209(1)(d) provides that the amount of tax deductible at source but not so deducted by the payer shall not be reduced from the income tax liability of the payee for determining his liability to pay advance tax.
- (iv) In effect, only if tax has actually been deducted at source, the same can be reduced for computing advance tax liability of the payee. Tax deductible but not so deducted cannot be reduced for computing advance tax liability of the payee.
- (v) Similarly, only if tax has actually been collected at source, the same can be reduced for computing advance tax liability of the buyer or licensee or lessee. Tax collectible but not so collected cannot be reduced for computing advance tax liability of the buyer or licensee or lessee.

Payment of advance tax

Advance tax shall be payable by companies and other assesseees as per the following schedule of installments:

Companies - Four installments

Due date of installment	Amount payable
On or before the 15th June	Not less than 15% of such advance tax.
On or before the 15th September	Not less than 45% of such advance tax, as reduced by the amount, if any, paid in the earlier installment.
On or before the 15th December	Not less than 75% of such advance tax, as reduced by the amount or amounts, if any, paid in the earlier installment or installments.
On or before the 15th March	The whole amount of such advance tax as reduced by the amount or amounts, if any, paid in the earlier installment or installments.

Non-corporate assessees - Three installments

Due date of installment	Amount payable
On or before the 15th September	Not less than 30% of such advance tax
On or before the 15th December	Not less than 60% of such advance tax, as reduced by the amount, if any, paid in the earlier installment or installments.
On or before the 15th March	The whole amount of such advance tax as reduced by the amount or amounts, if any, paid in the earlier installment or installments.

If the last date for payment of any installment of advance tax is a day on which the receiving bank is closed, the assessee can make the payment on the next immediately following working day and in such cases, the mandatory interest leviable under section 234B and 234C would not be charged.

Where advance tax is payable by virtue of the notice of demand issued by the Assessing Officer, the whole or the appropriate part of the advance tax shall be payable in the remaining installments.

Where the assessee does not pay any installment by the due date, he shall be deemed to be an assessee-in-default in respect of such installment.

28.9 Scheme of Mandatory Interest**28.9.1 Interest for defaults in furnishing return of income [Section 234A]**

1. Where the return of income for any assessment year under sub-section 139(4) or in response to a notice under section 142(1), is furnished after the due date or is not furnished, the assessee shall be liable to pay simple interest at the rate of 1% for every month or part of a month comprised in the period commencing on the day immediately following the due date and,

- (a) where the return is furnished after the due date, ending on that date of furnishing the return; and
 - (b) where no return has been furnished, ending on the date of completion of assessment under section 144.
2. The amount on which interest will be payable will be the amount of the tax on the total income as determined under section 143(1) or on regular assessment, as reduced by the amount of -
- (i) advance tax, if any, paid ;
 - (ii) any tax deducted or collected at source;
 - (iii) any relief of tax allowed under section 90 or 90A;
 - (iv) any deduction of tax allowed under section 91;
 - (v) any tax credit allowed to be set-off in accordance with the provisions of section 115JAA or section 115JD.
3. 'Due date' means the date specified in section 139(1) as applicable in the case of the assessee.
4. The tax on total income as determined under section 143(1) shall not include additional income-tax payable under section 143.
5. Where in relation to an assessment year an assessment is made for the first time under section 147, the assessment so made shall be regarded as regular assessment for the purposes of this section.
6. The interest payable under this section shall be reduced by the interest paid under section 140A.
7. Where the return of income for any assessment year required by a notice under section 148 issued after the determination of income under section 143(1) or after completion of assessment under section 143(3) or section 144 or section 147 is furnished after the expiry of the time allowed under such notice, or is not furnished, the assessee shall be liable to pay simple interest at the rate of 1% for every month or part of a month comprised in the period commencing on the date immediately following the expiry of the time allowed as aforesaid and,
- (i) where the return is furnished after the expiry of the time aforesaid ending on the date of furnishing the return;
 - (ii) where no return has been furnished ending on the date of completion of the reassessment or re-computation under section 147.
8. The amount on which the above interest is payable is the amount by which the tax on the total income determined on the basis of such reassessment or re-computation exceeds the tax on the total income determined under section 143(1) or on the basis of the earlier assessment aforesaid.
9. Where as a result of an appellate order or an order of the revision or an order from the Settlement Commission, the interest payable is reduced or increased the Assessing Officer

shall proceed as follows:

- (i) Where the interest is increased, the Assessing Officer shall serve on the assessee a notice of demand in the prescribed form specifying the sum payable and such demand notice shall be a notice under section 156.
- (ii) Where interest is reduced, the excess paid shall be refunded.

28.9.2 Interest for defaults in payment of advance tax [Section 234B]

1. The assessee will be liable to pay interest at the rate of 1% for every month or for part of month for the period starting from 1st April of the following financial year to the date of regular assessment on the amount of tax on the total income as determined under section 143(1) or on regular assessment after giving credit for any advance tax paid, tax deducted at source and collected at source, if the advance tax paid falls short of 90% of the 'assessed tax'.

2. The term 'assessed tax' means:

The tax on the total income determined under section 143(1) or on regular assessment as reduced by the amount of -

- (i) any tax deducted or collected at source on any income which is taken into account for calculating the total income.
- (ii) any relief of tax allowed under section 90 or 90A;
- (iii) any deduction of tax allowed under section 91;
- (iv) any tax credit allowed to be set-off in accordance with the provisions of section 115JAA or section 115JD.

3. An assessment made for the first time under section 147 shall be deemed to be regular assessment.

4. Tax on the total income determined under section 143(1) shall not include the additional income-tax if any, payable.

5. Where before the date of determination of total income under section 143(1) or completion of regular assessment, tax is paid by the assessee under section 140A:

- (i) interest shall be calculated up to the date on which the tax is so paid and reduced by the interest paid under section 140A.
- (ii) Thereafter interest shall be calculated on the amount by which the tax paid under section 140A together with the advance tax paid falls short of the assessed tax.

6. Where as a result of an order of reassessment or re-computation under section 147 the amount on which interest is payable is increased, the assessee shall be liable to pay simple interest at the rate of 1% for every month or part of a month, commencing on the day following the date of determination of total income under section 143(1), or regular assessment ending on the date of the reassessment or re-computation under section 147 on the amount by which the tax on the total income determined on the basis of reassessment or re-computation exceeds the tax on total income determined under section 143(1) on a regular assessment.

7. Where as a result of an appellate order, an order of revision or an order from Settlement Commission, the interest payable is increased or reduced, the Assessing Officer shall serve a notice of demand on the assessee where the interest is increased, and where the interest is reduced, the excess interest paid shall be refunded.

28.9.3 Interest for deferment of advance tax [Section 234C]

- ◆ In the case of companies: It has been provided that the shortfall for the purpose of charging interest for deferment of advance tax, in the case of companies, which are liable to pay advance tax shall be the difference between:

- (i) 15% of the tax due on the returned income and the advance tax paid by the company on or before 15th day of June;
- (ii) 45% of the tax due on the returned income and the advance tax paid by the company on or before 15th day of September;
- (iii) 75% of the tax due on the returned income and the advance tax paid by the company on or before 15th day of December.

It has also been provided that where the advance tax paid by the company on or before the 15th day of June is not less than 12% of the tax due on the returned income and the advance tax paid on or before the 15th day of September is not less than 36% of the tax due on the returned income, then the companies will not be liable to pay any interest on the amount of the shortfalls on the aforesaid dates.

- ◆ In the case of any other assessee: The shortfall for the purpose of charging interest for deferment of advance tax shall be the difference between:

- (i) 30% of the tax due on the returned income and the advance tax paid on or before 15th day of September.
- (ii) 60% of the tax due on the returned income and the advance tax paid on or before 15th day of December.

- ◆ Enlarging the scope of levy of interest for deferment of advance tax: The whole amount of the advance tax is required to be paid on or before 15th March during the financial year. The proviso to section 211(1), however, provides that any amount paid by way of advance tax on or before 31st March, is also to be treated as advance tax paid during the financial year. This proviso was inserted as certain High Courts had held that payment made after the 15th March during the financial year would not cease to be payment of advance tax. There is no penal provision in the law to enforce payment of the last installment of advance tax by 15th March. The aforesaid proviso and the absence of a penal provision have generated a tendency among the assesseees to make payment of advance tax only towards the last day of the financial year.

Section 234C(1), therefore, provides that where the whole amount of advance tax paid by an assessee on or before 15th March in the financial year is less than the tax due on the returned income, the assessee is liable to pay simple interest at the rate of 1% per month or part of the month on the amount of the shortfall from the tax due on the returned income.

An assessee is required to pay advance tax in specified installments on his estimated total income including capital gains and income from winnings from lotteries, horse races etc. covered by section 2(24)(ix). No interest will be levied under section 234C in respect of any shortfall in payment of advance tax due on returned income if the shortfall is on account of under estimation or failure to estimate the amount of capital gains or income under section 2(24) (ix) and the assessee has paid the whole amount of the tax payable in respect of the income as part of the installment of advance tax which is immediately due.

These provisions shall apply even in cases where no advance tax has been paid by the assessee who is liable to pay such tax during the financial year.

“Tax due on the returned income” means the tax chargeable on the total income declared in the return of income furnished by the assessee for the assessment year immediately following the financial year in which the advance tax is paid or payable, as reduced by the amount of –

- (i) any tax deductible or collectible at source on any income which is taken into account for calculating the total income.
 - (ii) any relief of tax allowed under section 90 or 90A;
 - (iii) any deduction of tax allowed under section 91;
 - (iv) any tax credit allowed to be set-off in accordance with the provisions of section 115JAA or section 115JD.
- ◆ **Payment of advance tax relatable to capital gain, etc. to be allowed in the remaining installments :** Under section 234C penal interest is not charged on account of underestimate or failure to estimate either the amount of capital gain or of income from winnings from lottery, horse races, etc., referred to section 2(24)(ix) if the assessee pays the whole of the tax payable in respect of such income, as part of the installment of advance tax which is immediately due after such income is earned or by 31st March if no such installment is due.

This requirement of paying the whole of the tax was causing hardship as the entire tax laid to be paid on a short notice. In many cases, even the sale proceeds of the capital asset were not received before the advance tax payment became due. Section 234C allows the assessee to pay the tax in relation to capital gain or to income from winnings from lottery, horse races, etc., as part of the remaining installments of advance tax which are due in the financial year and if no installment is due then before 31st March of the previous year.

28.9.4 Interest on excess refund granted at the time of summary assessment [Section 234D]

- (1) Under section 143(4), where a regular assessment under section 143(3) or section 144 is made, any tax or interest paid under section 143(1) shall be deemed to have been paid towards such regular assessment and if no refund is due on regular assessment or the amount refunded under section 143(1) exceeds the amount refundable on regular assessment, the whole or the excess amount so refunded is deemed to be tax payable by the assessee. However, no interest is charged for the period during which the refund amount has been utilised by the assessee.
- (2) Therefore, section 234D was inserted to charge interest on excess refund granted at the

time of summary assessment.

- (3) Sub-section (1) provides that where any refund is granted to the assessee under section 143(1) and no refund is due on regular assessment or the amount refunded under section 143(1) exceeds the amount refundable on regular assessment, then the assessee shall be liable to pay simple interest at the rate of two-third per cent on the whole or the excess amount so refunded for every month or part of the month from the date of grant of the refund to the date of such regular assessment.
- (4) Sub-section (2) further provides that the interest chargeable under sub-section (1) shall be reduced, where, as a consequence to the order passed due to rectification, appeal, revisions etc. under sections 154/155/250/254/260/262/263/264 or an order of the Settlement Commission under section 245D(4) of the Income-tax Act, the amount of refund granted under section 143(1) is held to be correctly allowed.
- (5) An assessment made for the first time under section 147 or section 153A shall be regarded as regular assessment for the purpose of this section.

28.9.5 Fee for default in furnishing TDS/TCS Statements

(1) A fee of ₹ 200 for every day would be levied under new section 234E for late furnishing of TDS/TCS statement from the due date of furnishing of TDS/TCS statement to the date of furnishing of TDS/TCS statement. However, the total amount of fee shall not exceed the total amount of tax deductible/collectible and such fee has to be paid before delivering the TDS/TCS statement. Such fees would be attracted in respect of tax deducted or collected at source on or after 01.07.2012.

(2) In addition to said fee, a penalty ranging from a minimum of ₹ 10,000 to a maximum of ₹ 1,00,000 shall also be levied under section 271H for not furnishing TDS/TCS statement within the prescribed time or furnishing incorrect information in the said statements in respect of tax deducted or collected at source on or after 01.07.2012. Consequently, with effect from 1.7.2012, penalty shall not be leviable under section 272A in respect of such failure.

Since late furnishing of TDS/TCS statements would attract levy of fees under section 234E, no penalty under section 271H shall be levied for delay in furnishing of TDS/TCS statement, if the TDS/TCS statement is furnished within one year of the prescribed due date after payment of tax deducted or collected along with applicable interest and fee. However, if the delay is beyond the period of one year, both fee under section 234E and penalty under section 271H would be leviable.

28.10 Collection and Recovery of Tax - Other Methods

28.10.1 Payment of tax and defaults by the assessee [Section 220]

Any tax, interest, penalty, fine or any other sum specified in a notice of demand (other than those relating to advance payment of taxes) issued under section 156 must be paid within 30 days of the service of notice at the place and to the person mentioned in the notice. The Assessing Officer may specify a period less than 30 days, if he has any reason to believe that if full period of 30 days is allowed, it may be detrimental to revenue. However, this requires the previous approval of the Joint Commissioner.

In case of failure by the assessee to pay the amount specified in the notice of demand within the period specified, he is liable to pay simple interest@1% per month or part of a month from the day immediately following the end of the period mentioned in the notice of demand and ending with the day on which the amount is paid.

Section 220(2A) empowers the Chief Commissioner or the Commissioner to reduce or waive any interest payable under section 220(2) if he is satisfied that:

- (i) payment of such amount has caused or would cause genuine hardship to the assessee;
- (ii) default in the payment of the amount on which interest was made payable under the said sub-section was due to circumstances beyond the control of the assessee; and
- (iii) the assessee has co-operated in any enquiry relating to the assessment or any proceeding for the recovery of any amount due from him.

Since the intimation generated after processing the TDS statement under section 200A(1) would be deemed as a notice of demand under section 156, consequently, interest under section 220 would be attracted for failure to pay the tax specified in the intimation. However, interest under section 201(1A) is leviable for non-payment of tax specified in the intimation. Therefore, it has been provided that in cases where interest is charged for any period under section 201(1A) on the tax specified in the intimation under section 200A, then, interest under section 220(2) would not be levied on the same amount for the same period.

28.10.2 Penalty payable [Section 221]: Where an assessee is in default in payment of tax including advance tax and interest payable thereon, the Assessing Officer shall impose a penalty which in cases of continuing default, may be increased from time to time. However, the total penalty should not exceed the tax in arrears. The Assessing Officer should give the assessee a reasonable opportunity of being heard before levying such a penalty.

No penalty shall be levied on the assessee for default in payment of tax in cases where the Assessing Officer is satisfied that default was for good and sufficient reasons. The Taxation laws (Amendment and Miscellaneous Provisions) Act, 1986 has shifted the burden of proof upon the assessee. Accordingly, penalty will not be levied under this section only when the assessee proves to the satisfaction of the Assessing Officer that the default was for good and sufficient reasons.

The *Explanation* to section 221(1) provides that an assessee would not cease to be liable to pay any penalty for his default or delay in payment of the tax merely by reason of the fact that before the date of levy of such penalty the tax which was in arrears had actually been paid by him. Thus wherever there is delay on the part of the assessee, he would be liable to penalty even though by the time the Assessing Officer initiates action for the levy of penalty the amount of tax in arrears is actually paid. An order imposing penalty is appealable and the assessee's right of appeal is subject to the condition that he must first pay the tax or penalty; the assessee should first pay the tax before filing the appeal.

28.10.3 Certificate to Tax Recovery Officer [Section 222]

1. When an assessee is in default or is deemed to be in default in making a payment of tax the Tax Recovery Officer may draw up under his signature a statement in the prescribed form

and specifying the amount of arrears due from the assessee (such statement being hereinafter and in the Second Schedule referred to as certificate) and shall proceed to recover from such assessee the amount specified in the certificate by one or more of the modes mentioned below in accordance with the Second Schedule.

- (a) Attachment and sale of the assessee's movable property.
- (b) Attachment and sale of assessee's immovable properties.
- (c) Arrest of the assessee and his detention in prison.
- (d) Appointing a receiver for the management of assessee's movable and immovable properties.

2. For the purpose of this section the assessee's movable or immovable property shall include any property which has been transferred directly or indirectly by the assessee to his spouse or minor child or son's wife or son's minor child otherwise than for adequate consideration and which is held by any of the persons aforesaid. So far as the movable or immovable property so transferred to his minor child or his son's minor child is concerned, they shall even after the date of attainment of majority by such minor child or son's minor child continue to be included in the assessee's movable or immovable property for recovering any arrears.

3. The Tax Recovery Officer may take action under sub-section (1) notwithstanding that proceedings or recovery of the arrears by any special mode have been taken.

28.10.4 Tax Recovery Officer by whom recovery is to be effected [Section 223]

- (1) The Tax Recovery Officer competent to take action under section 222 shall be:
 - (a) The Tax Recovery Officer within whose jurisdiction the assessee carries on business or profession is situated.
 - (b) The Tax Recovery Officer within whose jurisdiction the assessee resides or any movable or immovable property of the assessee is situated.
- (2) The jurisdiction is assigned either by the Board or the Chief Commissioner or Commissioner who is authorised in this behalf by the Board under section 120.
- (3) Where an assessee has property within the jurisdiction of more than one Tax Recovery Officer and Recovery Officer by whom the certificate is drawn up
 - (a) is not able to recover the entire amount by sale of the property within his jurisdiction.
 - (b) he may send the certificate to a Tax Recovery Officer within whose jurisdiction the assessee has property. There upon the Tax Recovery Officer shall proceed to recover the amount as if the certificate was drawn up by him.

28.10.5 Stay of proceedings in pursuance of certificate and amendment or cancellation thereof [Section 225]

- (1) It shall be lawful for the Tax Recovery Officer to grant time for the payment of any tax and when he does so he shall stay proceedings for the recovery of such tax until the expiry of the time so granted.
- (2) Where as a result of appeal the demand is reduced and the order is the subject matter of further proceedings the Tax Recovery Officer shall stay the recovery. Such part of the amount

specified in the certificate as pertains to such deduction for the period in which an appeal or other proceedings remains pending.

(3) Where a certificate has been drawn up and as a result of appellate order the amount is reduced, the Tax Recovery Officer shall modify the certificate or cancel it if it is necessary.

28.10.6 Other modes of recovery [Section 226]

(1) Where no certificate has been drawn up under section 222 the Assessing Officer may recover the tax by any one or more of the modes provided in the section.

(2) Where a certificate has been drawn up under section 222, the Tax Recovery Officer may without prejudice to the modes of recovery specified in this section recover the tax by any one or more of the modes provide in this section.

(3) This section enumerates the various modes of recovery by the Assessing or Tax Recovery Officer. Students may refer to the section for details.

28.10.7 Priority as regards recovery of taxes: Any claim in regard to any property in relation to which a notice under this section is issued, shall be void as against any demand contained therein. Where a person, on whom a notice (garnishee order) under this section has been served, objects on oath that the amount demanded from him is not due to the assessee or that he does not hold any money for or on behalf of the assessee, he cannot be compelled by the Assessing Officer to make the payment. But if it is later on found that such a statement made by him was false, he would personally become liable to pay the amount to the extent of his own liability to the assessee or to the extent of the assessee's liability, which ever is less. Such personal liability would arise even in cases where the person in receipt of a notice from the Assessing Officer makes a payment in disregard of the notice served on him.

Moneys belonging to the assessee in default which are in the custody of a Court or Receiver are also liable for attachment. Further, on being authorised by the Commissioner, the Assessing Officer is also empowered to recover the tax by distraint and sale of movable property as laid down in the Third Schedule. For details, students may refer to the Third Schedule in the Act. In addition, tax may be recovered, through the State Government if the recovery of tax in any area has been entrusted to it under the Constitution. In such a case the State Government may direct that the tax shall be recovered in respect of any particular area together with the municipal taxes or local rates by municipality or local authority [Section 227].

28.10.8 Tax Clearance Certificate [Section 230]: Sub-section (1) provides as follows -

(1) No person, who is not domiciled in India and who has come to India in connection with business, profession or employment; and who has income derived from any source in India, shall leave the territory of India by land, sea or air unless he furnishes to the prescribed authority an undertaking in the prescribed form.

(2) The said undertaking should be furnished from the employer of the said person or through whom such person is in receipt of the income.

(3) The undertaking should be to the effect that tax payable by such person who is not domiciled in India shall be paid by the employer or the person through whom any income is received.

(4) The prescribed authority shall, on receipt of the undertaking, immediately give to such

person a no-objection certificate, for leaving India.

(5) However, the provisions contained in sub-section (1) shall not apply to a person who is not domiciled in India but visits India as a foreign tourist or for any other purpose not connected with business, profession or employment.

Sub-section (1A) provides as follows -

(1) Every person, who is domiciled in India at the time of his departure, shall furnish, to the income-tax authority or such other authority as may be prescribed his permanent account number allotted to him under section 139A, the purpose of his visit and the estimated period of his stay outside India.

(2) In case no such permanent account number has been allotted to him, or his total income is not chargeable to income-tax or he is not required to obtain a permanent account number under the Income-tax Act, 1961 a certificate in the prescribed form shall be furnished to the income-tax authority or such other authority, as may be prescribed.

(3) However, where an income-tax authority opines that there exist circumstances which render an Indian domiciled to obtain a certificate under this section, such person shall not leave the territory of India by land, sea or air unless -

- (i) he obtains a certificate from the income-tax authority stating that he has no liabilities under the Income-tax Act 1961 and the Wealth-tax Act, 1957 or
- (ii) that satisfactory arrangements have been made for the payment of all or any of such taxes which are or may become payable by that person [First proviso to sub-section (1A)]

(4) No income-tax authority shall make it necessary for any person who is domiciled in India to obtain a certificate under this section unless he records the reasons therefor and obtains the prior approval of the Chief Commissioner of Income-tax.

If the owner or charterer of any ship or aircraft carrying persons from any place in India to any place outside India allows any of the above mentioned persons to travel by such ship or aircraft without first satisfying that such person is in possession of a certificate as required, he shall be personally liable to pay the whole or any part of the tax payable by such person. In such a case, the owner or charterer shall be deemed to be an assessee in default for such sum and recovery shall be as if it were an arrear of tax.

For the purpose of this section, the expressions "owner" and "charterer" include any representative, agent or employee empowered by the owner or charterer to allow persons to travel by the ship or aircraft.

28.10.9 Recovery by suit or under other law [Section 232]: Section 232 provides that the Assessing Officer or the Government can have recourse to the other modes of recovery under any other law for the time being in force, over the above various modes specified above to recover the tax dues under the Act, in the same way as other debts due to the Government. It shall also be lawful for the Assessing Officer or the Government to take recourse to any other law or file a suit in any manner for the recovery of the arrears due from the assessee.

28.11 Refunds

28.11.1 Eligibility and procedure: An assessee is entitled to claim a refund of tax if the tax actually paid (and not merely payable) by him or on his behalf for any assessment year exceeds the amount of tax with which he is properly chargeable under the Act for that year. This may arise usually as a result of excess deduction of tax at source from salaries, dividends, interest, to or as a result of excess payment of advance tax when the tax originally paid on assessment is reduced on appeal, revision, rectification or reference. Where such a claim or refund is made, the assessee cannot question the correctness or validity of the assessment or any other matter related thereto which has become final and conclusive. He is also debarred from asking for a review or revision of the assessment [Sections 237 and 242].

In case where the payer of income from salary, dividend, interest or other sum has wrongly deducted tax at source and paid the same to the credit of the Central Government, then it is the payer of the income who wrongly deducted tax (and not the recipient) who will be entitled to claim the refund provided that the recipient is neither taxable on the gross income nor entitled to credit in respect of the tax deducted. Where the tax payable by an unregistered firm is recovered from its partners the tax should be treated as having been paid by the firm and consequently, the application for refund must be made by the firm and not by the partner from whom the tax was recovered. In respect of tax free income (i.e. where salary, annuity, interest etc. is paid tax free) the amount of tax is included in the recipient's total income by adding it to the net income received; since the tax in such cases is deemed to have been deducted and paid on behalf of the recipient of the income, he would be entitled to claim a refund if the tax so paid is in excess of the amount with which he is properly chargeable.

Where the value of fringe benefits provided or deemed to have been provided by one employer is included under any provisions of Chapter XII-H in the value of fringe benefits provided or deemed to have been provided by any other employer, the latter alone is entitled to a refund under this Chapter in respect of such fringe benefits.

Generally, a claim for refund can be made only by the person on whose account the tax was already paid. But in cases where the income of one person is included in the total income of another person under sections 60 to 65, the latter person alone is entitled to claim the refund. If any person is not able to claim or receive the refund due to him on account of his death, mental incapacity, insolvency, dissolution, liquidation, etc., his legal representative or trustee, guardian liquidator or receiver, the case may be, is entitled to claim or receive the refund on behalf of such person [Section 238].

All claims of refunds should be made in the prescribed form (Form No. 30) and verified in the prescribed manner in accordance with Rule 41 of the Income-tax Rule and shall be accompanied by the return of income except in cases where such a return had already been filed. The requirements of the Rule are mandatory in nature and if an application or refund is not in compliance with the requirement of the Rule, it would be invalid and consequently will not be entertained. The claim for refund should be supported by the certificate of tax deducted at source. The claim may be presented by the claimant in person or through a duly authorised agent or may be sent by post.

The time-limit for making application for refund is one year from the last day of the relevant assessment year. This applies for a claim in respect of fringe benefits also [Section 239].

The Court has no power to extend this period of limitation in any case. This period of limitation would not, however, apply to cases where a refund becomes due to the assessee as a result of an order in appeal, reference, revision or making any reassessment; but in cases where the refund is due to the assessee on the basis of the completed regular assessment, the assessee may file a suit for the refund due to him if it is not granted on his application or he may file a petition for a writ of mandamus to compel the Department to make the refund. Where the refund becomes due to the assessee as a result of an order passed in appeal, reference, revision or rectification, he need not make an application to claim the same. In such a case, the Assessing Officer is bound to pass an order of refund without waiting for the application from the assessee. Where, by the order aforesaid an assessment is cancelled and an order of fresh assessment is directed to be made the refund shall become due only on the making of such fresh assessment. Where the assessment is annulled the refund shall become due only of the amount of tax paid in excess of the tax chargeable on the total income returned by the assessee [Section 240].

28.11.2 Correctness of assessment not to be questioned [Section 242] : While making a claim for refund, an assessee cannot question the correctness of any assessment or other matter decided which has become final and conclusive or ask for a review of the same. The assessee shall not be entitled to any relief on such claim except refund of tax wrongly paid or paid in excess.

28.11.3 Interest on Refunds [Section 244A]

(1) Section 244A provides that interest at $\frac{1}{2}\%$ for every month or part of a month shall be payable on tax or penalty becoming refundable on account of excess payment of advance tax, advance tax on fringe benefits, tax deducted at source or collected at source and other tax or penalty becoming refundable.

(2) The period for which the interest is payable will be -

- (i) Where the refund is of any advance tax or tax deducted or collected at source, the interest shall be payable for the period starting from 1st April to the date of the grant of refund.
- (ii) Where the refund is of other taxes/penalties, the interest shall be paid for the period starting from the date of payment of such tax or penalty upto the date on which the refund is granted.

(3) The assessee can claim interest on refund due also in pursuance of determination of total income under section 143(1) or on regular assessment. However, no interest shall be payable if the amount of refund due is less than 10% of the tax determined under section 143(1) or on regular assessment.

(4) Where there is a delay in granting refund and the reasons for such delay are attributable to the assessee, either wholly or in part, the period of the delay so attributable to the assessee shall be excluded from the period for which interest is payable. In case any question arises as to the period of delay attributable to the assessee, it shall be decided by the Chief Commissioner or Commissioner.

(5) Where as a result of an order passed under sections 143(3) or 144 or 147 or 154 or 155 or 250, 254, 260, 262, 263 or 264 or an order of Settlement Commission under section 245D, the amount on which interest is payable under section 244A is increased/reduced, the interest

shall be increased or reduced accordingly.

(6) Interest allowed under section 244A is the income of the previous year in which it is allowed, and should be declared in the return of income furnished in the assessment year relevant to the previous year.

28.11.4 Set off of refunds against tax remaining payable [Section 245]: Where a refund is found due to any person, the Assessing Officer, Deputy Commissioner (Appeals), Commissioner (Appeals) or Chief Commissioner or Commissioner may, in lieu of payment of the refund, set off the amount to be refunded or any part of that amount, against any tax or interest remaining payable by the said person under the Act. However, the set off can be done only after giving intimation in writing to such person of the action proposed to be taken under this section.

28.11.5 Other Provisions: In all cases where an assessment or reassessment is completed and any tax, interest, penalty, fine or any other sum is payable by the assessee, the Assessing Officer shall serve upon the assessee a notice of demand specifying the sum so payable. Though the Act does not prescribe any time limit within which a notice of demand should be served on the assessee the notice of demand must be issued within a reasonable time [Section 156]. Likewise, where the assessment results in a loss and such loss is to be carried forward, the Assessing Officer shall notify to the assessee by an order in writing the amount of such loss computed by him [Section 157]. In cases where a registered firm is assessed or an unregistered firm is assessed under section 183(b) as registered, the Assessing Officer shall notify to the firm, by an order in writing the amount of total income assessed and its apportionment amongst the several partners [Section 158]. The assessee has a right of appeal against any order passed by the Assessing Officer under sections 157 and 158.

Levy of Wealth Tax

1.1 Levy of Wealth Tax

The Wealth-tax Act came into force on 1st April, 1957. The Act seeks to impose an annual tax on the net-wealth of the specified classes of persons in respect of every assessment year commencing on and from 1st April, 1957. The tax is charged at the rate of 1% on the amount by which the net wealth of the assessee exceeds ₹ 30 lakh as on a particular date which is known as the valuation date. The tax is levied in accordance with the rate specified in section 3(2).

1.2 Applicability

The Wealth-tax Act, 1957 is applicable to the whole of India including Jammu & Kashmir. The Union Home Ministry has issued a notification extending the application of Wealth-tax Act 1957 to Sikkim. The Wealth-tax Act, 1957 will, therefore, apply to the net wealth of the residents of Sikkim on the valuation date being 31st March, 1990 or thereafter.

1.3 Definitions

Section 2 defines the various terms used in the Act. A thorough knowledge of these definitions is a *sine qua non* for a proper understanding of the various other provisions of the Act. Some of the important definitions are discussed below while some others have been discussed at appropriate places.

1.3.1 Assessee : The term 'assessee' as defined in section 2(c), means a person by whom wealth-tax or any other sum of money is payable under this Act and includes (i) every person in respect of whom proceedings under the Act have been taken for the determination of wealth tax payable by him or by any other person or the amount of refund due to him or such other persons (ii) every person who is deemed to be an assessee under the Act and (iii) every person who is deemed to be an assessee in default under the Act.

1.3.2 Assessment Year and Valuation Date : The definition of these two related expressions are given in sections 2(d) and 2(q) respectively. As mentioned at the outset, wealth-tax is chargeable on the net wealth of an assessee as on the valuation date relevant to the assessment year in question. The expression 'assessment year' means the period of 12 months commencing on the 1st day of April every year falling immediately after the valuation date. The 'valuation date' means the last day of the previous year in respect of the assessment year for the purpose of income tax assessment.

It may be noted that as a result of the introduction of the financial year as the uniform

1.2 Wealth tax

accounting year under the Income-tax Act, 1961, the valuation date in all cases will be 31st March.

In the case of assesseees who are not liable to pay any income-tax the valuation date is always the 31st March immediately preceding such assessment year. Where an executor is to be assessed to wealth-tax under section 19A, in respect of assets left by a deceased person, the valuation date shall be the same valuation date as would have been adopted in respect of the deceased if he were alive.

It is to be noted that as the tax is charged on the net wealth of an assessee on the corresponding valuation date, the existence of assets on the valuation date is a necessary condition for the levy. Where there is change of ownership of assets on the valuation date, it is the net wealth at the last moment of that day and not the first moment or during the day which shall be the subject of the assessment of wealth-tax.

1.3.3 Assets [Section 2(ea)] : The following assets would be chargeable to wealth tax: Section 2(ea) defines the term 'assets'. Accordingly "assets" mean:

- (i) Any building or land appurtenant thereto (hereinafter referred to as "house"), whether used for residential or commercial purposes or for the purpose of maintaining a guest house or otherwise including a farm house situated within 25 kilometers from local limits of any municipality (whether known as Municipality, Municipal Corporation or by any other name) or a cantonment Board, but does not include:
 - (1) a house meant exclusively for residential purposes and which is allotted by a company to an employee or an officer or a director who is in whole time employment, having a gross annual salary of less than ₹ 10,00,000.
 - (2) any house for residential or commercial purposes which forms part of stock-in-trade.
 - (3) any house which the assessee may occupy for the purpose of any business or profession carried on by him.
 - (4) any residential property that has been let out for a minimum period of 300 days in the previous year.
- (ii) **Motor cars:** All types of motor cars whether Indian or foreign will be treated as assets.
 - ◆ **Exclusion:** Motor car used by the assessee in the business of running them on hire or as stock-in-trade will be excluded from the scope of the term "assets".
Example: Maruti cars will not be treated as assets in the hands of Maruti Udyog Ltd. Similarly, in the hands of automobile dealers who purchase and sell cars, such cars will not be treated as assets.
- (iii) **Jewellery etc:** This head of assets includes jewellery, bullion and furniture, utensils or any other article made wholly or partly of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metal.
 - ◆ **Definition:** The Act has given an inclusive definition of the term 'jewellery' to include ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious

or semi-precious stones and whether or not worked or sewn into any wearing apparel. It also includes precious or semi-precious stones, whether or not set in any furniture, utensils or other article or worked or sewn into any wearing apparel.

- ◆ **Exclusion:** Following shall not be included in jewellery for the purpose of levy of wealth tax:
 - (a) Where any of the above assets is used by the assessee as stock-in-trade, it will not be considered as an asset.
 - (b) The Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 notified by the Central Government.
 - (iv) **Yachts, boats and aircraft:** It is to be noted that ships are not included in the definition.
- ◆ **Exclusion:** If the assessee uses the above assets for commercial purposes, then they will not be treated as assets. The term 'commercial purposes' has not been defined in the Act. Use for the purpose of the business of running on hire or as stock-in-trade can be treated as use for commercial purposes.

A different view was taken in *Garware Wall Ropes Ltd. v. Addl. CIT (2004) 89 ITD 221 (Mum.)*, where the aircraft used for one's own business is construed as used for "commercial purposes"

- (v) **Urban land:**

Inclusions within the definition of "urban land"

(i)	Land situated in any area which is comprised within the jurisdiction of a municipality or a cantonment board and which has a population of not less than 10,000.		
(ii)	Land situated in any area, within the distance, measured aerially, in relation to the range of population according to the last preceding census as shown hereunder –		
	Shortest aerial distance from the local limits of a municipality or cantonment board referred to in item (a)	Population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.	
	(1)	≤ 2 kilometers	$> 10,000 \leq 1,00,000$
	(2)	≤ 6 kilometers	$> 1,00,000 \leq 10,00,000$
	(3)	≤ 8 kilometers	$> 10,00,000$

1.4 Wealth tax

Example

	Area	Shortest aerial distance from the local limits of a municipality or cantonment board referred to in item (a)	Population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.	Is the land an urban land subject to wealth-tax?
(i)	A	1 km	9,000	No
(ii)	B	1.5 kms	12,000	Yes
(iii)	C	2 kms	11,00,000	Yes
(iv)	D	3 kms	80,000	No
(v)	E	4 kms	3,00,000	Yes
(v)	F	5 kms	12,00,000	Yes
(vi)	G	6 kms	8,000	No
(vii)	H	7 kms	4,00,000	No
(viii)	I	8 kms	10,50,000	Yes
(ix)	J	9 kms	15,00,000	No

Exclusions from the definition of "urban land"

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

Examples:

1. A acquires a plot of land measuring 500 square meters in New Delhi for constructing a house. He proposes lay out and gets the permission of Delhi Development Authority to build a house on the plot. However, he does not construct the house. The plot of land will be treated as urban land liable to wealth-tax.
2. In the above example, once A constructs house, the plot ceases to be an urban land. However, the house will be considered as an asset.

3. A was allotted an industrial plot in Ambattur industrial estate in Madras. This plot will not be considered as an urban land in A's hands for two years from the date of acquisition even if he does not start any industrial activity. However, once the period of two years expires, the plot will be considered as an urban land in A's hands unless he makes use of it for industrial purposes.

(vi) Cash in hand:

- (a) In the case of individual and HUF: Cash in hand whether recorded or unrecorded in excess of ₹ 50,000 will be considered as asset. Obviously, the limit of ₹ 50,000 will be considered as on the valuation date. It is clear that cash in bank will not be treated as asset.
- (b) In the case of other person: Any amount not recorded in the books of account will be considered as an asset. The ceiling limit of ₹ 50,000 is not applicable in this case. It follows that if cash is recorded, it will not be considered as an asset.

1.3.4 Net Wealth : The expression 'net wealth' according to the section 2(m) means the amount by which the aggregate value, computed in accordance with the provisions of this Act, of all the assets wherever located, belonging to the assessee on the valuation date, [including assets required to be included under section 4], in his net wealth as on that date under this Act, is in excess of the aggregate value of all the debts owed by the assessee, on the valuation date which have been incurred in relation to the said assets.

1.3.5 Company: As noted earlier, under section 3 of the Wealth-tax Act, 1957, wealth-tax is leviable on three categories of tax-payers namely, individuals, Hindu undivided families and companies. The definition of the term 'Company' in section 2 (h) provides that it will have the same meaning assigned to it as in clause (17) of section 2 of the Income-tax Act, 1961.

According to this definition, the term 'company' means any Indian company or (ii) any body corporate incorporated by or under the laws of a country outside India or (iii) any institution association or body which is or was assessable or was assessed as a company for any assessment year under the Income-tax Act, 1922 or for any assessment year commencing after 1.4.1970, or (iv) any institution, association or body, whether incorporated or not, whether Indian or non-Indian, which is declared by the Board by general or special order to be a company provided that such institution, association or body shall be deemed to be a company only for such assessment year or assessment years as may be specified in the declaration. The definition has got much importance in view of the fact that no wealth-tax is chargeable on the entities falling outside the scope, of this definition.

1.3.6 India [Section 2(ka)]

'India' means –

- (i) the territory of India as per article 1 of the Constitution,
- (ii) its territorial waters, seabed and subsoil underlying such waters,
- (iii) continental shelf,
- (iv) exclusive economic zone or

(v) any other specified maritime zone and the air space above its territory and territorial waters.

Specified maritime zone means the maritime zone as referred to in the Territorial Waters, Continental Shelf, Exclusive Economic Zone and other Maritime Zones Act, 1976.

1.4 Deductibility of Tax Liabilities

In the case of *Sethu Parvathi Bai vs. CWT (1968) 69 ITR (SC)*, it was held that the wealth tax liability of an assessee on the valuation date for the assessment year beginning on the first day of April next following is 'debt owed' within the meaning of section 2(m) and would be deducted from the estimated value of the assets as on the valuation date.

However, *CBDT Circular No. 663 dated 28-4-1993* observes that consequent to the amendment of section 2(m), w.e.f. the assessment year 1993-94, the question has arisen regarding admissibility of deduction of the wealth tax liability for the purpose of computing the taxable net wealth. The Board has opined in the circular that the liability under the Wealth-tax Act, 1957 is not a debt owed by the assessee in relation to the assets taxable under Wealth-tax Act, 1957. The liability of wealth tax is the personal liability of the assessee. Moreover, this liability is not a debt incurred by the assessee but is created by the Statute. Therefore, no deduction is to be allowed for the wealth tax liability in the computation of the taxable net wealth of the assessee from the assessment year 1993-94 onwards.

In *C.W.T. vs. H.H. Vijayamba Dowagar Maharani Saheb of Bhavnagar (1979) 117 I.T.R. 784*, the Supreme Court held that even a liability resulting from an enforceable, family arrangement is admissible as a 'debt' owed, under section 2(m). It may be noted that section 2(m) refers to debts actually and really owed by the assessee as distinguished from notional ones, thus estimated liability to capital gains on a notional sale would not be deductible as debt. [*Bharat Har Singhania vs. CWT (1979) ITR.258 (All)*].

However, it may be noted that the principles emerging from the above rulings would apply now in relation to debts which have been incurred in relation to the specified assets. Only those debts incurred in relation to those assets which are included in the wealth of the assessee and outstanding as on the valuation date are deductible.

1.5 Chargeability

1.5.1 Persons chargeable to tax: Wealth tax is chargeable on the net wealth of every individual, Hindu undivided family and company at the rate of 1% of the amount by which the net wealth exceeds ₹ 30 lakh.

The terms 'individual' and 'Hindu undivided family' have not been defined either in the Income-tax Act, 1961, or in the Wealth-tax Act, 1957, and, therefore, they have to be construed in their general sense. For the purpose of wealth-tax, the word 'individual' has been interpreted in several cases to include a group or body of individuals like joint heirs, joint donees, joint purchasers, body of trustees, Mappilla, Marumakkathiyam Tarward and a financial corporation established under the Central, Provincial or State Act.

As regards the Hindu undivided family, the expression is used with reference to all Schools of Hindu Law and it includes even a Jain undivided family [*C.W.T. vs. Shrimati Champa Kumari*

Singhi and others (1972) 83 ITR. 720 (SC)].

It is to be noted that the expression Hindu undivided family is different from the Hindu coparcenary. The Hindu joint family consists of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters. A Hindu coparcenary, on the other hand, is a much narrower body than the joint or coparcenary property, those being sons, grandsons and great grandsons of the holder of the joint family property for the time being. Therefore, there may be Hindu undivided family, even when there is a single coparcener along with the widows of deceased members. If there is property belonging to the Hindu undivided family, assessment can be made on the single coparcener in the status of Hindu undivided family. The Supreme Court held in *Narendranath vs. C.W.T. (1969) 74 ITR 190*, that there is nothing in the Wealth-tax Act, 1957 to suggest that the Hindu undivided family as an assessable unit must consist of at least two male members. It was held that when a coparcener of a Hindu undivided family governed by Mitakshara School of Hindu Law having a wife and two minor daughters and no son receives his share in the joint family property on partition such property in the hands of the coparcener belong to the Hindu undivided family of himself, of his wife and minor daughter and cannot be assessed as his individual property. In view of this decision the joint family-property acquired by a single coparcener on partition or by survivorship along with his wife and minor daughter shall be assessed in the hands of the sole coparcener as the property of the Hindu undivided family and not that of an individual. Similarly any property in the hands of the sole surviving coparcener on the induction of a lineal descendent or in the presence of a person who is to be treated as member of the joint family, e.g., mother who is entitled to maintenance, has to be impressed with the character of the joint family property. However, a single member by himself, cannot constitute a Hindu undivided family and to constitute joint family, there must be more than one member. The word 'family' always signifies a group. Plurality of persons is an essential attribute of a family. A single person, male or female does not constitute a family [*C. Krishna Prasad vs. CIT (1974) 97 ITR 493 (SC)*].

In *CWT. vs. Gaitri Shanker Bhar (1972) 84 ITR 609*, the Supreme Court affirming the view of the Calcutta High Court held that a joint family consisting of the legal heirs of deceased person did not come into existence spontaneously on the death of that person where he was governed by Dayabagha School of Hindu Law. After the death of a father, belonging to the Dayabagha School, his successors may live as Hindu undivided family or be separate. If they do not decide to live together as Hindu undivided family, they merely own the inherited property as joint property as tenants in common but do not form a joint family. A joint family amongst brothers under the Dayabagha law is not a creation of law but of desire to live jointly. On the facts of this case, the Court held that heir of the deceased had taken the property of the deceased in separate shares and that according to law each one of them become liable to pay wealth tax as an individual.

1.5.2 Nature of property inherited by a Hindu under section 8 of Hindu Succession Act: There was a judicial controversy regarding the issue as to whether the property which devolved on a Hindu, on the death of his father intestate, after the coming into force of the Hindu Succession Act, under section 8 of that Act, would constitute HUF property consisting of his own branch including his sons or his own individual property. The High Courts of Allahabad, Madras (Full Bench), M.P. and A.P. on the one side, held the view that

such property would be individual property in the hands of the son while the Gujarat High Court on the other hand took the view that such property would be in the nature of joint family property in the hands of the son and not his separate property.

The Supreme Court has resolved this controversy in the case of *CWT vs. Chander Sen (1986) 161 ITR 370 (SC)* by overruling the Gujarat High Court's decision and approving the view of the other courts. The Supreme Court pointed out that the Hindu Succession Act was enacted to amend and codify the law relating to intestate succession among Hindus. Section 8 of the Act lays down the scheme of devolution of the property of a Hindu dying intestate and the express words of this provision cannot be ignored and must prevail.

Certain heirs have been classified in the Schedule under section 8 on whom such property should devolve. Those specified in Class 1 take the property simultaneously to the exclusion of all other heirs. Class 1 heirs, include son, daughter, etc., including the son of a predeceased son but does not include specifically the grand son, being a son of son living. The Supreme Court emphasized that he (grand son) could not get any right in the property of his grandfather. In the view of the matter, the Supreme Court held that when son inherits the property in the situation contemplated by section 8 he does not take it as Karta of his own undivided family. The property which devolved on a Hindu on the death of his father intestate after the coming into force of the Hindu Succession Act, 1956 did not constitute HUF property consisting of his own branch including his sons.

In the case before the Supreme Court, R and his son C constituted a HUF. On 10-10-1961, there was a partial partition in the family by which the business was divided between the father and the son and thereafter it was carried on by a partnership consisting of the two. On 17-7-1965 R died leaving behind his son C and his grandsons i.e. the sons of C. His wife and mother predeceased him and he had no other issue except C. On his death, there was a credit balance of ₹ 1,83,043 in his account in the books of the firm. For the assessment year 1966-67 the sum of ₹ 1,83,043 standing to the credit of R was not included in the net wealth of the family of C. (the assessee family) on the ground that this amount devolved on C to his individual capacity and was not the property of the assessee family. A sum of ₹ 23,330 was credited to the account of late R on account of interest accruing on his credit balance. In the proceedings under the Income-tax Act, 1961 for the assessment year 1967-68 the sum of ₹ 23,330 was claimed as deduction.

The Assessing Officer disallowed the claim relating to interest on the ground that it was a payment made by C to himself. Likewise, in the Wealth-tax assessment, the amount standing to the credit of R was included by Assessing Officer in the wealth of assessee family.

The Supreme Court based on the reasoning explained earlier, held on the facts of the case, that the sums standing to the credit of R belonged to C in his individual capacity and not the Hindu family and the interest of ₹ 23,330 was an allowable deduction in respect of the income of the family from the business.

It is to be noted that the holder of an impartible estate is to be assessed to wealth-tax as an individual owner of the properties comprised in the estate. It may also be noted that firm or an association of persons is not chargeable to wealth tax as such. However, the value of the interest of the partner or the member in the assets of the firm or association determined in the

manner laid down in Schedule III is to be included in the assessment of the net wealth of the individual concerned. These points will be considered later in the context of the discussion on section 4.

- ◆ **Exemption Limit :** Wealth tax shall be charged on the net wealth of every individual, Hindu undivided family and company at the rate of 1% of the amount by which the net wealth exceeds ₹ 30 lakh.

1.5.3 Entities not liable to tax: According to section 45, no tax shall be levied under this Act in respect of the net wealth of:

- (i) any company registered under section 25 of the Companies Act, 1956¹;
- (ii) any co-operative society;
- (iii) any social club
- (iv) any political party.
- (v) a Mutual Fund specified under section 10(23D).
- (vi) the Reserve Bank of India incorporated under the Reserve Bank of India Act, 1934.

It may be noted that the expression 'political party' for the purposes of (iv) above will have the meaning assigned to it in the *Explanation* to section 13A of the Income-tax Act, 1961. The expression would cover an association or body of individual citizens of India registered with the Election Commission of India as a political party and would also include a political party deemed to be registered with that Commission under the Election Symbols (Registration and Allotment) order, 1968.

1.5.4 Gamut of taxation: In computing the net wealth of an individual who is not a citizen of India or an individual or a HUF not resident in India or resident but not ordinarily resident in India or a non-resident company during the year on the valuation date, the following assets will not be taken into account:-

- (i) The value of the assets and debts located outside India.
- (ii) The value of the assets in India represented by any loans or debts owing to the assessee.

However, in order to claim exemption, in respect of such assets, the interest payable on such loans or debts should not be includible in the total income of the assessee under section 10 of the Income-tax Act, 1961.

It is clear, therefore that the citizenship and the residential status affect both the chargeability and the liability under the Act. The residential status of the assessee is to be judged by the same principles as laid down in section 6 of the Income-tax Act, 1961

- ◆ **Location:** The above discussion will also make it clear that for the purpose of computing the net wealth it is essential to ascertain location of assets and debts whether they are in India or outside India. The question as to where the asset is located is essentially one of fact and will have to be decided in the light of the available evidence. The following instructions have been issued by the CBDT for general guidance in this regard:

¹ Section 8 of the Companies Act, 2013

- (a) Tangible immovable property is situated in India if the property lies in India.
- (b) Rights or interest in or over immovable property (otherwise than by way of security) or benefits arising out of immovable property are located in India in the immovable property to which the rights are attached, or on of which the benefits arise, lies in India.
- (c) Rights or interest (otherwise than by way of security in/over tangible movable property are located in India, if such property is located in India or if it is in transit to India.
- (d) Debts: The general principle of law is that the debts are situate where the debtor resides and a stipulation that the payment should be made in a country where the debtor is not residing does not affect the general rule and therefore 'Debts' secured or unsecured (other than those dealt separately) are located in India if they are contracted to be repaid in India or if the debtor is residing in India.
- (e) Moneys kept in a bank account in the form of deposits or otherwise are located in India if the branch of the bank at which the account is kept is situated in India.
- (f) Security issued by the Central Government or a State Government or a Municipality or other local authority in India are located in India unless they are inscribed for payment outside India.
- (g) Shares, stocks, debentures or debenture stock in a company are located at the place where the company is incorporated.
- (h) Ships or aircraft are located in India if they are registered in India.
- (i) Copyright or licence to use any copyright material, a patent, a trade mark or design is located in India if the right arising, therefrom is exercisable in India.
- (j) Patents trade marks and designs are located in India if they are registered in India.
- (k) Rights or causes of action ex-delicto (i.e., arising out of wrongs) not included in any of the items mentioned above, are situated in India if they are enforceable in India.

It is not possible to give an exhaustive list of assets and the principle to be applied in determining the location of all assets. For assets which are not covered under the above items, the location has to be fixed, having regard to the nature of the assets.

1.6 DEEMED ASSETS

Assets belonging to others but includible in the net wealth of an individual [Section 4]

1.6.1 Assets transferred to certain persons: Section 4 extends the gamut of taxation of net wealth of an individual. It provides that net wealth of an individual will include, in certain circumstances, certain assets belonging to others. This section applies only to individuals and the term "individual" for this purpose includes both male and a female.

Section 4(1) (a) provides that in computing the net wealth of an individual, the value of assets which, on the valuation date, are held by the following persons should be included as if they belong to the individual:

- (1) Assets held by his/her spouse to whom such assets have been transferred directly or indirectly without adequate consideration or otherwise than in connection with an agreement to live apart.

- (2) Assets held by his/her minor child. It is significant to note that it is not necessary that such assets must have been transferred directly or indirectly by the individual to the minor. Consequently, all assets held by a minor child will be included in the net wealth of the individual. However, if such a minor child is (a) suffering from any disability of the nature specified in section 80U of the Income-tax Act, 1961 or (b) a married daughter of such individual, there will be no such clubbing of wealth. The clubbing provisions will not apply in respect of such assets as have been acquired by the minor child out of his income earned from any manual work done by him or activity involving application of his skill, talent or specialised knowledge and experience. In all other cases of assets held by a minor child, the value of such assets will be clubbed with the value of assets held by the individual as per the procedure laid down in the provision.

Where the clubbing provisions operate, the assets will be clubbed as follows:-

- (a) Where the marriage of his parents subsists, the assets will be clubbed in the net wealth of that parent whose net wealth (excluding assets of the minor child so includible) is greater.
- (b) Where the marriage of his parents does not subsist, they will be clubbed in the net wealth of that parent who maintained the minor child in the previous year as defined by the Income-tax Act, 1961.

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

- (3) Any other person or AOPs to whom such assets have been transferred by the individual directly or indirectly otherwise than for adequate consideration for the immediate or deferred benefit of the individual or his/her spouse.
- (4) Any person or AOPs to whom such assets have been transferred by the individual otherwise than under an irrevocable transfer.

It is significant to note that the term "transfer" has not been defined by the Wealth tax Act, 1957.

- (i) For the purposes of section 4, the expression "transfer" includes any disposition, settlement, trust, covenant, agreement or arrangement.
- (ii) The expression "irrevocable transfer" includes a transfer of assets which, by the term of the instrument effecting it, is not revocable for a period exceeding 6 years or during the life time of the transferee and under which the transferor derives no direct or indirect benefit, but does not include a transfer of assets if such instrument
 - (a) contains any provision for the retransfer directly or indirectly of the whole or any part of the assets or income therefrom to the transferor; or
 - (b) in any way gives the transferor a right to reassume power directly or indirectly over the whole or any part of the assets or income therefrom.

It will be interesting here to note the definition of transfer and revocable transfer under section 63 of the Income-tax Act, 1961.

Accordingly, for the purposes of section 60, 61, 62 and 63, a transfer shall be deemed to be revocable if-

- (a) it contains any provision for the retransfer directly or indirectly of the whole or any part of the income or assets to the transferor or
- (b) it in any way gives the transferor a right to reassume power directly or indirectly over the whole or any part of the income or assets.

Transfer includes any settlement, trust, covenant, agreement or arrangement.

As noted earlier, section 4 applies only to individuals and consequently transfer by HUF or transfer of HUF's property made by a Karta to coparcener's wife or minor child or even to his own wife as Karta will not fall under the purview of this section. The relationship of spouse must exist on the date of transfer and subsist on the valuation date. If the husband buys his property in the name of his wife or child out of his own funds, it would amount to transfer within the meaning of this section.

- (5) Assets held by son's wife of such individual to whom such assets have been transferred by the individual directly or indirectly on or after 1st June, 1973 otherwise than for adequate consideration.
- (6) Assets held by a person or association of persons to whom such assets have been transferred by the individual directly or indirectly on or after 1st June 1973 otherwise than for adequate consideration for the immediate or deferred benefit of the son's wife of such individual or both.
- ◆ Transferred asset converted into another form — value of which asset is to be included: Section 4(1)(a) specifically provides that the clubbing envisaged under the provision would operate whether the assets referred to above are held in the form in which they were transferred or otherwise.

There was a judicial controversy regarding the question as to where a transferred asset is converted into another form, whether the value of the originally transferred asset or the converted asset as on the valuation date is to be included in the net wealth. Recently, the Supreme Court resolved this controversy in *CWT vs. Kishanlal Bubna (1993) 204 ITR 600* by holding that it is the value of the converted asset as on the valuation date that is to be included. The words, "such assets" in sub-clause (iii) of section 4(1)(a) do, no doubt refer to the assets described in clause (a) in the sense that they mean "those assets". However, the use of the words "such assets" does not imply that it is only the value on the valuation date of the assets that were actually transferred which is to be taken into account and not of any assets to which those transferred assets may have been converted. The words "whether the assets referred to in any of the sub clauses aforesaid are held in the form in which they were transferred or otherwise" put the matter beyond doubt. Where, what is transferred by the assessee is money and the transferee utilises that money to acquire an asset, it is the value of that asset on the valuation date which is relevant for the purpose of inclusion in the net wealth of the assessee. Where, what is transferred by the assessee is an asset and the transferee disposes of that asset and acquires with the consideration received another asset it is the value of that acquired asset on the valuation date which is relevant for the purposes of computing the net

wealth of the assessee.

Example Mr. A made a cash gift of ₹ 1,00,000 to Mrs. A in 2002. Mrs. A purchased a flat in Delhi with that money. The value of the flat on 31st March 2014 i.e. valuation date of Mr. A's wealth-tax assessment was ₹ 5,75,000. The value of the flat that is to be included in the net wealth of Mr. A as per section 4(1)(a) is ₹ 5,75,000 and not ₹ 1,00,000. It is assumed that Mr. A owns another house in respect of which he claims exemption under section 5(i).

1.6.2 Share in partnership firms or an Association of Persons: Section 4(1) provides that where the assessee is a partner in a firm or is a member of an association of persons, the value of his interest in the assets of the firm or association determined in the manner laid down in Schedule III is to be included in his net wealth.

The manner in which such value is to be computed has been prescribed in Rule 16 of Schedule III of the Wealth-tax Act, 1957. Valuation of assets under Schedule III to the Act has been discussed in detail later in this chapter.

1.6.3 Conversion of separate property of an individual into HUF property or gift of individual property into HUF property: Section 4(1A) prevents the avoidance or reduction of tax liability through the device of converting separate property of an individual into joint property. The relevant provisions are explained below:

- (i) Where an individual converts his separate property into a joint family property of the Hindu undivided family of which he is a member, by impressing such property with the character of the joint family property or by throwing such property into common stock of the Hindu undivided family or by transferring such individual property to the family otherwise than for adequate consideration he will be deemed to have transferred the converted property through the family to the members of the family for being held by them jointly.
- (ii) In such a case the entire value of the property so converted or transferred would be included in the net wealth of the individual who made the conversion.
- (iii) In the event of a partial or total partition in the Hindu undivided family the shares allotted to the spouse of such individual in the converted or transferred property will be included in the net wealth of the individual on the footing that they represent assets transferred by the individual indirectly.

The term 'property' has been given an extended meaning for the purposes of this provision. It includes any interest in property movable or immovable the proceeds or sale thereof and money or investment for the time being representing the proceeds of sale thereof and where the property is converted into any other property by any method such other property.

Thus this provision covers not only conversion of individual property into H.U.F. property but also gift of individual property into H.U.F. property.

1.6.4 Gift by book entries: Sub-section (5A) provides that in cases where a gift of money from one person to another is made by means of entries in the books of account maintained by the person making the gift or by an individual or H.U.F. or a partnership firm or an association of persons or body of individual with whom or with which the individual has any business or other relationship the value of such gift shall be included in the computation of the

net wealth of the person who makes the gift, unless the person proves to the satisfaction of the Assessing Officer that the money has actually been delivered to the other person at the time the entries were made.

1.6.5 Impartible estate: Section 4(6) provides that the holder of an impartible estate is deemed to be individual owner of all properties, comprised in the estate. Some properties, although partible by nature, can be impartible by custom or by the terms of a grant by Government in the sense that such properties always devolved on a single member of the family to the exclusion of other members. Impartible estate are estates which by special law or customs descend to one member and which are impartible, though they are joint property, in the eyes of law, belonging equally to other members. Ancient Zamindari estates descending to a single member by special family custom, jagirs, palayams in Tamil Nadu can be cited as examples of impartible estates.

As a result of the various legislations that have been and are being made by the various State Governments as well as Central Governments liquidating all Zamindari estates, big and small, whether partible or impartible and the abolition of the privileges of the former rulers of Indian States, the topic of ownership of impartible estates has got only academic importance now.

1.6.6 Tax treatment of members of co-operative housing societies, etc.: Sub-section (7) deals with tax treatment of members of co-operative society, company or other association of persons. Where the assessee is a member of a co-operative society, company or other association of persons and a building or part thereof is allotted or leased to him under a house building scheme of the society, company or association, as the case may be, the assessee shall, notwithstanding anything contained in this Act or any other law for the time being in force, be deemed to be the owner of such building or part and the value of such building or part, shall be included in computing the net wealth of the assessee; and, in determining the value of such building or part, the value of any outstanding installments of the amount payable under such scheme by the assessee to the society, company or association towards the cost of such building or part and the land appurtenant thereto shall, whether the amount so payable is described as such or in any other manner in such scheme, be deducted as a debt owed by him in relation to such building or part.

1.6.7 Tax treatment in the case of part performance etc. : As per sub-section (8), a person

- (a) who is allowed to take or retain possession of any building or part thereof in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882;
- (b) who acquires any rights (excluding any rights by way of a lease from month to month or for a period not exceeding one year) in or with respect to any building or part thereof by virtue of any such transaction as is referred to in clause (f) of section 269UA of the Income-tax Act, 1961, shall be deemed to be the owner of that building or part thereof and the value of such building or part shall be included in computing the net wealth of such person.

Section 269UA(f) defines "transfer" for the purposes of purchase of immovable properties by the Central Government. Accordingly, "transfer"

- (i) in relation to any immovable property means transfer of such property by way of sale or

exchange or lease for a term of not less than twelve years, and includes allowing the possession of such property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882 (4 of 1882).

Explanation : For the purposes of this sub-clause, a lease which provides for the extension of the term thereof by a further term or terms shall be deemed to be a lease for a term of not less than twelve years, if the aggregate of the term for which such lease is to be granted and the further term or terms for which it can be so extended is not less than twelve years.

- (ii) in relation to any immovable property of the nature referred to in sub-clause (ii) of clause (d) means the doing of anything (whether by way of admitting as a member of or by way of transfer of shares in a co-operative society or company or other association of persons or by way of any agreement or arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, such property.

◆ **Certain definitions for the purposes of section 4**

- (i) the expression "transfer" includes any disposition, settlement, trust, covenant, agreement or arrangement;
 - (ii) the expression "child" includes a step-child and an adopted child;
 - (iii) the expression "irrevocable transfer" includes a transfer of assets which, by the terms of the instrument effecting it, is not revocable for a period exceeding six years or during the lifetime of the transferee, and under which the transferor derives no direct or indirect benefit, but does not include a transfer of assets if such instrument-
 - (a) contains any provision for the retransfer, directly or indirectly, of the whole or any part of the assets or income therefrom to the transferor; or
 - (b) in any way gives the transferor a right to reassume power, directly or indirectly, over the whole or any part of the assets or income therefrom;
 - (iv) the expression "property" includes any interest in any property movable or immovable, the proceeds of sale thereof and any money or investment for the time being representing the proceeds of sale thereof and where the property is converted into any other property by any method, such other property.
- ◆ **Liability of transferee:** It may be noted that section 33 of the Wealth-tax Act, 1957 fastens a liability on the transferees to pay the ratable part of tax on the assets held by them and which are included in the transferor's wealth under the provisions of section 4, under certain circumstances.

1.7 Exemptions

Section 5 enumerates assets that are not to be included in the net wealth of an assessee and on which the assessee is not required to pay any wealth tax. A thorough knowledge of this provision is important not only from the point of view of examination but also from the point of view of claiming one's rights under the Act. The properties which enjoy the exemption under various clauses of section 5 are listed below.

- (1) Any property held by the assessee under trust or other legal obligation for any public purpose of a charitable or religious nature in India [Clause (i)].

However, as under the Income-tax Act, 1961, the exemption under this provision will not be available in respect of business assets of public charitable or religious trusts and institutions except in the following cases:

- (a) Where the business is carried on by a trust wholly for public or religious purposes and the business consists of printing and publication of books or the business is of a kind notified by the Central Government in this behalf in the Official Gazette.
- (b) The business is carried on by an institution wholly for charitable purposes and the work in connection with the business is mainly carried on by the beneficiaries of the Institution.

The exemption which is available to the trustees of a public trust, is subject to the provisions of section 21A discussed later. It is to be noted that in the case of a trustee of a private trust, there is no exemption and the value of the trust property becomes includible in the net wealth of the trustee in his capacity as trustee.

The Bombay High Court held in *Trustees of Bhiwandiwalla Trust vs. C. W.T. (1976) I.T.R. 709* that under section 5(i) all the objects need not fall within the expression "public purpose of a charitable or religious nature in India". It would be sufficient if the objects of the trust considered as a whole could be regarded to be within the expression. But the A.P. High Court held in *C.W.T. vs. Hyderabad Race Club (1978) 119 ITR 453*, that where assets are held for a public purpose which was both charitable and non-charitable in nature the assets held by assessee were liable to tax irrespective of whether they are applied solely for charitable purpose or for non-charitable purpose. The Andhra Pradesh High Court held in *C.W.T. vs. Trustees of H.E.H. The Nizam's Religious Endowment Trust (1977) 108 ITR 229* that in order to be entitled to exemption under section 5(i) of the Wealth-tax Act, 1957, the property must be held under trust for religious and charitable purpose and such purpose must be confined in its scope to the taxable territories. The area or purpose of the trust is the decisive factor for claiming exemption.

However, exemption in respect of property forming part of business of the aforesaid institutions would now be available only if such institution satisfies the conditions of section 11(4A) of the Income-tax Act, 1961.

- (2) The interest of the assessee in the coparcenary property of the Hindu undivided family of which he is a member [Clause (ii)].
- (3) Any one building in the occupation of a Ruler, being a building which immediately before the commencement of the Constitution (26th Amendment) Act, 1971, was his official residence by virtue of a declaration by the Central Government [Clause (iii)].
- (4) Jewellery in the possession of a Ruler which is not his personal property and which is recognised by the Central Government as his heirloom [Clause (iv)].

This recognition of the jewellery in the possession of a Ruler as his heirloom is also subject to certain conditions and if any of the specified conditions is not fulfilled the Board has the power to withdraw the recognition. In such a case of withdrawal of the recognition, wealth-tax shall be payable by the Ruler for the assessment years for which the jewellery was exempted on account of the recognition. The fair market value of the jewellery on the date of the withdrawal of the recognition shall be deemed to be the fair

market value of such jewellery on each successive valuation date relevant to the assessment years. However, in such a case, the aggregate amount of wealth tax payable in respect of the jewellery for all the assessment years (in respect of which tax becomes payable consequent on withdrawal of the recognition) shall not exceed 50% of its fair market value on the valuation date relevant for the assessment year in which recognition was withdrawn.

- (5) Clause (v) provides wealth tax exemption in respect of
- (a) money
 - (b) value of assets brought into India and
 - (c) value of assets acquired by him out of such moneys to an assessee, who must be person of Indian origin or Indian citizen and who must have returned to India from a foreign country for settling down permanently.

This exemption will be available only for a period of seven assessment years commencing with the assessment year next following the date on which such persons returned to India.

In the case of a person covered by the provisions the moneys and the value of assets brought by him into India and the value of the assets acquired by him out of such moneys within one year immediately preceding the date of his return and at any time thereafter will qualify for exemption.

The Explanation to this clause clarifies that the moneys standing to the credit of a person (to whom this clause is applicable in a non-resident external) account in any Bank in accordance with the *Foreign Exchange Management Act, 1999* and rules made thereunder on the date of his return shall be deemed to be moneys brought by him into India on that date.

- (6) The following are exempt under clause (vi) in the case of an individual/HUF –
- a house or part of house, or
 - a plot of land not exceeding 500 sq. meters in area.

Valuation Under Wealth Tax Act, 1957

2.1 Valuation of Assets [Section 7 read with Schedule III]

Under section 7, the value of any asset other than cash on the valuation date is to be determined in the manner laid down in the Schedule III to the Wealth-tax Act, 1957. Sub-section (2) of section 7 gives option to the assessee in the case of a house belonging to him and exclusively used by him for residential purposes to have the value determined under Schedule III as on the valuation date next following the date on which he became the owner of the house or the value determined for valuation date relevant to the assessment year ending on 1.4.71, whichever valuation date is later.

The *Explanation* to section 7(2) clarifies that where the house is constructed by the assessee, he shall be deemed to have become the owner of the house on the date on which the construction of such house was completed. For this purpose, the term “house” includes a part of a house being an independent residential unit.

Schedule III contains the rules for the valuation of various types of assets. It contains Parts A-H:

2.2 Valuation of Assets other than cash (Part-A)

- (a) Rule 1 in this part provides that the value of any asset other than cash for the purposes of the Wealth-tax Act shall be determined in the manner laid down in Rules 2 to 21.
- (b) Rule 2 contains the definition of various terms for the purposes of this Schedule. The following are some of the more important definitions:
 - (i) “accounting year” in relation to a company means, a period in respect of which any profit and loss account of the company laid before it in the annual general meeting is made up;
 - (ii) “gold” means, gold, including its alloy whether virgin, or melted or remelted, wrought or unwrought in any shape or form of a purity of not less than 9 carats and includes any gold coin [whether legal tender or not] in gold ornament and any other article of gold;
 - (iii) “gold ornament” means, any article in a finished form made for personal adornment or for the adornment of any idol, deity or any other object of religious worship made of, or manufactured from gold, whether or not set with stones or gems, real or artificial or with pearls, cultured or imitation, or real or with all or any of them and includes parts, pendants or broken pieces of gold ornaments.
 - (iv) “investment company” means, a company whose gross total income consists mainly of income which is chargeable to income- tax under the heads “income from house property”, “capital gains” and “income from other sources”.

- (v) "jewellery" includes -
 - (a) ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stones and whether or not worked out or sewn into any wearing apparel;
 - (b) precious or semi-precious stones, whether or not set in any furniture, utensils or any other article or worked out or sewn into any wearing apparel.

2.3 Valuation of Immovable Property (Part-B)

Rules 3-8 of Schedule III of the Wealth-tax Act, 1957, provide for the valuation of immovable property. The term immovable property includes commercial property also.

- ◆ **Step 1 : Gross maintainable rent (Rule 5) :** The first step for finding out the valuation of immovable property is to find out the gross maintainable rent. Rule 5 defines gross maintainable rent. There are two situations here:
 - (a) *Where the property is let:* Gross maintainable rent here means the annual rent received or receivable by the owner or the annual value assessed by the local authority in whose area the property is situated for the purpose of levy of property tax or any other tax on the basis of such assessment, whichever is higher;
 - (b) *Where the property is not let out:* Gross maintainable rent means the annual rent assessed by the local authority or if there is no such assessment, the amount which the owner can reasonably be expected to receive as annual rent had such property been let.

Annual rent : For the purposes of the above rule, "annual rent" means,

- (a) where the property is let out throughout the year ending on the valuation date, the actual rent received or receivable by the owner;
- (b) where the property is let for only a part of the previous year, the amount which bears the same proportion to the amount of actual rent received or receivable by the owner for the period for which the property is let as the period of taxable months bears to the number of months (including part of a month) during which the property is let during the previous year.

In the following cases, the actual rent is to be increased in the manner specified below :

- (i) Where the property is occupied by a tenant and he agrees to bear the municipal taxes, by the taxes so borne by him;
- (ii) Where the property is occupied by a tenant and he agrees to bear the cost of repairs, then, by 1/9th of the actual rent;
- (iii) Where the owner has accepted any amount as deposit (not being advance payment towards rent for a period of three months or less), by the amount calculated at the rate of 15% per annum on the amount of deposit outstanding from month to month, for the number of months (excluding part of a month) during which such deposit was held by the owner in the previous year and if the owner is liable to pay interest on such deposit, the increase to be made under this clause shall be limited to the sum by which the amount

calculated as aforesaid exceeds the interest actually paid.

- (iv) Where the owner has received any amount by way of premium or otherwise as consideration for leasing of the property or any modifications of the terms of the lease, by the amount obtained by dividing the premium or other amount by the number of years of the period of the lease;
- (v) Where the owner derives any benefit or perquisite, whether convertible into money or not, as consideration for leasing of the property or any modification of the terms of the lease by the value of such benefit or perquisite.

Rent received or receivable: This term includes all payments for the use of the property by whatever name called, the value of all benefits or perquisites whether convertible into money or not obtained from a tenant and any sum paid by a tenant in respect of any obligation which but for such payment would have been payable by the owner.

- ◆ **Step 2: Net Maintainable Rent (Rule 4):** For arriving at the net maintainable rent, the following amounts are to be deducted from the gross maintainable rent:
 - (i) The amount of taxes levied by any local authority in respect of the property;
 - (ii) 15% of the gross maintainable rent.
- ◆ **Step 3: Valuation of Immovable Property (Rule 3)**
 - (i) The above net maintainable rent is to be multiplied by 12.5 in case the property is a freehold property;
 - (ii) Where the property is leasehold and the unexpired period of such lease is 50 years or more, the multiplying factor is 10.
 - (iii) Where the property is leased out and the unexpired period of lease is less than 50 years, the multiplying factor is 8.
 - (iv) Where such property is acquired or constructed after 31.3.1974, if the value of cost of acquisition or construction plus improvement thereto is more than the value arrived at as above, the cost of acquisition or cost of construction as so increased will be the value of the property;
 - (v) The restriction mentioned in point (iv) will not apply in the case of one house belonging to the assessee if the following conditions are satisfied:
 - (a) such house is acquired or constructed after 31.3.1974;
 - (b) the house is exclusively used by the assessee for his own residential purposes throughout the period of 12 months immediately preceding the valuation date;
 - (c) cost of construction does not exceed Rs.50 lakhs if the house is situated at Bombay, Calcutta, Delhi or Madras or Rs.25 lakhs where the house is situated at any other place.
 - (d) where more than one house belonging to the assessee is exclusively used by him for residential purposes, the above relaxing provision will apply in respect of one house at the option of an assessee.

- ◆ **Adjustment to the above value:** To the value as ascertained above, certain adjustments have to be made for unbuilt area of the plot of land. Rule 6 provides for the same:

Where the unbuilt area of the plot of land on which the property is constructed exceeds the specified area, such value will be increased by an amount calculated in the following manner:

- (a) where the difference between the unbuilt area and the specified area exceeds 5% but does not exceed 10% of the aggregate area by an amount equal to 20% of such value;
- (b) where the difference between the unbuilt area and the specified area exceeds 10% but does not exceed 15% of the aggregate area, by an amount equal to 30% of such value;
- (c) where the difference between the unbuilt area and the specified area exceeds 15% but does not exceed 20% of the aggregate area by an amount equal to 40% of such value.

- ◆ **Relevant definitions:**

1. **Aggregate area:** This means, the aggregate of the area on which the property is constructed and the unbuilt area;
2. **Specified area:**
 - (a) Where the property is situated at Bombay, Calcutta, Delhi or Madras, 60% of the aggregate area;
 - (b) Where the property is situated at Agra, Ahmedabad, Allahabad, Amritsar, Bangalore, Bhopal, Cochin, Hyderabad, Indore, Jabalpur, Jamshedpur, Kanpur, Lucknow, Ludhiana, Madurai, Nagpur, Pune, Patna, Salem, Solahpur, Srinagar, Surat, Thiruchirappalli, Tirunelveli, Vadodara (Baroda) or Varanasi, 65% of the aggregate area;
 - (c) Where the property is situated at any other place, 70% of the aggregate area.

Proviso: Where under any law for the time being in force, the minimum area of the plot of land required to be kept as open space for the enjoyment of the property exceeds the specified area, such minimum area shall be deemed to be specified area.

- ◆ **Unbuilt area:** This means, that part of such aggregate area on which no building has been erected.
- ◆ **Adjustment for unearned increase in the value of the land - Rule 7:** It is possible that the assessee might have constructed the property on land obtained on lease from the Government, a local authority or any authority referred in section 10(20A) of the Income-tax Act, 1961. The Government or the authority concerned may be entitled to claim a specified part of the unearned increase in the value of the land at the time of the transfer of the property. In such a case, a reduction is to be made in the value of the property as determined under Rule 3. Accordingly, the amount to be claimed by the Government or 50% of the value of the property so determined whichever is less is to be deducted.
- ◆ **Definition - Unearned increase:** This mean the difference between the value of such land on the valuation date as determined by the Government or such authority and the

amount of premium paid or payable to the Government for the lease of such land.

- ◆ **Rule 3 not to apply in certain cases (Rule 8) :** The valuation procedure contains in Rule 3 will not apply in the following cases:
 1. Where the Assessing Officer is of opinion that it is not practicable to apply the provisions of Rule 3 to such a case. Before forming such an opinion, the Assessing Officer must have regard to the facts and circumstances of the case. He must also get the previous approval of the Deputy Commissioner;
 2. Where the difference between the unbuilt area and the specified area exceeds 20% of the aggregate area;
 3. Where the property is constructed on leasehold land and the lease expires within a period not exceeding 15 years from the relevant valuation date and the deed on lease does not give an option to the lessee for the renewal of the lease.

In all the above circumstances, the value of the property shall be determined in the manner laid down in Rule 20.

2.4 Global Method of Valuation of Business

Part D contains Rule 14 which provides the manner in which the net value of the assets of the business as a whole, having regard to the balance-sheet of such business, is to be determined.

- ◆ **Global method of valuation:** In some cases the valuation of the various assets of business may involve considerable difficulty. In such case, if the accounts of the business are being regularly maintained instead of valuing each and every assets separately the Assessing Officer may determine the net value of the assets of the business as a whole having regard to the balance sheet of such business as on the valuation date after making the prescribed adjustment therein. Rule 14 of Schedule III specifies the adjustments to be made by the Assessing Officer wherever he applies this global method of. These rules provide a uniform and statutory basis for adjustments. The adjustment to be so made are discussed in the following paragraphs under three main heads as follows:
 - (A) Adjustment in the value of assets:
 - (B) Adjustment in the value of liabilities:
 - (C) Exclusion of non-business assets and liabilities.
 1. **Adjustment in the value of an asset disclosed in the balance-sheet**

The value of an asset disclosed in the balance sheet will be taken to be

 - (a) where depreciation is admissible - its written down value;
 - (b) where depreciation is not admissible - its book value;
 - (c) in the case of closing stock its value adopted in the income-tax assessment for the relevant previous year.

Where the value of any of the asset referred to above, determined in accordance with the

provisions of Schedule III as applicable to that particular asset or if there are no such provisions, determined as per Rule 20, exceeds the value arrived at as per (i), (ii) or (iii) above, by more than 20%, the higher value shall be taken to be the value of the asset.

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

2. Adjustment in the value of liabilities [Rule 14(2)(e)]

The following amounts shown as liabilities in the balance-sheet are not to be taken into account -

- (a) Capital employed in business, other than those attributable to borrowed money.
- (b) Reserves by whatever name called. For this purpose, provision for any purpose other than taxation will be treated as reserve.
- (c) Provision made for meeting any future or contingent liability.

The *Explanation* to Rule 14 makes it clear that provision for any purpose other than taxation shall be treated as a reserve.

- (d) Any liability shown in the balance sheet not really pertaining to the business;
- (e) Any debt owed by the assessee to the extent to which it has been specifically utilised for acquiring an asset in respect of which wealth-tax is not payable under the Act; if however, it is not possible to calculate the amount of debt so utilised, it shall be taken as the amount which bears the same proportion to the total of the debts owed by the assessee as the value of that asset bears to the total value of the assets of the business.

3 Exclusion of certain assets from balance-sheet [Rule 14(2)(d)]

- (a) Any amount paid as advance tax under the Income-tax Act, 1961.
- (b) Bad debts appearing in the balance-sheet but allowed in the Income-tax assessment for the previous year relevant to the corresponding assessment year.
- (c) Assets exempted from wealth-tax.
- (d) Any amount in the balance sheet including debit balance in the Profit and Loss Account of the Profit and Loss Appropriation Account which does not represent the value of any asset.
- (e) Any asset shown in the balance sheet not really pertaining to the business.

After making all the above adjustments in the balance-sheet the Assessing Officer has to ascertain net value of the assets and liabilities. The excess of the assets over the value of liabilities will represent the net wealth of the business.

2.5 Interest in Firm or Association of Persons

Part E contains Rules 15 and 16 which provide the manner in which the value of the interest of a person in a firm of which he is a partner or an association of persons of which he is a member, is to be determined.

Rule 16 provides the computation of net wealth of the firm or an association of persons and its allocation amongst the partners or members. The provisions of this rule are on the same lines

as those of the earlier Rule 2 of the Wealth-tax Rules, 1957.

The rule provides that the net wealth of the firm or the association has to be determined first. Then, that portion of the net wealth which is equal to the amount of its capital is to be allocated among the partners or members in the proportion in which capital has been contributed by them. The residue of the net wealth is to be allocated in accordance with the agreement of partnership or association for the distribution of assets in the event of the dissolution of the firm or association or in the absence of such agreement, in the proportion in which the partners or members are entitled to share profits. The sum total of the amount so allocated to a partner or members is to be treated as the value of the interest of the partner or members in the firm or association.

The net wealth of the firm or association may include the value of assets located outside India and in such a case the value of the interest of the partner or member in the assets located in India is to be determined having regard to the proportion which the value of such assets diminished by debts relating to those assets, bears to the net wealth of the firm or association [Clause (a) of Explanation to Rule 16].

The proviso to Rule 16, makes it clear that in determining the net wealth of the firm or association for the purposes of the rule, no account shall be taken of the exemptions in sub-sections (1) and (1A) of section 5.

Clauses (b) and (c) of the Explanation to Rule 16, provide that where the net wealth of the firm or association computed in accordance with this rule includes the value of any assets which are exempt from inclusion in the net wealth under sub-sections (1) and (1A) of section 5 or any assets referred to in section 5(2), the value of the interest of the partner or member shall be deemed to include the value of his proportionate share in the said assets and the provisions of sub-sections (1), (1A) and (2) would apply to him accordingly. These express provisions in the rules have resolved the earlier judicial controversy regarding the question of application of the exemption provisions of section 5, while computing the value of the interest of a partner of a firm or member of an association.

It may be noted that clause (a) of section 4(1) applies to an individual and clause (b) dealing with share in partnership firms or association of persons not being a co-operative housing society applies to any assessee.

In the case of an assessee who is a partner in a firm or a member of an AOP the value of his interest in the assets of the firm or AOP determined in the manner laid down in Schedule III will be included in his net wealth as belonging to the assessee. The proviso to new Clause (b) also seeks to include the interest of a minor child in a firm or association of persons in the net wealth of the parent having a higher net wealth. It is to be noted that the new Rules 15 and 16 of the Schedule III seek to provide the manner in which the value of the interest of a person in a firm of which he is a partner or in an AOP of which he is a member is to be determined.

2.6 Life Interest

Part F contains Rule 17 which provides the manner in which the value of life interest of an assessee is to be determined.

Rule 17 lays down that the market value of the life interest of an assessee is to be arrived at by multiplying the average annual income that accrued to the assessee from the life interest by $[1/(p+d)]-1$ where P represents the annual premium for a whole life insurance without profits on the life tenant for a unit sum assured as specified in an appendix to the Wealth-tax Rules and 'd' is equal to $i/(1+i)$, "i" being the rate of interest.

For this purpose the average, annual income is to be arrived at on the basis of the average of the annual gross income derived by the assessee from the life interest during the period of three years ending on the valuation date as reduced by the average of the expenses incurred on the collection of such income during the period. However the deduction on account of expenses on collection should in no case exceed five per cent of the average of the annual gross income. By reference to the Appendix to the Wealth-tax Rules one can impute the value of the life interest held by an assessee. That table on the Appendix gives the multipliers for the age up to 80 years. The multipliers are based on the above formula and the rate of interest adopted is 6.5% per annum. Where the life tenant cannot be insured at normal premium rates but only at higher rates, then the valuation has to be varied suitably. In any case, the value of the interest should not exceed the market value of the trust corpus as on the valuation date. If the age of tenant is 80 years or above, then *ipso facto*, the rule would not apply and the value would be nil.

2.7 Jewellery

Part G contains rules 18 and 19 which provide the manner in which valuation of jewellery is to be determined.

1. The value of the jewellery shall be estimated to be the price which it would fetch if sold in the open market on the valuation date.
2. The return of net wealth furnished by the assessee shall be supported by -
 - (i) a statement in the prescribed form, where the value of the jewellery on the valuation date does not exceed ₹ 5 lakh.
 - (ii) a report of a registered valuer in the prescribed form, where the value of the jewellery on the valuation date exceeds Rs.5 lakh.
3. In spite of the above provision, the Assessing Officer may, if he is of the opinion that the value of the jewellery declared in the return -
 - (a) is less than its fair market value by the percentage prescribed under section 16A(1)(b)(i).
 - (b) is less than its fair market value as referred to in section 16A(1)(a), refer the valuation of such jewellery to a Valuation Officer and the value of such jewellery shall be the fair market value as estimated by the Valuation Officer.

2.8 Other Assets

Part H contains rules 20 and 21 which provide that the value of any asset, other than cash, being an asset which is not covered by Rules 3 to 19 shall be estimated either by the Assessing Officer himself or by the valuation officer if reference is made to him under section 6A. This Rule further

provides that in both these cases, the value shall be estimated to be the price which it would fetch in the case of assets not saleable in the open market, in the open market on the valuation date. Sub-rule (3) provides that where the value of an asset cannot be estimated because it is not saleable in the open market, the value shall be determined in accordance with guidelines or principles specified by the Board from time to time by general or special order.

Rule 21 provides that for the purposes of determining market value under any provision of this Schedule, the price or other consideration for which the property may be acquired by or transferred to any person under the terms of a deed of trust, or through or under any restrictive covenant in any instrument of transfer shall be ignored. This Rule enables the tax authorities to ignore restrictive covenants contained in an instrument of transfer of property which enables acquisition of such properties at stipulated prices, irrespective of the market value thereof.

- ◆ **Registered Valuers :** Valuers are appointed by the Central Board of Direct Taxes. Section 34AB of the Wealth-tax Act, 1957 sets forth the procedure for registration of valuers. The Chief Commissioner or Director General maintain a register called the Register of Valuers in which the names and addresses of persons registered under section 34AB(2) as valuers are entered. Persons who possesses the qualifications prescribed in this behalf may apply to Commissioner or Director General in the prescribed form along with the prescribed fees for registration as valuers. Rule 8 of the Wealth-tax Rules, 1957 prescribes different qualifications for different classes of assets. The application for registration as valuer is to be made in Form "N" prescribed under Rule 8B of the Wealth-tax Rules, 1957. The application should contain a declaration to the effect that the applicant will:
 - (i) make an impartial and true valuation of any asset which he may be required to value;
 - (ii) furnish a report of such valuation in the prescribed form;
 - (iii) charge fees at a rate not exceeding the rate or rates prescribed in this behalf;
 - (iv) not undertake valuation of any asset in which he has a direct or indirect interest.

The valuers should act according to the above declaration. The fees charged by the registered valuer should not exceed the maximum limits laid down by Rule 8C. The report of valuation of different classes of assets is to be submitted by the registered valuer in the forms prescribed by Rule 8D.

Section 34AC places certain restrictions on practice as a registered valuer. It provides that no person either alone or in partnership with any other person, shall be entitled to practice, describe or hold himself out as a registered valuer permit him self to be so described or held out unless he is registered as a valuer or in the case of a partnership, unless all the partners are registered as valuers. It also imposes a ban on a company or other corporate body from practising or describing itself or holding out as registered valuers.

Section 34AD provides for the removal of the names of the valuers from the Register and also for their restoration under certain circumstances.

Section 34AE provides that any assessee who is entitled or required to attend before any Wealth-tax Authority or the Appellate Tribunal in connection with any proceeding relating to the valuation of any asset may be represented by a registered valuer. This right to appear through a registered valuer does not however extend to cases where the assessee is required under the Act to attend personally.

Section 34ACC and 35EE impose certain obligation on every registered valuer or a person who has made an application for registration as a valuer; if such valuers are convicted of any offence and sentenced to a term of imprisonment or found guilty of professional misconduct by the professional association or institution of which he is a member, they should intimate the particulars thereof to the CBDT, and the Board has been empowered to notify any punishment with rigorous imprisonment for a term which may extend to two years and liability to fine.

Assessment Procedure

3.1 Administration

The machinery for the administration of wealth-tax is modeled on the lines of the Income-tax Act, 1961 and, in fact, the wealth-tax is administered by the very same income-tax authorities who administer income-tax in relation to an assessee.

The Income-tax authorities specified in section 116 of the Income-tax Act, 1961 shall be the Wealth-tax authorities for the purposes of this Act and every such authority shall exercise the powers and perform the functions of a wealth tax authority under this Act. For this purpose his jurisdiction shall be the same as he has under the Income-tax Act, 1961. Section 23A provides for a direct appeal before Commissioner (Appeals).

Section 9 provides that the provisions of section 118 of the Income-tax Act, 1961 would apply in relation to control of wealth tax authorities also. Section 10 deals with instructions to subordinate authorities from time to time. Section 11 deals with jurisdiction of Assessing Officers and power to transfer cases.

Valuation Officers: Section 12A provides for the appointment of Valuation Officers by the Central Government. The expression 'Valuation Officers' for this purpose means and includes Regional Valuation Officers, District Valuation Officers and Assistant Valuation Officers. The Wealth-tax authorities are also empowered to appoint as many overseers, surveyors and assessors as may be necessary to assist the Valuation Officer in the execution of their functions. The powers of the Valuation Officer are specified in section 38A. Their jurisdiction is specified by Rule 3A of the Wealth-tax Rules, 1957.

3.2 Assessment Procedure

3.2.1 Return of wealth [Section 14]: Every person having taxable wealth shall, on or before the due date, furnish a return of his net wealth as on the valuation date in the prescribed form. A person will also be liable to file the return if the net wealth of any other person in respect of which he is assessable under the Act exceeds the maximum amount not chargeable to tax.

3.2.2 Introduction of provisions for enabling electronic filing of annexure-less return of net wealth [Sections 14A & 14B]

(i) As per section 14 of the Wealth-tax Act, 1957, every person, whose net wealth or net wealth of any other person in respect of which he is assessable under the Act on the valuation date, exceeds the maximum amount not chargeable to wealth-tax, is required to

furnish a return of his net wealth or the net wealth of such other person as on the valuation date in the prescribed form and verified in the prescribed manner setting forth particulars of the net wealth and such other particulars as may be prescribed.

(ii) The Wealth-tax Act, 1957 and the Wealth-tax Rules, 1957 require furnishing of certain documents and reports along with the return of net wealth.

(iii) Consequent to implementation of e-filing of income-tax returns and making the same mandatory for certain classes of income-tax assesseees, sections 139C and 139D were introduced in the Income-tax Act, 1961. These sections contain enabling provisions for electronic filing of annexure-less return of income.

(iv) Likewise, for promoting electronic filing of annexure-less return of net wealth, new sections 14A and 14B have been inserted in the Wealth-tax Act, 1957 in line with sections 139C and 139D of the Income-tax Act, 1961.

(v) Section 14A empowers the CBDT to provide for a class or classes of persons who may not be required to furnish documents, statements, certificates, audit reports, reports of registered valuers etc. which are otherwise required to be furnished under any other provision of the Wealth-tax Act, 1957 (except section 14B) along with the return of net wealth. However, such documents, statements etc. have to be produced on demand before the Assessing Officer.

(vi) Further, for facilitating e-filing of return of net wealth, section 14B empowers the CBDT to make rules for the following purposes –

- (1) to specify the class or classes of persons who are mandatorily required to e-file the return of net wealth;*
- (2) to prescribe the form and manner in which the returns are to be e-filed;*
- (3) to specify the documents, statements, receipts, certificates, audit reports etc. which may not be furnished with the e-return but are to be produced on demand before the Assessing Officer;*
- (4) to specify the computer resource or the electronic record to which the e-return may be transmitted.*

Note – Consequential amendment has been made in section 46(2) of the Wealth-tax Act, 1957 which provides for rule making powers of the Board, has been amended to empower the CBDT to make rules for implementing the provisions of section 14A and 14B i.e., the CBDT is empowered to make rules to provide for -

- (1) the documents, statements, receipts, certificates, audit reports, reports of registered valuers, etc. which may not be furnished along with the return but shall be produced on demand before the Assessing Officer;*
- (2) (i) the class or classes of persons who are mandatorily required to e-file their wealth-tax returns,*
(ii) the prescribed form and manner in which returns may be e-filed; and

(iii) *the documents, statements, receipts, certificates, audit reports etc. which may not be furnished along with the e-return; and*

(iv) *the computer resource or electronic record to which such return may be transmitted under section 14B.*

3.2.3 Revised return [Section 15]: If any person has not furnished a return within the time limit allowed under section 14(1) or in response to a notice issued under section 16(4)(i) or having furnished a return discovers any omission or wrong statement therein, he may furnish a return or a revised return. The time limit for filing such return is before the expiry of one year from the end of the relevant assessment year or before the completion of the assessment whichever is earlier.

3.2.4 Signing of return [Section 15A]: (1) Section 15A provides that in the case of an individual the return should be signed by -

- (a) the individual himself;
- (b) where he is absent from India, by the individual himself or by any person authorised in this behalf;
- (c) where the person is mentally incapacitated from attending to his affairs, by his guardian, or any other person competent to act on his behalf; and
- (d) where for any other reason, it is not possible for the individual to sign the return, by any person authorised by him in this behalf.

In case (b) and (d) above, the person signing the return should hold a valid power of attorney from the concerned individual and it should be attached to the return.

(2) In the case of a Hindu undivided family, the return should be signed by the karta, and, where the karta is absent from India or is mentally incapacitated from attending to his affairs, by any other adult member of such family; and

(3) In the case of a company, the return should be signed by the managing director thereof, or where for any unavoidable reason such managing director is not able to sign and verify the return or where there is no managing director, by any director thereof;

Further, that where a company is not resident in India, the return may be signed and verified by a person holding valid power of attorney from the company and it should be attached to the return. Further where a company is being wound up, whether under the orders of the court or otherwise, or where any person has been appointed as receiver, the return should be signed and verified by the liquidators referred to in section 178(1) of the Income-tax Act, 1961. Where the management of the company has been taken over by the Central Government or any State Government under any law the return should be signed and verified by the principal officer thereof.

3.2.5 Self-assessment [Section 15B]: (i) Where any tax is payable on the basis of any return furnished under section 14 or section 15 or in response to a notice under section 16(4)(i) or under section 17 after taking into account the amount of tax already paid, the assessee shall be liable to pay such tax together with interest payable for any delay in

furnishing the return. Such payment must be made before furnishing the return and the return shall be accompanied by proof of payment of such tax and interest.

(ii) Where the amount paid by the assessee falls short of the aggregate of the tax and interest as mentioned above, the amount so paid shall first be adjusted towards the interest payable and the balance, if any, shall be adjusted towards the tax payable.

(iii) Once regular assessment is made, any amount payable as above, shall be deemed to have been paid towards such regular assessment.

(iv) Failure to pay self-assessment tax will make the assessee an 'assessee in default' in respect of the tax or interest or both remaining unpaid.

♦ **Section 16:** Section 16 is similar to section 143 of the Income-tax Act, 1961.

(1) Accordingly, where a return has been made under section 14 or section 15 or in response to a notice under section 16(4)(i) if any tax or interest is found due on the basis of such return after adjustment of any amount paid, an intimation shall be sent to the assessee specifying the amount payable. Such an intimation shall be deemed to be a notice issued under section 30 and the provisions of the Act will apply accordingly. Such an intimation shall not however be sent after the expiry of two years from the end of the assessment year in which the net wealth was first assessable.

If any refund is due on the basis of such return it will be granted to the assessee and an intimation to this effect shall be sent to the assessee.

Except as otherwise provided in section 16(1), the acknowledgement of the return shall be deemed to be intimation under section 16(1) where either no sum is payable by the assessee or no refund is due to him.

(2) Where a return has been made under section 14 or section 15, or in response to a notice under clause (i) of sub-section (4) of this section, the Assessing Officer shall, if he considers it necessary or expedient to ensure that the assessee has not understated the net wealth or has not underpaid the tax in any manner, serve on the assessee a notice requiring him, on a date to be specified therein, either to attend the office of the Assessing Officer or to produce, or cause to be produced there, any evidence on which the assessee may rely in support of the return:

However, no notice under this sub-section shall be served on the assessee after the expiry of twelve months from the end of the month in which the return is furnished.

(3) On the day specified in the notice issued under sub-section (2) or as soon afterwards as may be, after hearing such evidence as the assessee may produce and such other evidence as the Assessing Officer may require on specified points, and after taking into account all relevant material which he has gathered, the Assessing Officer shall, by order in writing, assess the net wealth of the assessee and determine the sum payable by him on the basis of such assessment.

(4) For the purposes of making an assessment under this Act, the Assessing Officer may serve on any person who has made a return under section 14 or section 15 or in whose case the time allowed under sub-section (1) of section 14 for furnishing the return has expired, a notice requiring him, on a date to be specified therein,

3.5 Wealth tax

- (i) where such person has not made a return [within the time allowed under sub- section (1) of section 14] to furnish a return of his net wealth or the net wealth of any other person in respect of which he is assessable under this Act on the valuation date, in the prescribed form and verified in the prescribed manner, setting forth the particulars of such net wealth and such other particulars as may be prescribed, or
 - (ii) to produce or cause to be produced such accounts, records or other documents as the Assessing Officer may require.
- (5) If any person -
- (a) fails to make the return required under sub-section (1) of section 14 and has not made a return or a revised return under section 15, or
 - (b) fails to comply with all the terms of a notice issued under sub-section (2) or sub-section (4),
- the Assessing Officer, after taking into account, all relevant material which he has gathered, shall after giving such person an opportunity of being heard, estimate the net wealth to the best of his judgement and determine the sum payable by the person on the basis of such assessment:
- However, such opportunity shall be given by the Assessing Officer by serving a notice calling upon the person to show cause, on a date and time to be specified in the notice, why the assessment should not be completed to the best of his judgement:
- It shall not be necessary to give such opportunity in a case where a notice under sub-section (4) has been issued prior to the making of the assessment under this sub-section.
- (6) Where a regular assessment under sub-section (3) or sub-section (5) is made,-
- (a) any tax or interest paid by the assessee under sub-section (1) shall be deemed to have been paid towards such regular assessment;
 - (b) if no refund is due on regular assessment or the amount refunded under sub section (1) exceeds the amount refundable on regular assessment, the whole or the excess amount so refunded shall be deemed to be tax payable by the assessee and the provisions of this Act shall apply accordingly.

3.2.6 Reference to Valuation Officer: Section 16A provides that for the purpose of making an assessment, the Assessing Officer may refer the valuation of any asset to a Valuation Officer.

In case where the value of an asset has been estimated by a registered valuer, a reference may be made to the Valuation Officer, if the Assessing Officer considers that the estimate made by the registered valuer is less than its fair market value and consequently, requires an upward revision.

In any other case, such a reference may be made if the Assessing Officer considers it necessary to do so on account of the nature of the asset and other relevant considerations or he is of the opinion that the fair market value of the asset exceeds the value of the asset as returned by more than 33% of the assets as returned by more than ₹ 50,000.

On a reference having been made to the Valuation Officer, he will proceed to value the asset after giving notice to the assessee to produce or cause to be produced before him, such accounts, records or other documents as he may require. For this purpose, he shall have all the powers vested in a Court under the Code of Civil Procedure 1980.

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

Where, however, the Valuation Officer is of the opinion that the value of the asset is higher than the value declared in the return made by the assessee or where the asset is not disclosed or the value of the asset is not declared in such return or where no such return has been made the Valuation Officer is required to serve on the assessee a notice intimating the value which he proposes to estimate and give the assessee an opportunity to state his objections, if any, to the proposed valuation on a date fixed by the Valuation Officer.

On the date so specified the assessee shall have the option either to state his objections personally or through a registered valuer or in writing before the Valuation Officer and to produce or cause to be produced such evidence as the assessee wants to rely in support of his objections.

After hearing all the evidence which the assessee produced and that which the Valuation Officer may require on any specified point and considering all the material which the Valuation Officer has gathered, he shall estimate the value of the assets and send a copy of his order to the Assessing Officer and to the assessee.

The order of the Valuation Officer, so far as the Valuation of the asset in question is concerned, shall be binding on the Assessing Officer, who after receiving the order shall proceed to complete the assessment in conformity with the estimate of the Valuation Officer.

The Assessing Officer is statutorily bound by the valuation report submitted by the Valuation Officer and he has no option but to complete the assessment in conformity with the assessment of the Valuation Officer insofar as the valuation of the assets in question are concerned - *CWT vs. Rahman (1991) 189 ITR 307 (All)* and *M.C. Khunnah vs. Union of India (1979) 189 ITR 414 (All)*.

3.2.7 Assessment of escaped wealth: Sub-sections (1), (1A) and (1B) of section 17 deal with assessment of escaped wealth.

- (a) Reassessment proceedings can be taken if the Assessing Officer has reason to believe that the net wealth chargeable to tax has escaped assessment, whether by reason of under-assessment or assessment at too low a rate or otherwise.
- (b) Notice has to be served subject to the conditions of sections 17 and 17A, requiring the person to furnish a return in the prescribed form and in the prescribed manner within such period along with such other particulars as may be required by the notice. The Assessing Officer has to record his reasons for doing so.
- (c) On the basis of the same, the Assessing Officer may proceed to assess or reassess such net wealth and also any other wealth that has escaped assessment and comes which to the notice of the Assessing Officer in the course of the proceedings under this provision.

3.7 Wealth tax

The Assessing Officer may assess or reassess the net wealth which is chargeable to tax and has escaped assessment other than the net wealth which is the subject matter of any appeal, reference or revision.

- (d) As assessment completed under section 16(3), scrutiny assessment or reassessment under section 17 (wealth escaping assessment) can be reopened after 4 years from the end of the relevant assessment year only if the wealth has escaped assessment due to the failure on the part of the assessee to file a return of wealth (under section 14/15/16(4)) or to disclose fully and truly all material facts necessary for his assessment.

However, this restriction will not apply in a case where any net wealth in relation to any asset (including financial interest in any entity) located outside India chargeable to tax, has escaped assessment for any assessment year.

- (e) For this purpose, production before the Assessing Officer of account books or other evidence from which material evidence could with due diligence have been discovered by the Assessing Officer would not necessarily amount to disclosure.
- (f) Before issuing any notice under section 17(1), the Assessing Officer should record his reasons for doing so.
- (g) The time limits for issue of notice are –
 - (i) six years, if the net wealth chargeable to tax which has escaped assessment amounts to or is likely to amount to ₹ 10 lakhs or more for that year;
 - (ii) sixteen years, if the net wealth in relation to any asset (including financial interest in any entity) located outside India, chargeable to tax has escaped assessment for any assessment year;
 - (iii) four years, in all other cases.
- (h) Notice under section 17 can be issued at any time to give effect to any directions contained in any order passed under sections 23, 24, 25, 27 or 29 or by a court in any proceeding which need not necessarily be under the Wealth-tax Act, 1957.

For the above purposes, the following will also be deemed to be cases where net wealth chargeable to tax has escaped assessment.

- (i) cases of failure to file return of net wealth by persons having wealth exceeding basic exemption limit.
- (ii) where return of wealth has been furnished but no assessment has been made and it is noticed by the Assessing Officer that the assessee has understated his wealth or claimed excessive exemptions or deductions in his return;
- (iii) where a person is found to have any asset (including financial interest in any entity) located outside India.

3.2.8 Sanctioning Authorities: The sanctioning authorities for issue of notice under section 17 are as follows:

- (i) Where a scrutiny assessment is to be reopened:

- (a) Notice under section 17 can be issued only by an Assessing Officer. Where the Assessing Officer is below the rank of Assistant Commissioner, or the Deputy Commissioner notice can not be issued unless the Joint Commissioner is satisfied on the reasons recorded by such Assessing Officer that it is a fit case for the issue of the notice.
- (b) If notice under section 17 is to be issued after the expiry of 4 years from the end of the relevant assessment year, sanction of the Chief Commissioner or Commissioner is necessary.
- (ii) In any other case:
 - (a) Notice under section 17 can be issued by any Assessing Officer as in (a) above.
 - (b) If notice under section 17 is to be issued after the expiry of 4 years from the end of the relevant assessment year, sanction of the Joint Commissioner will be necessary, if the notice is being issued by an Assessing Officer below the rank of Joint Commissioner.

It may be noted that the Joint Commissioner, the Commissioner or the Chief Commissioner, as the case may be, on being satisfied with the reasons recorded by the Assessing Officer about the fitness of a case for the issue of notice under section 17, need not issue the notice himself. Thus, where the approval of the Joint Commissioner/Chief Commissioner/Commissioner is required for issue of notice under section 17, it is not necessary that such notice should be issued by the Joint Commissioner/Chief Commissioner/Commissioner himself. It would be sufficient if the Assessing Officer issues the notice.

3.2.9 Time limit for completion of assessment/reassessment [Section 17A]

- (1) Sub-section (1) of section 17A provides that no order of assessment shall be made under Section 16 at any time after the expiry of 2 years from the end of the assessment year in which the net wealth was first assessable.
- (2) Sub-section (2) provides that no order of assessment/reassessment shall be made under section 17 after the expiry of 1 year from the end of the financial year in which the notice under sub-section (1) of section 17 was served.
- (3) Sub-section (3) provides that where a fresh assessment is to be made in pursuance of order passed by the Deputy Commissioner (Appeals) in an appeal under section 23A, or by the Appellate Tribunal in an appeal under section 24, or by the Commissioner in an order of revision under section 25 such fresh assessment may be made at any time before the expiry of 1 year from the end of the financial year in which the order under section 23A or section 24 is received by the Chief Commissioner or the order under section 25 is passed by the Commissioner.

The time limits for assessments w.e.f. 1st July, 2012 are as indicated in the table below –

Proceeding under section	Earlier time limit of completion of assessment or reassessment	New time limit for of completion assessment or reassessment	Applicability of new time limit
16	21 months from the end of the	2 years from the end of the assessment	In case where the net wealth is first assessable

3.9 Wealth tax

	assessment year in which the net wealth was first assessable	year in which the net wealth was first assessable	in the assessment year 2010-11 or any subsequent assessment year
17	9 months from the end of the financial year in which the notice under section 17(1) was served	1 year from the end of the financial year in which the notice under section 17(1) was served	Where the notice under section 17(1) is served on or after 01.04.2011.
Fresh assessment where the original assessment has been set aside, cancelled and referred back by an order under section 23A/24/25	9 months from the end of the financial year in which the said order under section 23A/24 is received by the CIT or the order under section 25 is passed by the CIT	One year from the end of the financial year in which the said order under section 23A/24 is received by the CIT or the order under section 25 is passed by the CIT	Where the order under section 23A/24 is received by the CIT or order under section 25 is passed by the CIT on or after 01.04.2011.

(4) Sub-section (4) provides that where assessment or reassessment on the assessee or any person is made to give effect to any finding or direction contained in an order under section 24 (Tribunal) or section 25 (Revision by Commissioner) or section 27 (order a High Court in reference) or section 29 (order of the Supreme Court in an appeal (or in an order of any court in a proceeding otherwise than by way of appeal of reference, such proceeding shall be subject to the time limit mentioned in the item (3) above [Section 17(4)]).

(5) *Explanation 1* to section 17A(4) provides that the following will be excluded in computing the period of limitation.

- Time taken in reopening the whole or any part of the proceeding or in giving an opportunity to the assessee to be re-heard under the proviso to section 39.
- The period not exceeding sixty days commencing from the date on which the wealth-tax officer received the declarations from the assessee under section 18C and ending with the date on which an order under sub-section (5) of that section is passed by him.
- The period of pendency of proceeding before the Wealth-tax settlement commission.
- The period during which assessment proceedings are stayed by an order or injunction of any court.

Where immediately after the exclusion of the aforesaid period, the period of limitation available to the Assessing Officer for making an assessment is less than 60 days, such remaining period shall be extended to 60 days and the aforesaid period of limitation shall be deemed to be extended accordingly.

Further, section 17A allows a minimum time period of one year to the wealth-tax authority before whom the case was pending when the application was filed with the Settlement Commission. This revised time limit is deemed to apply to all cases where settlement proceedings have abated from 1.6.2007 and thereafter.

(6) Where in a direction under section 24, 25, 27 or 29 or an order of a court any asset is excluded from the net wealth of one person and held to be the asset of another person then an assessment in respect of such asset on such other person shall for the purposes of section 17(2) and section 17A, be deemed to be one made in consequence of, or to give effect to any finding or direction contained in the said order. However, before the order is passed, such other person should be given an opportunity of being heard.

3.2.9 Interest for defaults [Section 17B]: Section 17B provides for mandatory interest for defaults in furnishing return of net wealth. The assessee will be liable to pay simple interest at the rate of 1% for every month or part of a month comprised in the period commencing on the date immediately following the due date as specified in section 14(1) as applicable in the case of the assessee and ending on the date of furnishing of the return in a case where the return under section 14/15 or in response to a notice under 16(4)(i) is furnished after the due date.

Where the return is not furnished, the interest is to be paid for the period commencing from the date immediately following the due date and ending on the date of completion of assessment under section 16(5). Such interest is to be paid on the amount of tax payable on the net wealth as determined under section 16(1) or on regular assessment. For this purpose, where an assessment is made for the first time under section 17 the assessment so made shall be regarded as regular assessment.

For the purpose of computing this interest, the tax payable on the net wealth as declared in the return will be taken as the basis.

The interest payable under section 17B(1) will be reduced by the interest if any paid under section 15B (self-assessment) towards the interest chargeable under section 17B.

Sub-section (3) provides for a similar levy of interest where the return of net wealth for any assessment year is required by a notice under section 17(1). Such a notice could have been issued either after the determination of net wealth under section 16(1) or after the completion of an assessment under section 16(3) or 16(5) or 17. In such cases, where the return is furnished after the expiry of the time allowed under such notice, a simple interest @1% for every month or part of a month is to be paid for the period commencing on the date immediately following the expiry of the time allowed and ending with the date of furnishing the return. Where no return has been furnished in response to such a notice, the interest should be paid up to the date of completion of assessment under section 17.

The interest should be paid on the amount by which the tax on the net wealth determined on the basis of such reassessment exceeds the tax on the net wealth as determined on the basis of the earlier assessment.

Where as a result of an order passed in an appeal, revision, rectification or by settlement commission the amount of tax on which interest is payable under this provision has been

increased or reduced, the interest shall be increased or reduced, accordingly. Where the interest is so increased, a notice of demand will be served by the Assessing Officer and where the interest is reduced the excess interest paid will be refunded.

3.2.10 Avoidance of repetitive appeals [Section 18C]: This provision lays down the procedure to be followed when an identical question of law is pending before the High Court or Supreme Court. Where an assessee claims that any question of law arising in his case (any proceedings for assessment of net wealth or imposition of penalty) for an assessment year, which is pending before the Assessing Officer or the Appellate Commissioner or the Appellate Tribunal is identical with a question of law arising in his case for another assessment year which is pending in appeal before the High Court under section 27A or in appeal before the Supreme Court under section 29, he may, furnish to the Assessing Officer or the appellate authority concerned, as the case may be a declaration in the prescribed form, that if the authority concerned agree to follow the final decision on the question of law in the pending appeal, he shall not raise such a question of law in the later case in an appeal before any appellate authority or in appeal before the High Court under section 27A or in appeal before the Supreme Court under section 29.

On receipt of such declaration the Assessing Officer or the concerned appellate authority (after giving opportunity to the Assessing Officer) may by order in writing admit the claim of the assessee, on being satisfied that the question of law arising in the pending reference is identical with the question of law in the later case, which is now under assessment or appeal. If he is not so satisfied, he may reject the claim. When the claim is admitted, the Assessing Officer or the appellate authority, as the case may be, may dispose of the relevant case, without awaiting the final decision on the question of law in the other case. The assessee will not be entitled to raise in relation to the relevant case such question of law in appeal before any appellate authority. When the decision of the Court in the other case become final, it shall be applied to the later case. The Assessing Officer or the appellate authority, as the case may be, shall, if necessary, amend the order passed in the later case conformably to such final decision of the Court in the earlier case of the assessee.

An order passed under this provision admitting or rejecting the claim shall be final and not appealable and cannot be called into question in any proceeding by way of appeal or revision.

3.3 Assessment in Special Cases

3.3.1 Assessment of executors: Where a person dies, his executors, administrator or other legal representative becomes liable in respect of the liability to wealth-tax for the valuation dates falling before the person's death which has remained unassessed or undischarged on the date of death. The liability cannot in any case, exceed the value of the estate of the deceased person which comes into possession of such executor, administrator or legal representative [Section 19].

Section 19A would apply only to a case where an assessee dies after executing a will and appointing an executor. It does not apply to cases of inheritance. The inheritor is liable himself under section 3. [CWT vs. Keshub Mahindra (1983) 130 ITR 22 Bom.]

In *Smt. Yawarunnisa Begum vs. W.T.O.* (1975) 100 ITR. 645 A.P. it was held that the legal

representatives of the deceased- assessee are not liable for penalty for the default committed by the deceased-assessee under section 18. The liability of the legal representative is only to pay the tax assessed to be payable or any other sums which would have been payable by the deceased. Section 19(8) does not authorise the department to levy penalty on the legal representative for the default committed by the deceased under section 14, inasmuch as section 19(3) has not included any liability of the legal representative in this respect. The Madras High Court also expressed similar view in *[C.W.T. vs. Varadarajan (122) ITR 014]*.

Section 19A provides for the assessment of executors in respect of the estate of a deceased person for a period from the date of the death of the deceased till the completion of the distribution of the beneficiaries.

The net wealth in respect of the estate of a deceased person is assessed in the hands of executors (including administrator or any other person administering the estate of a deceased person). For all purposes of assessment, the executor becomes the representative assessee of the deceased and the status is that of an individual. His residential status and citizenship would also be the same as those of the deceased on the valuation date immediately preceding his death. However, if there are more executors than one having an indivisible title and interest the co-executors receiving the income and acting jointly would be assessed in the status of a 'body of individuals'.

Separate assessments are to be made in respect of the net wealth as on each valuation date as is included in the period from the date of the death to the date of complete distribution among the beneficiaries of the estate according to their several interests. Some of the assets may be distributed to specific legatees during the period of administration. In computing the net wealth on any valuation date assessable in the hands of the executors, any assets distributed to or applied to the benefit of any specific legatees prior to the particular valuation date shall be excluded. But the assets so excluded shall to the extent such assets are held by the legatee on the valuation date, be included in the net wealth of such specific legatee on the valuation date.

The assessment of an executor under section 19A shall be made separately from any assessment that may be made on him in respect of his own net wealth or on the net wealth of the deceased under section 10.

3.3.2 Assessment after partition of Hindu Undivided Family: Section 20 lays down that if the Assessing Officer finds at the time of making an assessment that a HUF has been partitioned, then if he is satisfied that the joint family property has been partitioned as a whole in definite portions, he shall have to record a finding and pass orders to that effect. In such a case, he will have to make an assessment on the net wealth of the undivided family as such in respect of all previous years completed before the date of partition (not the date of the order recognising partition) for which the assessments are yet to be made. The liability in respect of such assessment is joint and several for such members or group of members.

If partition by metes and bounds has taken place on the last day of the previous year relevant to the year of assessment, the undivided family has to be assessed under the wealth-tax as such in spite of the partition having taken place so far as that assessment year is concerned.

The last day of the previous year is the 'valuation date'— Refer to section 2(q). If the partition had taken place on any date in the previous year prior to the 'valuation date' the assessment of that previous year would not be governed by section 20 but by section 3. In other words, in such cases, the divided members would have to be separately assessed in respect of their divided portion or shares in the usual manner as for any other individuals.

If the Assessing Officer is not satisfied that a partition as claimed by the assessee has taken place, he may pass an order declaring that the family shall be deemed, for purposes of the Wealth-tax Act, 1957, to continue to be a joint family and is liable to be assessed as such. When an order recognising partition on a particular date has been passed each member of group or members, as the case may be, will be required to include in his net wealth on a particular valuation date, the value of the family property falling to his share and remaining with him on such valuation date.

De-recognition of partial partition: With a view to curbing the practice of creating multiple Hindu undivided families by making partial partitions, section 20A has been introduced. Under this provision, partial partitions of Hindu undivided family effected after 31st December, 1978 will not be recognised for tax purposes.

(1) It provides that in the case where a partial of a HUF has taken place after 31st December, 1978, such family shall continue to be liable to be assessed as a HUF as if no such partition had taken place i.e. the property shall be deemed to continue to belong to the HUF and no member shall be deemed to have separated from the family.

(2) Each member or group of members of such family immediately before such partial partition and the family shall be jointly and severally liable for any tax, penalty, interest, fine or any other sum payable under the Wealth-tax Act, 1957 by the family in respect of any period whether before or after such partial partition.

(3) The several liability of any member or group of members of such family shall be computed according to the partition of the joint family property allotted to him at the time of such partial partition. The term 'partial partition' for the purpose will have the same meaning assigned to it in clause (b) of the Explanation to section 171 of the Income-tax Act, 1961.

The Supreme Court has upheld the constitution validity of the provisions of section 20A de-recognition partial partition.

3.3.3 Assessment when assets are held by a Court of Wards, Administrator General etc: If court of wards, administrator general or legatees etc fall within the scope of taxable entity contained in the charging section wealth tax will be chargeable at the rate of one per cent on their net wealth.

3.3.4 Assessment of charitable trust in certain special circumstances: Section 21A contemplates forfeiture of exemption available to charitable trusts under section 5(i) in cases of diversion of property or of income from property held under trust. The section is analogous to section 13 of the Income-tax Act, 1961. Under this new provision, where any property is held under trust or any legal obligation for any public purpose of a charitable or religious nature in India and-

(i) any part of such property or income of such trust, including voluntary contribution except

for forming a part of the corpus is used or applied directly or indirectly for the benefit of any person referred to in section 13(3) of Income-tax Act, 1961; or

- (ii) any part of the income of the trust including such voluntary contributions, being a trust created after 1st April, 1952 enures directly or indirectly for benefit of any of the prohibited category of persons wealth-tax is to levied on the whole of the trust property as if it were held by a resident India citizen; or
- (iii) funds of the trust are invested in shares of a company or deposited or held by the trust in contravention of the provisions of section 13(1)(d) of the Income-tax Act, 1961

then wealth tax at the maximum marginal rate, i.e. the rate of wealth tax applicable in relation to the highest slab of wealth in the case of an individual, will be levied. It has also specifically provided that no exclusion will be made under the provisions of section 5.

In the case of trusts created prior to 1st April, 1962 the use of application referred to in (i) above is by way of compliance with a mandatory term of the trust, there will be no forfeiture of the exemption available under section 5(i).

The third proviso to section 21A provides that (i) scientific research association enjoying exemption of income under section 10(21) will not be subject to the restriction mentioned in (i) and (ii) above. So far as investing or depositing of funds or holding of shares by these institutions, restrictions placed by the proviso to section 10(21) will be applicable.

Therefore we can see that scientific research association are subject only to the restrictions mentioned in the proviso section 10(21) of the Income-tax Act, 1961, so far as the application or investment of their income or property is concerned. Contravention of the above restrictions will make them liable to wealth tax at the rates specified in section 3(2). None of the above three restrictions will be applicable to the following:

- (a) University or other educational institution [Section 10(22)]
- (b) Hospitals [Section 10(22A)]
- (c) Approved charitable trust [Section 10(23B)]
- (d) Public charitable institutions [Section 10(23C)]

The prohibited category of persons referred to in section 13(3) are as follows:

(i) the author of the trust or the founder of the institution, (ii) any person who has made substantial contribution to the trust or institution (iii) where such author, founder or person is a Hindu undivided family, a member of the family (iv) any trustee, or manager of the institution, (v) any relative of such author, founder, person, member, trustee or manager as aforesaid and (vi) concern in which any of the person referred to in items (i) to (iv) above as a substantial interest.

In this context, the term 'relative' in relation to an individual means (i) spouse of the individual; (ii) brother or sister of the individual; (iii) brother or sister of the spouse of the individual, (iv) any lineal ascendant or descendant of the individual; (v) any lineal ascendant or descendant of the spouse of the individual; (vi) spouse of a person referred to in (ii), (iii), (iv) or (v) and (vi) any lineal descendant of a brother or sister of either the individual or of the spouse of the individual.

For the purposes of section 21A, any part of the property or income of a trust shall be deemed to have been used or applied for the benefit of any of the specified categories of person if it can be deemed to have been so used or applied within the meaning of section 13(l)(c) of the Income-tax Act at any time during the period of the twelve months ending within the relevant valuation date.

3.3.5 Association of persons without specified shares of members

[Section 21AA]: Sub-section (1) of section 21AA provides that where assets chargeable to wealth-tax are held by an association of persons other than the company or a, cooperative society or a society registered under the Societies Registration Act, 1986 or under any law corresponding to that Act in force in any part of India and individual shares of the member of association in the income or assets or both, of the association on the date of its formation or at any time thereafter are indeterminate or unknown, wealth- tax will be levied and recovered from such association in the same manner and to the same extent as an individual citizen of India and resident in India.

Where any business or profession carried on by an association of persons, referred to in the above paragraph, has been discontinued or the association has been dissolved the Assessing Officer will be empowered to make an assessment on the net wealth of the association, as if no such discontinuance or dissolution had taken place and all other provisions of the Act including the provisions relating to the levy of penalty or any other sum will apply to such assessments. The Assessing Officer, Deputy Commissioner (Appeals), and the Commissioner (Appeals) are being empowered to impose or direct the imposition of penalty referred to in sections 18 and 18A, if such association has been found to be guilty of any of the acts specified in those sections. Every person who was a member of the association at the time of such discontinuance or dissolution and legal representative of any deceased person will be jointly and severally liable for the tax and penalty or other sums payable. Where any such discontinuance or dissolution takes place after any proceeding in respect of an assessment year have commenced, the proceedings may be continued against the persons referred to earlier from the stage at which it stood at the time of such discontinuance or dissolution."

3.3.6 Assessment of persons residing outside India: If the person liable to tax under this Act resides outside India, the tax may be assessed on the agent of such person [Section 22(1)]. The agent is a person appointed, *ad hoc*, by the Assessing Officer. The Assessing Officer chooses the agent from the following three categories:

- (a) persons employed by or on behalf of the outsider;
- (b) persons acting as media of transmission to the outsider of income, profit or again; and
- (c) persons having the possession or custody of any assets of outsider.

The first category of persons would include all regular and authorised agents and also factors, commission agents, etc, whether appointed in writing or not. It would also include all such persons who would be regarded in law as agents by virtue of the conduct of parties. The second category of persons are those who form the channel for the flow of money from India to the outsider. It is transference of the income, profits or gains belonging to the outsider that attracts the liability to be appointed as agents. Transference of any other funds of a capital

nature would not require appointment of agent. The third category comprises persons who are in a possession of the assets of the outsider under some lawful title or persons who happen to be in physical or has custody of any assets of the outsider [Section 22(2)]. Before deeming a person to be an agent as aforesaid, he must be given an opportunity of being heard by the Assessing Officer [Section 22(3)].

Such an agent is entitled to be reimbursed by his principal on whose account he pays the amount of wealth-tax. For this purpose he can retain the amount from the money that may be in his possession or may come to him as an agent. The power of retention out of any money payable by the agent to his principal residing outside India may also be exercised by him when he apprehends that he may be assessed as an agent. In such case, if any disagreement as to the amount to be so retained arises between him and his principal, then the agent may obtain from the Assessing Officer a certificate showing the amount to be so retained pending settlement of the liability. The certificate shall be warrant of the agent for retaining that amount [Section 22(6)].

Despite the aforementioned provisions of this section any arrears of tax due from a person residing outside India may be recovered also in accordance with the provisions of this Act from any assets of such person, which are or may at any time come within India [Section 22(7)].

3.4 Penalties [Section 18]

If any of the authorities is satisfied in the course of any proceedings under the Wealth-tax Act, 1957 that any person has committed the prescribed defaults, he may, by order in writing direct that such person shall pay a penalty as specified in the order.

3.4.1 Defaults : The following are the specified defaults:

1. Failure to comply with a notice under section 16(2) or (4);
2. Concealment of particulars of any assets;
3. Furnishing inaccurate particulars of any assets or debts.

The first default would attract a penalty of a sum which shall not be less than ₹ 1,000 and which may extend to ₹ 25,000 for each such failure. Further, in the case of such defaults, no penalty shall be levied if the person proves that there was a reasonable cause for such failure.

In the case of concealment of particulars of wealth or furnishing inaccurate particulars, the minimum penalty will be the amount of tax sought to be evaded and the maximum penalty will be five times the amount of tax sought to be evaded.

There are six *Explanations* expanding the scope of the section levying penalty.

- ◆ **Explanation 1** defines the expression 'the amount of tax sought to be avoided for the purposes of section 18(1)(iii)'. The expression denotes the amount that is arrived at by taking the difference between the tax on the net wealth assessed and that would be chargeable had such net wealth been reduced by the amount of concealed wealth and debts in respect of which inaccurate particulars have been furnished.

- ◆ Explanation 2 provides that where, in respect of facts material to the computation of the net wealth of an assessee, he furnishes no explanation or he cannot substantiate the explanation offered by him or the explanation offered by him is found to be fake, the relevant assets shall be deemed to be his concealed assets. However, if the explanation offered is *bona fide* and the assessee has disclosed all facts material to the computation of his net wealth such deeming provision will not operate. The deemed concealment will apply where the assessee offers an explanation which he is not able to substantiate and fails to prove that such explanation is *bona fide* and that all the facts relating to the same and material to the computation of his net wealth have been disclosed by him. Students may note that the burden to prove that his explanation is *bona fide* etc. has been specifically placed upon the assessee.
- ◆ Explanation 3 brings within the scope of deemed concealment cases of failure without reasonable cause, to furnish return of net wealth by any person within the period specified in section 17A(1). Such a penalty can be imposed where no notice has been issued to the person under section 16(4)(i) or 17(1) and the Assessing Officer or the Deputy Commissioner (Appeals) or the Commissioner (Appeals) or the Commissioner is satisfied that in respect of such assessment year such person has assessable net wealth. Such a levy can take place notwithstanding that such person furnishes the return of his net wealth at any time after the expiry of either of the periods aforesaid applicable to him in pursuance of a notice under section 17.
- ◆ Explanation 4 provides that the assessee will be presumed to have concealed his wealth if the value of any asset returned by him is less than 70% of the value determined in assessment.
- ◆ Explanation 5 In a case where an assessee is found in the course of a search under section 37A to be the owner of any money, bullion, jewellery or other valuable article or thing and the assessee claims that such assets represent wholly or partly, his wealth for (a) any valuation date falling before the date of the search but return in respect of the net wealth on such valuation date has not been furnished before the date of the search or such assets have not been declared in any return furnished before that date or (b) that such assets represent his wealth for any valuation date falling on or after the date of the search, then the assessee shall be deemed to have concealed the particulars of such assets or to have furnished inaccurate particulars of such assets, notwithstanding the fact that such assets are declared by the assessee in any return of net wealth furnished on or after the date of search. Consequently, in such cases penalty will be levied for concealment of wealth.

These provisions will not apply in a case where the relevant assets are recorded, on or before the date of search in the books of account maintained by the assessee or they are otherwise disclosed to the Commissioner before the date of search.

- ◆ Explanation 6 seeks to exclude the application of the penalty provisions in relation to adjustments made under the proviso to clause (a) of section 16(1) in respect of which additional wealth-tax is charged.

Where any amount is added or disallowed in computing the net wealth of an assessee in any order of assessment or reassessment and the said order contains a direction for initiation of penalty proceedings under section 18(1)(c), such an order of assessment or reassessment shall be deemed to constitute satisfaction of the Assessing Officer for initiation of the penalty proceedings [Sub-section (1A)].

Sub-section (3) of section 18 provides that where a penalty order under section 18(1) is passed by the Income-tax Officer, and the amount of penalty exceeds ₹ 10,000, the prior approval of the Joint Commissioner is required. Where the order is passed by the Assistant Commissioner or Deputy Commissioner such a prior approval is necessary only where the penalty exceeds ₹ 20,000.

Where a penalty is levied by a Deputy Commissioner (Appeals), the Chief Commissioner or the Commissioner or Appellate Tribunal, a copy of the order should be sent to the concerned Assessing Officer.

No order imposing a penalty shall be passed in a case where the assessment to which proceedings for imposition of penalty relate is the subject matter of an appeal to the Tribunal under section 24(2), after the expiry of the financial year in which the proceedings in the course of which action for the imposition of penalty has been initiated are completed or 6 months from the end of the month in which the order of the Deputy Commissioner (Appeals) or the Commissioner (Appeals) or as the case may be, the Appellate Tribunal is received by the Chief Commissioner or the Commissioner, whichever is later.

Where the relevant assessment order is the subject matter of revision under section 25(2) the order of penalty has to be passed before the expiry of 6 months from the end of the month in which such order of revision is passed.

In any other case, the penalty order has to be passed before the expiry of the financial year in which the proceedings in the course of which action for the imposition of penalty has been initiated are completed or six months from the end of the month in which the action for imposition of penalty is initiated, whichever is later.

3.4.2 Penalty for failure to answer questions, sign statements, furnish information etc. [Section 18A]: This section provides for levy of a minimum penalty of ₹ 500, which may go up to a maximum of ₹ 10,000 for each of the following default or failure :

1. (a) Failure to answer any question put by a Wealth-tax authority in exercise of his power.
- (b) Refusal to sign any statement made in the course of any proceedings which a Wealth-tax authority may legally require a person to sign.
- (c) Failure to attend to give evidence or produce books of accounts or other documents in response to summons issued under section 37(1).

In the case of (c) above, no penalty will be levied if the person concerned proves that there was reasonable cause for the failure.

2. Failure to furnish in due time any statement or information which a person is bound to furnish to the Assessing Officer under section 38 would also lead to levy of penalty or a

sum which shall not be less than ₹ 100 and may extend to ₹ 200 for everyday during which the default continues. Here also, if the person concerned proves reasonable cause for the failure, no penalty will be levied.

3. The penalty in respect of (1) or (2) above can be levied by any wealth tax authority not lower in rank than a Joint Director/Joint Commissioner, if the default occurs in the course of proceedings before such authority. In any other case, the penalty under section 18A can be levied by the Joint Director or the Joint Commissioner.
4. Before levying penalty under this provision the assessee must be given an opportunity of being heard

3.4.3 Power to reduce or waive penalty [Section 18B]: This section gives very wide powers to the Chief Commissioner or the Commissioner for waiving or reducing the penalty. An order of reduction or waiver of penalty may be made either on an application by the assessee or on the Commissioner's own motion.

Under this section, the power to reduce or waive penalty is confined to penalty for concealment under section 18(1)(iii). The Chief Commissioner or the Commissioner can reduce or waive the minimum penalty only if the assessee makes a full and true disclosure of all particulars regarding his wealth before Assessing Officer. In the case of both these defaults, there are two more conditions to be satisfied so that the Chief Commissioner or the Commissioner can reduce or waive the minimum penalty. The conditions are (1) that the assessee should have co-operated in any enquiry relating to the assessment of his net wealth and (2) that he should have either paid or made satisfactory arrangement for payment of any tax or interest payable in respect of the relevant assessment year. An assessee will be deemed to have made full and true disclosure of the particulars of his assets, or debts in any case where the excess of net wealth assessed over the net wealth returned is of such a nature as not to attract the provisions of section 18(1)(c). In cases of concealment or inaccurate particulars, if the amount in respects of which the penalty is imposable for furnishing the relevant assessment year or where such disclosure relates to more than one assessment year, such amount for any one of the relevant assessment years exceeds ₹ 5,00,000 the Commissioner cannot reduce or waive the penalty without obtaining the previous approval of the Chief Commissioner or Director General, as the case may be.

If in the case of person, reduction or waiver has been allowed once, he shall not be entitled to any relief or any subsequent occasion under this section. The Commissioner may, on any application made by the assessee and after recording his reasons, reduce or waive any penalty payable by the assessee or may stay or compound any proceedings for its recovery, if he is satisfied that it is a case of genuine hardship and the assessee has been co-operative. It is to be noted that the order of the Commissioner reducing or waiving penalty under this section will be final and cannot be challenged in any court.

3.4.4. Power of Commissioner to grant immunity from penalty [Section 18BA]: Section 18BA empowers the Commissioner to grant immunity from penalty.

- (1) The application for the immunity has to be made by the assessee (person whose case has been abated under section 22HA) to the Commissioner.

- (2) Where penalty was levied before or during the pendency of settlement proceedings, then the assessee can approach the Commissioner for immunity at any time.
- (3) However, if no penalty was levied till the time of abatement of proceedings before Settlement Commission, then the assessee must make an application for immunity before the imposition of penalty by the Wealth-tax authority.
- (4) The Commissioner can grant immunity, subject to such conditions as he may think fit to impose, on being satisfied that the assessee has –
 - (i) co-operated in the proceedings after abatement; and
 - (ii) made a full and true disclosure of his net wealth and the manner in which such net wealth has been derived.
- (5) The immunity granted shall stand withdrawn, if such assessee fails to comply with any condition subject to which the immunity was granted.
- (6) The immunity granted to a person may, at any time, be withdrawn by the Commissioner, if he is satisfied that such person had, in the course of any proceedings, after abatement,-
 - (i) concealed any particulars material to the assessment from the wealth-tax authority; or
 - (ii) given false evidence.

Consequently, such person would become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

3.5 Settlement of Cases

Chapter VA (sections 22A to 29M) gives a statutory basis for settlement of cases which are necessitated at times in the interest of the revenue. The Constitution of the Settlement Commission and their powers and functions are explained briefly in the following paragraphs.

As per section 22A(b), 'Case' means any proceeding under this Act for the assessment under this Act, of any person in respect of any assessment year or assessment years which may be pending before an Assessing Officer on the date on which an application under sub-section (1) of section 22C is made.

However, application cannot be made to the Settlement Commission, where

- notice for assessment/reassessment has been issued under section 17.
- fresh assessment has been directed on account of the original assessment being set aside by the Commissioner(Appeals)/Appellate Tribunal/Commissioner under sections 23A/24/25.

Further, the additional amount of wealth-tax offered and interest thereon should be paid before filing the application and proof of payment should be attached with the application.

In the case of a person whose income is being assessed or reassessed as a result of search or as a result of requisition of books of account or other documents or any assets, the

proceedings for assessment or reassessment shall be deemed to have commenced on the date of issue of notice initiating such proceedings and concluded on the date on which the assessment is made.

3.5.1 Constitution: Settlements are to be made by a Commission called the Wealth-tax Settlement Commission. The Commission shall consist of a Chairman and as many vice-chairmen and other members as the Central Government thinks fit. The chairman and members shall be appointed by the Central Government from amongst persons of integrity and outstanding ability and shall possess special knowledge of and experience in problems relating to direct taxes and business account. Until such whole time members are appointed, the Central Government are empowered to require from time to time any members of the Board to function as part time members of the Settlement Commission [Section 22B].

22BA deals with the jurisdiction and powers of Settlement Commission. Accordingly the jurisdiction, powers and authority of the Settlement Commission may be exercised by Benches. A Bench shall be presided over by the Chairman or a Vice-Chairman and shall consist of two other members. The Bench for which the Chairman is the Presiding Officer shall be the principal Bench and the other Benches shall be known as additional Benches. The Chairman may authorise the Vice-Chairman or other member appointed to one Bench to discharge also the functions of the Vice-Chairman or other member of another Bench.

When one of the members is unable to discharge his functions owing to absence, illness or any other cause or in the case of vacancy in the office of the Presiding Officer or any other member, the remaining two persons may function as the Bench and if the Presiding Officer of the Bench is not one of the remaining two persons, the senior among the remaining two persons, the senior among the remaining persons shall act as the Presiding Officer. Provision has also been made for the transfer of a case from a two member Bench to a three-member Bench.

The Chairman may, for the disposal of any particular case, constitute a Special Bench consisting of more than three members. The places at which the principal and additional Benches shall sit will be notified by the Central Government.

The Commission shall, subject to the provisions of this Chapter have power to regulate its own procedure and the procedures of Benches thereof in all matters arising out of the exercise of its power or of the discharge of its functions including the places at which the Bench shall hold their meetings.

Section 22BB provides for the circumstances under which the Vice-Chairman will discharge the functions of the Chairman. Section 22BC gives power to the Chairman to transfer any case pending before one Bench to another Bench.

The decision of a Bench is to be by majority but if the members are equally divided they shall state the point of different persons to the Chairman who will either hear it himself or refer it to one or more of the other members of the Commission and such point shall be decided according to the opinion of the majority of all members who heard the case.

3.5.2 Application for settlement [Section 22C]: 1. An assessee, may, at any stage of a case relating to him, make an application to the Settlement Commission to have the case settled. The application for settlement should *inter alia* contain a full and true disclosure of the

applicant's wealth which has not been disclosed before the Assessing Officer the manner in which such wealth has been derived and the additional amount of wealth tax payable on such wealth [Sub-section (1)]

2. The additional amount of wealth-tax has to be calculated in the following manner as provided in the sub-section (1B) of section 22C read with the amended sub-section (1C), in a case where the income disclosed in the application relates to only one previous year–

(i)	If the applicant has not furnished a return in respect of the net wealth of that year.	Wealth-tax should be calculated on the wealth disclosed in the application as if such wealth is the net wealth. Such tax represents the additional amount of wealth-tax
(ii)	If the applicant has furnished a return in respect of the net wealth of that year.	The wealth-tax should be calculated on the aggregate of net wealth returned and the wealth disclosed in the application i.e. as if the aggregate represents the net wealth. The additional amount of wealth-tax is the amount calculated on such aggregate as reduced by the amount of wealth-tax calculated on the net wealth returned for that year.

3. Where the wealth disclosed in the application relates to more than one previous year, then the above procedure is to be adopted in respect of each previous year and the aggregate of tax payable is to be calculated [Sub-section (1D)].

4. Where any books of account or other documents belonging to an assessee are seized under section 37A, the assessee would not be entitled to make a settlement application before the expiry of 120 days from the date of seizure [Sub-section (1E)].

5. Every settlement application made under sub-section (1) should be accompanied by the prescribed fees of ₹ 500 [Sub-section (2)].

6. The settlement application made under sub-section (1) cannot be withdrawn by the applicant [Sub-section (3)].

7. The assessee should also intimate to the Assessing Officer in the prescribed manner that he has made an application to the Settlement Commission. Such intimation should be made on the same date when he makes an application to the Settlement Commission [Sub-section (4)].

3.5.3 Procedure before the Settlement Commission [Section 22D]

(1) Admission of Petition [Sub-section (1) of section 22D]

- (i) On receipt of the settlement application, the Settlement Commission shall issue a notice to the applicant within 7 days from the date of receipt of application.
 - (ii) After hearing the applicant, the Settlement Commission shall pass an order either rejecting or allowing the application to be proceeded with within 14 days from the date of application.
 - (iii) Application not disposed off within 14 days shall be treated as admitted.
- (2) A copy of every order shall be sent to the applicant and to the Commissioner [Sub-section (1A) of section 22D].

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- (3) Deemed date of admission/disposal of Settlement applications made before 1.6.2007 [Sub-section (2A) of section 22D]
- (i) Settlement applications made prior to 1.6.2007, if not disposed off by 31st May, 2007, shall be deemed to be admitted, if the additional wealth-tax on the wealth disclosed in such application and the interest thereon is paid on or before 31.7.2007.
- (ii) 31.7.07 shall also be deemed to be the date of the order of rejection or admission for such applications.
- (4) Time limit for furnishing report by Commissioner and passing order by the Settlement Commission [Sub-sections (2B) & (2C) of section 22D]
- (i) The Settlement Commission shall call for a report from the Commissioner within the time limit specified below –

(i)	In respect of an application admitted under section 22D(1)	Within 30 days from the date of application
(ii)	In respect of an application deemed to have been admitted under section 22D(2A)	On or before 7.8.2007

- (ii) The Commissioner is required to furnish the report within 30 days from the receipt of communication from the Settlement Commission.
- (iii) The Settlement Commission can also pass an order declaring the application as invalid on the basis of the report of the Commissioner.
- (iv) Such order should be passed in writing within 15 days of the receipt of report after giving the applicant an opportunity of being heard.
- (v) A copy of the order should be sent to the applicant and the Commissioner.
- (vi) However, in a case where the Commissioner has not furnished the report within the prescribed time, the Settlement Commission shall proceed further in the matter without the report of the Commissioner.
- (5) Status of pending settlement applications as on 1st June 2007, which are already admitted under the old provisions [Sub-section (2D) of section 22D]: All settlement applications which are admitted under the existing provisions of section 22D(1), but for which an order under section 22D(4) is not passed before 1.6.2007, will not be allowed to be proceeded with further unless the applicant pays the additional wealth-tax and interest thereon on or before 31.7.2007.
- (6) Proceedings after admission [Sub-section (3) of section 22D]
- (i) The Settlement Commission may call for records from the Commissioner in respect of an application which has not been declared invalid under sub-section (2C) or an application which has been allowed to be further proceeded with under sub-section (2D).
- (ii) After examination of such records, the Settlement Commission may require the Commissioner to make further enquiry or investigation and furnish a report on the matters covered by the application and any other matter relating to the case.

- (iii) The Commissioner shall furnish the report within a period of 90 days of the receipt of communication from the Settlement Commission.
- (iv) If the Commissioner fails to furnish the report within the said period of 90 days, the Settlement Commission may proceed to pass an order under sub-section (4) without such report.

(7) Final order of settlement [Sub-sections (4) and (4A) of section 22D]

- (i) The Settlement Commission may pass such order as it thinks fit on the matters covered by the application and any other matter relating to the case not covered by the application but referred to in the report of the Commissioner.
- (ii) Such order should be passed by the Settlement Commission after –
 - (1) examining the records and report of the Commissioner, if any, received at the time of admission or on investigation or enquiry conducted as per the instructions of the Settlement Commission;
 - (2) giving an opportunity of being heard to the applicant and the Commissioner;
 - (3) examining such further evidence as may be placed before it or obtained by it.
- (iii) The time limit for passing such order is –

(1)	In respect of an application made on or after 1.6.2010	Within 18 months from the end of the month in which the application was made.
(2)	In respect of an application made on or after 1.6.2007 but before 1.6.2010	Within 12 months from the end of the month in which the application was made.
(3)	In respect of an application filed before 1.6.2007 [under sub-section (2A) or (2D)]	On or before 31.3.2008

- (8) The materials brought on record before the Settlement Commission shall be considered by the members of the bench before passing any order [Sub-section (5)].
- (9) Such order shall provide for the terms of settlement, including any demand by way of tax, penalty or interest, the manner of payment of the sum due under settlement etc. It shall also provide that the settlement shall not be valid if it is subsequently found to have been obtained by fraud or misrepresentation of facts [Sub-section (6)].
- (10) Where the tax payable in pursuance of an order passed by the Settlement Commission is not paid by the assessee within 35 days of receipt of a copy of final order, the assessee shall be liable to pay simple interest @ 1¼% for every month or part of a month on the outstanding amount from the date of expiry of 35 days. Such liability will arise even in cases where the commission extended the time allowed for such payment or permitted payment by installment [Sub-section (6A)].
- (11) The Settlement Commission may amend any order passed by it under section 22D(4) to rectify any mistake apparent from the record within a period of six months from the date

of the order. However, the Settlement Commission should not make a rectification which has the effect of modifying the liability of the applicant, without –

- (1) giving a notice to the applicant and the Commissioner of its intention to do so; and
 - (2) allowing the applicant and the Commissioner an opportunity of being heard. [Sub-section (6B)]
- (12) If a settlement becomes void, the proceeding with respect to matters covered by the settlement shall be deemed to have been received and the Wealth-tax authority shall complete such proceedings within a period of two years from the end of the financial year in which the settlement become void [Sub-section (7)].

3.5.4 Power of Settlement Commission to order provisional attachment to protect revenue [Section 22DD]

(i) Under section 22DD, the Settlement Commission is empowered to provisionally attach the property belonging to the applicant for protecting the interest of the revenue. The manner in which such provisional attachment is to be effected is provided in the Second Schedule to the Income-tax Act, 1961. Such provisional attachment is valid for a period of 6 months, after which it ceases to have effect.

(ii) The Settlement Commission may, for reasons to be recorded in writing, extend the aforesaid period by such further period or period as it thinks fit. The power to provisionally attach property is available to the Settlement Commission for an unlimited period.

3.5.5 Powers of the Settlement Commission: The Settlement Commission has been conferred with all powers which are invested in a Wealth-tax authority under the Act [Section 22F(2)]. In respect of an application made under section 22C on or after 1.6.2007, such exclusive jurisdiction would begin with the date of filing of application with the Settlement Commission. The exclusive jurisdiction of the Settlement Commission would end on –

- (a) the date of passing an order under section 22D(4); or
- (b) the date of passing the order rejecting the application (made on or after 1.6.2007) under section 22D(1); or
- (c) the date on which the application is not allowed to be proceeded with under section 22D(2A); or
- (d) the date on which the application is declared invalid under section 22D(2C); or
- (e) the date on which the application is not allowed to be further proceeded with under section 22D(2D).

The following additional powers have also been conferred on the Commission:

- (i) **To reopen completed proceedings [Section 22E]:** If the Settlement Commission is of the opinion that for the proper disposal of the case pending before it, it is necessary or expedient to reopen any proceeding connected with the case, but which has been completed under Income-tax Act, 1961 by any Income-tax authority before the application of the assessee under section 22C was made, it may, with the concurrence of the applicant, reopen such proceedings and pass such orders thereon as it deems fit as if

the case in relation to which the application for the settlement had been made by the applicant covered by the proceedings for reopening of assessments as well. Before initiating the proceedings for reopening of assessment in any case, the reasons for arriving at the opinion for such reopening of the assessment must be recorded by the Settlement Commission. However, no proceeding shall be reopened by the Settlement Commission under this section if the period between the end of the assessment year to which such a proceeding relates and the date of application for settlement exceeds nine years.

Further, the Settlement Commission shall not have any power to reopen the proceedings in respect of an application made on or after 1.6.2007.

- (ii) To grant and withdraw immunity from prosecution and penalty [Section 22H]: The Settlement Commission may, if it is satisfied that the applicant has co-operated with it in the proceeding before it and made full and true disclosure of his wealth and the manner in which it has been acquired, grant the applicant immunity from prosecution and penalty.

Under section 22H, the Settlement Commission may grant immunity from prosecution for any offence under the Indian Penal Code, Income-tax Act, 1961 and any other Central Act. This power has now been restricted in respect of application made under section 22C on or after 1.6.2007. In respect of such cases, the Settlement Commission shall not grant immunity from prosecution for any offence under the Indian Penal Code or under any Central Act other than the Income-tax Act, 1961 and Wealth-tax Act, 1957.

However, in respect of applications pending as on 1.6.2007, the Settlement Commission has the power to grant immunity from prosecution for any offence under the Indian Penal Code and other Central Acts also.

The Settlement Commission can grant partial immunity also from imposition of penalty. Such immunity can be withdrawn by it at any time under the following circumstances:

- (a) If the applicant has not complied with the conditions subject to which the immunity was granted.
- (b) If it is found that the applicant has during the proceeding before the Settlement Commission, concealed material particular relating the settlement.
- (c) If the applicant has given false evidence during the proceedings before the Settlement Commission.

When the immunity is withdrawn by the Settlement Commission, the authorities concerned can start proceeding for prosecution under the law applicable at the relevant time and can also impose penalties. In coming the time limit for starting prosecution on for levy of penalty, the period during which the immunity subsisted will be excluded.

The proviso to section 22H(1) precludes the Commission from granting immunity from prosecution in cases where the prosecution has been launched prior to the date of receipt of application for settlement. Sub-section (1A) provides that an immunity granted by the commission to any person shall stand withdrawn i.e. the discretionary power available to the Settlement Commission under (a) above has been withdrawn on failure

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of such person to pay tax with the time allowed or to comply with any other condition subject to which immunity was granted.

3.5.6 Abatement of proceeding before the Settlement Commission [Sections 22HA & 22HAA]

- (i) In the following cases, the proceedings before the Settlement Commission shall abate on the specified date as given below –

	Case	Specified date
(1)	where an application made to the Settlement Commission on or after 1.6.2007 has been rejected under section 22D(1).	The date on which the application was rejected.
(2)	where any application is not allowed to be proceeded with under section 22D(2A) or further proceeded with under section 22D(2D).	31.7.2007
(3)	where an application has been declared invalid under section 22D(2C).	The last day of the month in which the application was declared invalid.
(4)	Where an order under section 22D(4) has not been passed within the time allowed under section 22D(4A).	The date on which the time or period specified in section 22D(4A) expires.

- (ii) On abatement of proceedings, the case would revert back to the Assessing Officer having jurisdiction or any other wealth-tax authority before whom the proceedings were pending at the time of making the application. Such wealth-tax authority shall dispose of the case in accordance with the provisions of the Act.
- (iii) For completing the proceedings, the Assessing Officer or other wealth-tax authority shall be entitled to use the material and information produced by the assessee before the Settlement Commission as if such material and information had been produced before the Assessing Officer or other wealth-tax authority. Similarly, the Assessing Officer or other wealth-tax authority shall be entitled to use the results of the inquiry held or evidence recorded by the Settlement Commission in the course of the proceedings before it, as if such inquiry or evidence had been held or recorded by him in the course of the proceedings before him.
- (iv) The period from the date on which the application was made before the Commission up to the date on which proceedings get abated shall be excluded from the time limit for completion of proceedings by the Assessing Officer and for payment of interest under section 34A.
- (v) In case of abatement of settlement proceedings, the Assessing Officer is required to give credit for the tax and interest paid on or before the date of making the application or during the pendency of the case before the Settlement Commission [Section 22HAA] .

3.5.7 Order of Settlement Commission to be conclusive [Section 22-I]: Section 22-I provides that every order of the Settlement Commission passed under section 22D(4) shall be conclusive in respect of the matters contained therein and consequently no matter covered by the settlement order shall be liable to be reopened in any proceeding under the Wealth-tax Act, 1957 or under any other law for the time being in force except, however, in those cases wherein the reopening of the case is specifically provided in Chapter VA of the Wealth-tax Act, 1957.

3.5.8 Recovery of settled amount [Section 22J]: According to section 245J, any amount specified in an order of settlement passed by the Settlement Commission under section 22D(4), may be recovered and any penalty for default in making the payment may be imposed and recovered from the person concerned in accordance with the provisions of section 32. The power for making the recovery if any, as may be specified by the Settlement Commission in the order passed by it. The right of recovery may be exercised by the Assessing Officer having jurisdiction over the person who has made the application for settlement under section 22C.

3.5.9 Bar on subsequent application for settlement [Section 22K]

- (i) In the event of occurrence of any of the following, the person concerned shall not be entitled to apply for settlement in relation to any other matter –
 - (1) the order of settlement passed under section 22D(4) provides for imposition of penalty for concealment of income; or
 - (2) after the passing of order under section 22D(4) in relation to a case, the person is convicted of an offence under Chapter XXII in relation to that case; or
 - (3) the case of such person was sent back to the Assessing Officer by the Settlement Commission on or before 1.6.2002.
- (ii) Further, with effect from 1.6.2007, the option of going to the Settlement Commission would be available only once in the lifetime of a person. Therefore, where an application for settlement is made on or after 1.6.2007 and such application has been allowed to be proceeded with, then such person will not be subsequently entitled to make any application under section 22C.

3.5.10 Proceedings to be judicial proceedings [Section 22L]: Any proceeding under Chapter VA before the Settlement Commission shall be deemed to be judicial proceedings within the meaning of sections 193 and 228, and for the purposes of section 196 of the Indian Penal Code, 1860.

3.6 Appeals and Revision

3.6.1 Appeal against orders of Assessing Officers: An appeal against the order of the Assessing Officer lies to the Commissioner (Appeals), who is the first appellate authority.

3.6.2 Appealable orders before Commissioner (Appeals) [Section 23A]: Any person may appeal to the Commissioner (Appeals) against an assessment or order in respect of the following :

- (a) Objecting to net wealth computed
- (b) Objecting to amount of wealth tax determined
- (c) Denying liability to be assessed under this Act
- (d) Objecting to penalty imposed under section 18/18A
- (e) Objecting to order passed under section 20
- (f) Objecting to penalty imposed under section 221 of the Income tax Act, 1961 as applied under section 32 for the purposes of wealth tax.
- (g) Objecting to order made under section 22 treating him as agent of a person residing outside India.
- (h) Objecting to an order by the Assessing Officer under section 35 having the effect of enhancing the assessment or reducing a refund or refusing to allow the claim made by the assessee under that section.
- (i) Objecting to any order of the Valuation Officer under section 35 having the effect of enhancing the assessment or reducing a refund or refusing to allow the claim made by the assessee under that section.
- (j) Objecting to penalty imposed by the Joint Director or Joint Commissioner under section 18A.

The appeal should be in the prescribed form and should be made on payment of ₹ 250.

3.6.3 Procedure in appeal to Commissioner (Appeals): 1. An appeal must be presented within 30 days of the receipt of the demand of notice relating to the assessment or penalty objected to, or the date on which the order objected to is communicated to the assessee. However, the Commissioner (Appeals) may admit an appeal after expiration of the aforesaid period if he is satisfied that the appellant had sufficient cause for not presenting the appeal within the specify period.

2. No appeal by an assessee shall be admitted unless at the time of filing the appeal he has paid the tax due on the net wealth returned by him.

3. The Commissioner (Appeals) shall fix a day and place for the hearing and may, from time to time, adjourn the hearing.

4. In case of appeal against the valuation of an asset, where such valuation has been done by a Valuation Officer, the Commissioner (Appeals) shall give such Valuation Officer an opportunity of being heard. In any other case, on a request being made by the Assessing Officer, the Commissioner (Appeals) shall give an opportunity of being heard to any Valuation Officer nominated for the purpose by the Assessing Officer.

5. During the course of the hearing, the Commissioner (Appeals) may allow the appellant to go into any ground of appeal not specified earlier.

6. Before disposing of an appeal, the Commissioner (Appeals) may make such further enquiry as he thinks of fit.

7. The Commissioner (Appeals) may also considered and decide any matter arising out of the proceedings notwithstanding that such matter was not raised earlier by the appellant.

3.6.4 Order of Commissioner (Appeals) under section 23A: 1. The Commissioner (Appeals) may pass such order as he thinks fit which may include an order enhancing the assessment or penalty.

2. The order shall be in writing and shall state the points for determination, the decision thereon and the reasons for the decision.

3. A copy of the order shall be forwarded the Appellant and the Chief Commissioner or Commissioner.

4. In every appeal, where it is possible, the Commissioner (Appeals) may hear and decide such appeal within one year from the end of financial year in which such appeal is filed under this section.

5. In disposing of an appeal, the Commissioner (Appeals) may consider and decide any matter arising out of the proceedings in which the order appealed against was passed, notwithstanding that such matter was not placed before the Commissioner (Appeals) by the appellant.

6. The Commissioner (Appeals), in disposing of an appeal against the assessment order in respect of which the proceeding before the Settlement Commission abates under section 22HA, is empowered to confirm, reduce, enhance or annul the assessment after taking into consideration the following -

- (1) all the material and other information produced by the assessee before the Settlement Commission;
- (2) the results of the inquiry held by the Settlement Commission;
- (3) the evidence recorded by the Settlement Commission in the course of the proceedings before it; and
- (4) such other material as may be brought on his record.

3.6.5 Commissioner's power to revise orders passed by his subordinates [Section 25]

(1) Revision of orders prejudicial to assessee [Sub-section (1)]: 1. The Commissioner has the power to revise any order passed by any authority subordinate to him. For this purpose even a Deputy Commissioner (Appeals) shall be deemed to the subordinate to him.

2. The Commissioner may, either on his own motion on an application made by the assessee, revise an order passed by his subordinate. For this purpose, he may call for the record of any proceeding under the Act, and make such enquiry as he thinks fit.

3. Order passed under sub-section (1) of this section cannot be prejudicial to the assessee.

4. The Commissioner does not have the power to revise an order in the following circumstances:

- (i) Where the assessee right to obtain relief by way of appeal to Deputy Commissioner (Appeals) or Commissioner (Appeals) or the Appellate Tribunal has not expired or where the assessee has not waived his right of appeal;
- (ii) Where the order is the subject matter of appeal before Deputy Commissioner (Appeals), Commissioner (Appeals) or the Tribunal.

5. Where the application for revision is made by the assessee, it must be accompanied by a fee of ₹ 25.

6. The application for revision must be made within one year from the date of the order which is sought to be revised.

However, the Commissioner may extend the period if he thinks fit.

7. Where the order is sought to be revised by the commissioner on his own motion, the time limit is 1 year from the date of subordinate authority's order.

8. The Commissioner shall pass the order of revision within 1 year from the end of the financial year in which the application was made. In computing this period of limitation, the time taken in giving an opportunity to the assessee to be reheard under the proviso to section 39 and any period during which any proceeding under section 25 is stayed by an order or injunction of any court shall be excluded.

(2) Revision of orders prejudicial to revenue [Sub-section (2)]: 1. Under this sub-section the Commissioner has the power to revise any order of an assessing officer which is prejudicial to the interest of revenue.

2. For this purpose, he may call for and examine the record of any proceeding under the Act. After giving the assessee an opportunity to be heard, and after making such enquiry as he thinks fit, the Commissioner may pass the revision order.

3. He may enhance, modify or cancel the Assessing Officer's order and may direct a fresh assessment to be made.

4. No order shall be made under this sub-section after the expiry of 2 years from the end of the financial year in which the order sought to be revised was passed.

5. For the purpose of this sub-section, the Commissioner shall be competent to revise an order of assessment passed by an Assessing Officer on all matters except those that have been considered and decided in appeal.

3.6.6 No time limit for revising an order to give effect to any finding or direction contained in an order of the Appellate Tribunal, National Tax Tribunal (NTT), the High Court or the Supreme Court [Section 25(4)]: Section 25(4) provides that an order in revision may be passed at any time in the case of an order which has been passed in consequence of, or to give effect to, any finding or direction contained in an order of the Appellate Tribunal, National Tax Tribunal (NTT), the High Court or the Supreme Court.

3.6.7 Appeal to Appellate Tribunal from orders of Commissioner [Section 24]

1. An assessee can file an appeal to the Appellate Tribunal against the following orders:

- (a) Order passed by the Deputy Commissioner (Appeals) or Commissioner (Appeals) under section 18/18A/23/23A/37(2).
- (b) Order passed by the Chief Commissioner or Commissioner under section 18 or 18A or 25(2).
- (c) Order passed by the Director General or Director under section 18A.

2. The Commissioner may file an appeal to the Tribunal against section 23A.
3. The appeal is to be made within 60 days of the date on which the order is communicated to the assessee or the Commissioner, as the case may be.
4. The appeal shall be in the prescribed form and verified in the prescribed manner and shall be accompanied by a fee of ₹ 1000.

However, where the appeal does not relate to net wealth as computed by the Assessing Officer, the fee will be ₹ 500.

5. Section 24(2A) enables the Assessing Officer or the assessee as the case may be, to file a memorandum of cross-objections within 30 days of receipt of notice of the appeal by the other party.
6. In appropriate cases, the Tribunal may admit an appeal, or permit the filing of a memorandum of cross-objections after the expiry of the relevant period.
7. When the valuation of any asset is in dispute before the Tribunal and the valuation of the asset was made by the Valuation Officer, the Appellate Tribunal shall give an opportunity for hearing such Valuation Officer. In any other case, where no such valuation has been made at the stage of assessment or where such Valuation Officer is not available, the Tribunal if so, requested by the Assessing Officer shall be given an opportunity for hearing to Valuation Officer nominated by the Assessing Officer.
8. No order enhancing an assessment or penalty shall be made under the person affected thereby has been given a reasonable opportunity of showing cause against such enhancement.
9. The Appellate Tribunal, where it is possible, may hear and decide such appeal within a period of 4 years from the end of the financial year in which such appeal was filed.
10. The cost of any appeal to the Appellate Tribunal shall be at the direction of that Tribunal.
11. A copy of every order passed by the Appellate Tribunal shall be forwarded to the assessee and the Commissioner.

3.6.8 Appeal to the Appellate Tribunal from orders of enhancement by the Chief Commissioner or Commissioner [Section 26]

1. Any assessee may appeal to the Tribunal objecting to the following orders:
 - (i) an order passed by the Chief Commissioner or Commissioner under section 18 or 18A or 25(2);
 - (ii) an order passed by the Director General or Director under section 18A.
2. The appeal must be made within 60 days of the date on which the order is communicated to the assessee.
3. The appeal shall be in the prescribed form and shall be accompanied with a fee of ₹ 250.

3.6.9 Direct appeal to High Court [Section 27A]: 1. The assessee or the Chief Commissioner or Commissioner may file an appeal to a High Court against any order passed under section 24 or 26 or section 35(1)(e). This is applicable only in respect of filing of appeals on or after 1.10.98 but before the date of establishment of NTT.

2. The appeal must be made within 120 days of the day on which he is served with notice of the order. The High Court has and always had the power to condone the delay and admit an appeal after the expiry of the period of 120 days, if it is satisfied that there was sufficient cause for not filing the appeal within that period.

3. In case of an order passed by the Appellate Tribunal under section 24(1), an appeal shall lie to the High Court before the date of establishment of the NTT, only if the High Court is satisfied that the case involves a substantial question of law. Thereafter, the appeal shall lie to the NTT.

4. The Memorandum of Appeal shall state precisely the substantial question of law involved in the appeal under this section.

5. Where the High Court is satisfied that a substantial question of law is involved, it shall formulate the question.

6. The appeal shall be heard only on the question so formulated, and the respondent shall be allowed to argue during the hearing that the case does not involve such question.

7. The High Court shall decide the question of law so formulated and deliver such judgement as it deems fit. The judgment shall contain the ground on which the decision is founded. The Court may also award such cost as it deems fit.

8. The provisions of the Court of Civil procedure, 1908 relating to appeals to High Court shall apply in a case of Appeals under this section.

3.6.10 Hearing by High Court [Section 28]: 1. An appeal under section 27A shall be heard by the bench of not less than 2 Judges of the High Court and it shall be decided in accordance with the opinion of such judges or of the majority of such judges, if any.

2. Where the judges shall state the point upon which they differ and the case shall then be heard only upon that point by one or more judges of the High Court. Such point shall then be decided according to the majority opinion of the judges including the judges who first heard it.

3.6.11 Appeal to Supreme Court [Section 29]: 1. An appeal shall lie to the Supreme Court from any judgment of the High Court delivered before the date of establishment of the NTT, on a reference made under section 27 or appeal made under section 27A only if the High Court certifies it to be a fit case for appeal to the Supreme Court. Thereafter, an appeal shall lie to the Supreme Court from any judgment of the NTT as per the provisions of the National Tax Tribunal Act, 2005.

2. Where the judgement of the High Court is varied or reversed by the Supreme Court under this section, effect shall be given to the order on the basis of a certified copy of the judgement delivered.

3. The High Court may, on application made to it for the execution of any order of the Supreme Court in respect of any cost awarded by it, transit the order for execution to any court subordinate to it.

3.6.12 Wealth-tax to be paid in all cases [Section 29A]: Notwithstanding that a reference has been made to the High Court or the Supreme Court, or an appeal has been preferred to the Supreme Court under this Act before the commencement of the National Tax Tribunal Act, 2005, wealth-tax shall be payable in accordance with the assessment made in the case.

3.7 Collection and Refund

3.7.1 Collection and recovery of tax: The Assessing Officer is under an obligation to serve upon the assessee a notice of demand in the prescribed form specifying the sum payable, if any as tax, interest, penalty, fine or any order passed under this Act [Section 31]. The amount specified in the aforesaid notice of demand is to be paid within 30 days of the notice. The Assessing Officer may specify in the notice a lesser period than that of 30 days, if the full respite of 30 days is reasonably believed to be likely to be detrimental to revenue. However, he may do so only with the previous approval of the Deputy Commissioner [Section 31(1)].

Any failure on the part of the assessee to pay the amount within such period as specified in the preceding paragraph will render him liable to payment of interest @ 1% for every month or part of a month comprised in the period commencing from the day immediately following the end of the period mentioned in 31(1) and ending with the day on which the amount is paid. However, if in consequence of an order under sections 23, 23A, 24, 25, 26, 27, 29 or 35 the amount on which interest was payable as aforesaid had been reduced, the interest will accordingly suffer reduction, and the interest paid in excess, shall be refunded [Section 31(2) and the proviso]. Sub-section (2A) empowers the Chief Commissioner or the Commissioner to reduce or waive the interest payable under section 31(2) for reasons of hardship, circumstances beyond control and the co-operation extended by the assessee.

Without prejudice to the provisions of sub-section (2), if the assessee makes an application before the due date under sub-section (1) expires, the Assessing Officer may either extend the time for payment or allow payment by installments. But while doing so the Assessing Officer may lay down such conditions as the circumstances of the case might warrant [Section 31(3)].

The modes of recovery of tax, interest, penalty, etc. are similar to those prescribed under sections 221 to 227, 228A, 229, 231 and 232 of the Income-tax Act, 1961 and the Second and Third Schedules thereto and any rules made thereunder [Section 32].

Any reference to section 173 and section 220(2)/(6)/(7) of the Income-tax Act, 1961 will be treated as references to section 22(7) and section 31(2)/(6)/(7) of the Wealth-tax Act, 1957 respectively. The Chief Commissioner or the Commissioner and the Tax Recovery Officer referred to in the Income-tax Act, 1961 shall be deemed to be the corresponding wealth-tax authorities for the purpose of recovery of wealth-tax and sums imposed by way of penalty, fine and interest.

3.7.2 Liability of transferees: Section 33 provides that in cases (falling under the purview of section 4 out of the tax assessee in the hands of the transferor individual that portion which is attributable to the transferred assets (on a pro rata basis) may be recovered from the transferee. Where the assets are transferred more than one person jointly, all such persons are jointly and severally liable for the apportioned tax. If the transferee or joint transferees fail to pay the tax as specified in the notice of demand he or they would be deemed to be assesses in default and all the provisions in regard to recovery would apply to them.

3.7.3 Refunds [Section 34A] : (a) If as result of any order passed in an appeal or other proceeding (including a rectification proceeding), the refund of any amount becomes due to the assessee the Assessing Officer should refund to the assessee the amount due to him without his being required to make any claim in that behalf [Section 34A(1)]. In other words, it

not necessary for the assessee to make a claim in that behalf.

Sub-section (3) of the section further provides that where a refund is so due and the Assessing Officer does not grant the refund within 6 months from the date of the order, the Central Government shall pay to the assessee simple interest at 6% per annum on the amount of refund due from the date immediately following the expiry of the 6 month period to the date on which the refund is due.

(b) The proviso to section 34A(1) provides that (i) where an assessment is set aside with the direction to make it afresh, any refund will become due only after the fresh assessment is made and (ii) where an assessment is annulled, the tax on the net wealth returned will not be refunded. Only the tax paid in excess of the tax chargeable on the net wealth returned will be refunded.

(c) According to sub-section (2), where refund of any amount becomes due to the assessee as a result of an order under this Act or under the provisions of sub-section (1) of section 16 after a return has been made under section 14 or section 15 or in response to a notice under clause (i) of sub-section (4) of section 16 and the Assessing Officer is of the opinion having regard to the fact that (i) a notice has been issued or is likely to be issued under section 16(2) in respect of the said return or (ii) the order is the subject matter of an appeal or further proceeding or (iii) any other proceeding under this Act is pending, that the grant of the refund is likely to adversely affect the revenue the Assessing Officer may, with the previous approval of the Chief Commissioner or the Commissioner, withhold the refund till such time as the Chief Commissioner or the Commissioner may determine.

(d) Sub-section (4B) provides that where refund becomes due to the assessee, he shall be entitled to receive in addition to the said amount simple interest thereon calculated at the rate of $\frac{1}{2}\%$ for every month or part thereof comprised the period or periods from the date or dates of payment of the tax or penalty to the date on which the refund is granted. The expression 'date of payment of the tax or penalty' for this purpose means the date on and from which the amount of tax or penalty specified in the notice of demand is paid in excess of such demand.

(e) For the purpose of computing the period of delay any delay in proceedings (including assessment proceedings) attributable to the assessee shall be excluded.

(f) There is also a provision for automatic revision of interest on refund where the refund has been increased or reduced on reassessment, appeal, revision, rectification or by an order of the Settlement Commission.

(g) The Assessing Officer, or the Deputy Commissioner (Appeals) or the Commissioner (Appeals) or the Chief Commissioner, as the case may be, has the power under section 34A(5) to set off the amount of refund or any portion of the amount against the sum, if any remaining payable under this Act by the person to whom the refund is due. Such a person must, however be informed in writing of the action proposed to be taken.

3.8 Prosecution

3.8.1 Summary of offences and prosecution: Section 35A to 35N, deal with prosecutions for offences under the Wealth-tax-Act, 1957. These provisions envisage a variety of offences and harsh punishment for the same.

The nature of the offences and the quantum of penalty or other punishment prescribed are briefly indicated below in a tabular form:

No.	Nature of the offence	Relevant Section	Quantum of penalty or punishment
1A.	Wilful attempt to evade tax, penalty.	Section 35A(1)	(i) In a case, where the amount sought to be evaded exceeds 1 lakh, rigorous imprisonment for a minimum term of 6 months up to a maximum term of 7 years and fine.
			(ii) In any other case, rigorous imprisonment for a minimum term of 3 months up to a maximum term of 3 years and fine.
1B.	Wilful attempt to evade payment of tax, penalty or interest	Section 35A(2)	Rigorous imprisonment for a minimum term of 3 months up to a maximum term of 3 year and in the discretion of the Court also with fine.
For the purpose of both the above offences, willful attempt to evade tax etc. shall also include a case, where any person - (i) has in his possession or control, any books of account or other documents relevant to any proceeding under the Act containing a false entry or statement; or (ii) makes or cause to be made any false entry or statement in such books of account or other documents; or (iii) willfully omits or causes to be omitted, any relevant entry or statement in such books account or other documents; or (iv) causes any other circumstance to exist which will have the effect of enabling a person to evade and tax, penalty or interest.			
2.	Willful failure to furnish return of net wealth under section 14(1) or 14(2) or 17(1).	Section 35B	Same as in 1A above. Penalty or prosecution under this section will not be attracted if the return is furnished by the assessee before the expiry of assessment year and the tax payable on the wealth determined on regular assessment does not exceed ₹ 3,000.

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3.	Willful failure to produce accounts records, etc. on or before the date 16(4)	Section 35C	Rigorous imprisonment up to 1 year or with fine equal to a sum calculated at a rate which shall not be less than specified in section shall not be less than ₹ 4 or more than ₹ 10 for every day during which the default continues, or with both.
4.	False statement in a verification under the Act (other than under section 34AB) or under any rule.	Section 35D	Same as in 1A above
5.	False statement in a verification mentioned in section 34AB (registration of valuers).	Section 35E	Imprisonment for a term which may extended to 6 months or with fine or with both.
6.	Failure by a registered valuer, without reasonable cause or excuse, to intimate to the Board particulars of conviction or finding referred to in section 34ACC.	Section 35EE	Imprisonment up to two years and fine.
7.	Contravention of order issued to effect constructive seizure	Section 35EEE	If a person makes any contravention of the above-mentioned orders he shall be punishable with rigorous imprisonment for a term which may extend to five years and with fine
8.	Abetting or inducing Section 35F another person to deliver a false account, statement or declaration in relation to any return of wealth or to commit an offence under section 35A(1). (Willful attempt to evade tax, etc.)	Same as in 1A above.	

9.	Punishment of second Section 35G and subsequent offences under : section 35A(1) above “ 35B above “ 35D above “ 35F above		If a person convicted of an offence under section 35A(1) or 35B or 35D or 35F is again convicted under any of these sections he shall be punishable for the second and subsequent offences with rigorous imprisonment for a minimum term of 6 months and upto a maximum of 7 years and with fine.

3.8.2 Power of Commissioner to grant immunity from prosecution [Section 35GA]: Section 35GA empowers the Commissioner to grant immunity from prosecution.

- (1) The application for the immunity must be made by the assessee (person whose case has been abated under section 22HA) to the Commissioner before institution of the prosecution proceedings after abatement.
- (2) If prosecution proceedings were instituted before or during the pendency of settlement proceedings, then the assessee can approach the Commissioner for immunity any time. However, if the assessee has received any notice etc. from the Wealth-tax authority for institution of prosecution, then he must apply to the Commissioner for immunity, before actual institution of prosecution.
- (3) The Commissioner can grant immunity, subject to such conditions as he may think fit to impose, on being satisfied that the assessee has –
 - (i) co-operated in the proceedings after abatement; and
 - (ii) made a full and true disclosure of his net wealth and the manner in which such net wealth has been derived.
- (4) Where application for settlement under section 22C had been made before the 1st June, 2007, the Commissioner can also grant immunity from prosecution for any offence under this Act or under the Indian Penal Code or under any other Central Act.
- (5) The immunity granted shall stand withdrawn, if such assessee fails to comply with any condition subject to which the immunity was granted.
- (6) The immunity granted to a person may, at any time, be withdrawn by the Commissioner, if he is satisfied that such person had, in the course of any proceedings, after abatement, -
 - (i) concealed any particulars material to the assessment from the wealth-tax authority; or
 - (ii) given false evidence.

Consequently, the person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the proceedings.

3.8.3 Offences by Hindu Undivided Families :Section 35H provides that where the offence has been committed by a HUF, the Karta shall be deemed to be the guilty of the offence and shall be liable to be proceeded against and punished accordingly unless he can prove that the offence was committed without his knowledge or that he had exercised due diligence to prevent the commission of such offences. The section also makes a member of the family equally guilty in case where the offence was committed with his consent or convenience or due to his neglect.

3.8.4 Offences by Companies: (a) Under section 35HA, where an offence has been committed by a company, the company as well as the person who was in charge of, and was responsible for the conduct of the business at the time when the offence was committed will be deemed to be guilty of the offence.

(b) It is also provided that, where the offence had been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of the offence.

(c) In respect of the some of the offences, it is provided that the person found guilty shall be punishable with rigorous imprisonment and with fine. A company being a juristic person cannot be punished with imprisonment. It can be punished with fine only.

(d) Sub-section (3) provides that if an offence under the Act has been committed by a person being a company, it shall be punished with fine.

(e) Every other person who was in charge of and was responsible for the conduct of business of the company, or any director, manager, secretary or other officer of the company (with whose consent or connivance of or due to whose failure, the offence was committed) is liable for punishment of imprisonment and fine wherever so provided.

3.8.5 Other provisions governing prosecutions: Section 35-I lays down that a person can be proceeded against for an offence under the Act only at the instance of the Chief Commissioner or the Commissioner (Appeals) either before or after the institution of proceedings, the Chief Commissioner or the Commissioner can also compound any offence under the Act.

Section 35J makes offences punishable under section 35A (willful attempt to evade tax penalty, etc.), section 35B (failure to furnish returns, etc.), section 35D (false statement in verification, etc.) and section 35F (abetment of false return, etc.) non-cognizable under the Code of Criminal Procedure, 1973. Section 35M bars the application of section 360 of the Code of Criminal Procedure, 1973 and the Probation of Offenders Act, 1958, unless the person convicted of an offence under the Act is under 18 years of age. Section 35K bars prosecution under Section 35A or 35D in relation to the assessment for an assessment year in respect of which the penalty imposed or imposable on him under Section 18(1)(iii) has been reduced or waived by an order under section 18B. Section 35K also lays down that where any proceeding for prosecution has been taken against any person, any statement made or account or other document produced by such person before any of the Wealth-tax authorities

shall not be admissible as evidence for the purpose of such proceedings merely on the ground that such statement was made or such account or other document was produced in the belief that the penalty imposed would be reduced or waived under section 18B or that the offence in respect of which such proceedings were taken would be compounded.

Section 35K provides for bar on prosecution and inadmissibility of evidence in certain circumstances on the lines of section 279(1A) of the Income-tax Act, 1961.

3.8.6 Presumption as to books of account etc.: Section 35N provides that where -

- (i) books of account or other documents, articles or things including money found in the possession of any person during search made under section 37A or
- (ii) books of account, documents, or inventory of any articles or thing taken in custody by an officer or authority under sub-section (1) or section 37B and delivered to a requesting officer under sub-section (2) of section 37B

are tendered as evidence by the prosecution against such person and the person who is accused of abetment of false return under section 35F, the provision of section 37A(5)-presumption as to books of account, documents, etc. will apply.

Section 36: Section 36 provides for production of evidence in prosecution for offences under the Act on the same lines as those of section 279B of the Income-tax Act.

3.8.7 Power to tender immunity from prosecution: The Central Government has been empowered by section 36A with a view to obtain evidence of any person, appearing directly or indirectly to be concerned in or privy to the concealment of particulars in respect of net wealth or to the evasion of payment of tax on net wealth to tender such person immunity from prosecution for offence as well as from the imposition of any penalty under this Act. However, this tender of immunity is not irrevocable in character. The Central Government may withdraw it, if it thinks that the person who was granted the immunity and subsequently either fails to comply with the condition on which such immunity was granted or was willfully concealing anything or giving false evidence.

3.8.8 Power to take evidence on oath: The Wealth-tax authorities including Valuation Officers shall have the same powers as the Court has under the Civil Procedure Code when trying suit as in respect of the following matters:

- (i) discovery and inspection;
- (ii) enforcing the attendance of any person and examining him on oath;
- (iii) compelling the production of books of account and other documents;
- (iv) issuing commissions [section 37(1)].

The provisions of section 37 are on the same lines as those of section 131 of the Income-tax Act. Accordingly, the Valuation Officer also is an authority and the power to summon, etc. has been conferred on Valuation Officer also.

3.9 Search and Seizure

3.9.1 Power of search and seizure: Sections 37A and 37B deal with this power.

The warrant of authorisation to make search and to seize could be issued by the Director General or the Director or the Chief Commissioner or the Commissioner or any such Joint Director or the Joint Commissioner may be empowered by the Board in this behalf.

The warrant of authorisation can be issued in the case of the following persons:

- (a) Any person who has received a notice under section 16(4) or a summon under section 37 to produce books of account or other documents but has failed or omitted so to produce.
- (b) Any person to whom the aforesaid notice or summon has actually been or might be served and who will not or would not produce any books of account or other documents which will be useful or relevant for the purpose of any proceeding under the Act.
- (c) Any person who is in possession of any articles or things including those disproportionate to his known assets, particulars of which will be useful or relevant to any proceeding under this Act.

In the above cases, the authorised officer will have the power to enter and search any building, place, vessel, vehicle or aircraft where he has reason to suspect that such books of account or other documents, articles of things including money are kept. The officer can also search any person who got out of or is about to get into or is in the building, place, vessel, vehicle or air craft when the officer has reason to suspect that such person has secreted about his person any books of account, documents, money, bullion, jewellery or other valuable article etc. The authorised officer can break open the lock of any door, box, locker, safe, almirah or other receptacle where the keys are not available and seize any such books of account or other documents, place marks of identification on them and make a note or inventory of them.

If any building, place, vessel, vehicle or aircraft which is to be searched is situated in an area over which a particular Commissioner has jurisdiction, whereas the assessee in whose case the search is to be made, is under the jurisdiction of another Commissioner, the warrant of authorisation can be issued by any of the two Commissioners. In case where search has been authorised by one Commissioner etc. but some of the premises to be searched fall outside his jurisdiction, the Commissioner available locally is empowered to authorise extension of search of premises not mentioned in the search authorisation issued by the first Commissioner, etc. where he is satisfied that such extension of the search is necessary.

Where any books of account, document, bullion, jewellery, etc. are found in possession of a person or in control of any person or in the course of any search the Wealth-tax Authority can draw the following presumptions:

- (a) That such books of accounts, documents, money, bullion; jewellery etc. belong to that person.
- (b) That the contents of such books of accounts and documents are true.
- (c) That the signature, the books of account, documents, etc. purported to be in the handwriting of a particular person are in his handwriting and documents stamped and

executed or attested were duly stamped and executed or attested. The assessee can rebut the presumption by proving the real fact by conclusive evidence. The books of account or other documents seized can be retained by the authorised officer for a period not exceeding 180 days from the date of seizure. It can be retained for period exceeding 180 days only with the approval of the Commissioner and only after recording the reasons for such retention. However, even the Commissioner cannot authorise such retention for a period exceeding 30 days after all proceeding under the Act in respect of the year for which the books of account or other documents are relevant the completed.

Whenever necessary, the authorised officer will have to transfer the books of accounts, documents and other seized assets to the Assessing Officer who exercises jurisdiction over the assessee within a period of 15 days of the seizure. After such transfer is made, the power of retention of book, documents and assets shall be exercised by Assessing Officer who has jurisdiction over the case.

If the legal owner of the books of account, etc. from whom these are seized objects to the aforementioned approval of the Commissioner, he may make an application to the Board stating the reasons for objections and requesting for their return. There upon, the Board after giving the applicant an opportunity for being heard may pass order as it thinks fit. The provisions of the Code of Criminal Procedure Code, 1973 relating to searches and seizure will be applicable to searches under the Wealth-tax Act, 1957 also.

3.9.2 Power to requisition books of account, etc. : Section 37B deals with power to requisition books of account, documents and other valuable assets which have been seized by other authority such as Customs, Police, etc. According to this provision, the Director General or the Director or the Chief Commissioner or the Commissioner can authorise a Deputy Director or the Deputy Commissioner or the Assistant Director or the Assistant Commissioner or the Assessing Officer or receive from any authority which has seized books of account, documents or other-assets. The Director of Inspection or Commissioner can issue requisition to such authority to return the seized books of account and other assets to the authorised officer on receipt of such requisition, the authority concerned shall be bound to return the seized books of account assets, etc., to the authorised officer. He may do so immediately on receipt of such requisition or at a time when the said books and other assets are no longer required by such authority. Such books of accounts, documents, and other assets shall be treated as if they were seized in the course of search made under section 37A(1) and the provisions of sub-section (12) would be applicable to them.

Section 37C deals with the method of application of assets seized and retained in the course of search.

Section 38 deals with the power of the Assessing Officer to obtain information not merely from the assessee but also from other persons. Section 38A as pointed out earlier deals with the powers of Valuation Officer. Section 39 deals with the effect of transfer of authorities on pending proceeding. Section 41 deals with service of notice.

3.10 Miscellaneous Provisions

3.10.1 Transfers to defraud revenue [Section 34B]: The provisions of section 34B are as follows:

- (1) There would be automatic lien for taxes due not only during the course of pendency of proceeding but even after the finalisation thereof up to the stage a notice under rule 2 of the Second Schedule to the Income-tax Act, 1961 as made applicable to the Wealth-tax Act, 1957 is issued.
- (2) The department would no longer be under an obligation to prove that the transfer was effected with the intention to defraud revenue.
- (3) The charge or transfer shall not be void if made for adequate consideration and without any notice of the pendency of proceedings or without notice of tax etc, payable by the assessee or if made with previous permission of the Assessing Officer.
- (4) The lien would be on assets of the nature of land, buildings, machinery plant, share, securities and fixed deposits in banks; not being stock-in-trade of the business and the same would be operative only if the amount of tax payable or is likely to be payable exceed ₹ 5,000 and the asset charged or transferred exceed in value ₹ 10,000.

3.10.2 Provisional attachment of property [Section 34C]: Section 34C empowers the Assessing Officer to make a provisional attachment on the assets of tax payer whose case is under investigation even before a tax demand is actually raised against him if he is of the opinion that it is necessary to do so for the purpose of protecting the interests of the revenue. However, for this purpose he should take the previous approval of the Chief Commissioner or the Commissioner. The provisional attachment will be initially for a period of six months, but may be extended by the Chief Commissioner or the Commissioner for reasons to be recorded in writing by a further period or periods not exceeding in all two years.

3.10.3 Rectification of Mistakes [Section 35]: With a view to rectifying any mistake apparent from record:

- (i) The Assessing Officer may amend any order of assessment or refund or any other order passed by him;
- (ii) A Wealth-tax authority may amend any intimation sent by it under section 16(1) or enhance or reduce the amount of refund granted by it under that sub-section;
- (iii) The Valuation Officer may amend any order passed by him under section 16A;
- (iv) The Joint Director or the Joint Commissioner or the Director or the Commissioner or the Deputy Commissioner (Appeals) or Commissioner (Appeals) may amend any order passed under section 18A;
- (v) The Deputy Commissioner (Appeals) or the Commissioner (Appeals) to amend any order passed by him under section 23;
- (vi) The Commissioner may amend any order passed by him under section 25;
- (vii) The Appellate Tribunal may amend any order passed by it under section 18 or 24 [Section 35(1)].

If the amount of tax, penalty or interest determined as a result of the first appeal or revision

against the order referred to in the erstwhile section 2(m)(iii) is paid within six months of the date of the order passed in such appeal or revision, the Assessing Officer may, in spite of anything to the contrary in this Act, rectify the assessment as if such rectification were that of a mistake apparent on record. The rectification may be done by allowing a deduction to the extent of the aforesaid tax, penalty or interest paid [Section 35(2)].

The authority concerned may, on its own motion, rectify the mistake in the aforementioned circumstances. But it must do so, when the mistake is brought to its notice by the assessee. If, however, the authority concerned is the Valuation Officer or the Deputy Commissioner (Appeals) or the Commissioner (Appeals) or the Appellate Tribunal it must rectify the mistake brought to its notice by the Assessing Officer as well [Section 35(3)].

The aforesaid amendment may have the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee. In any one of these circumstances, an amendment shall be made only if the authority concerned has given notice to the assessee of its intention so to do and has allowed him a reasonable opportunity of being heard [Section 35(4)].

Where the amendment has the effect of enhancing the value of any asset, the Valuation Officer will be required to notify the assessee of his intention to make the amendment and provide him a reasonable opportunity for being heard. Any order of amendment passed by the Valuation Officer will have to be in writing and copies thereof will have to be sent to the assessee and to the Assessing Officer. The Assessing Officer will thereafter be required to make necessary amendment to the assessment order so as to give effect to the changes made in the valuation of the asset. An amendment under this section cannot be made after the expiry of a period of 4 years from the end of the financial year in which the order in first appeal or revision or as the case may be, the order sought to be rectified was passed and not from the date of the order.

However, where the Valuation Officer has made any amendment in the order passed by him under section 16A, the consequential amendment to the order of assessment made by the Assessing Officer at any time before the expiry of one from the date of Valuation Officer's under section 35 [Section 35(7A)].

The Central Board of Direct Taxes has clarified that a mistake arising as a result of subsequent interpretation of law by the Supreme Court would constitute a mistake apparent from the record; and the rectification action under section 35 of the Wealth-tax Act, 1957 would be in order [*Circular No. 1036, dated January 24, 1977*].

3.10.4 Deemed service of valid notice in certain circumstances [Section 42]: Section 42 provides that the assessee would be precluded from raising any objection in any proceeding or inquiry that the notice was not served upon him or was not served in time or was served in an improper manner, if he had appeared in any proceedings or co-operated in any inquiry relating to assessment or re-assessment.

In short, if the assessee had appeared in any proceedings or co-operated in any enquiry, it shall be deemed that any notice required to be served on him has been duly served upon him in time in accordance with the provisions of the Act. However, such deeming provision would not apply where the assessee has raised an objection (regarding non-service of notice or non-service of notice in time or improper service of notice) before the completion of such assessment or reassessment.

3.10.5 Publication of information regarding assessee [Section 42A]: The Central Government may if it thinks necessary and expedient in the public interest to do so, cause to be published the names of the assesseees as well as any other particulars relating to any proceedings or prosecutions in respect of such assesseees in any manner it thinks fit. But either until the time for judgement on appeal with the Deputy Commissioner (Appeals) or, as the case may be, the Commissioner (Appeals) or with the first Appellate Court as the case may be, has expired or until the time the appeal if already preferred, has been disposed of, no publication shall be made in relation to any penalty imposed. However, the government can publicise prosecutions for offences under the Act even before the matter has been disposed of by the first Appellate Court where an appeal has been filed:

3.10.6 Return of wealth not to be invalid due to technical defects [Section 42C]: This section provides that on return of wealth, assessment notice, summons or other proceedings under the Act shall be invalid merely by reason of any mistake, defect or omission, if the return of wealth, etc. is in substance and effect in conformity with or according to the intent and purpose of Act.

3.10.7 Disclosure of information regarding assesses [Section 42B]: Wherein a person makes an application to the Commissioner in the prescribed form any information in respect of any assessment under the Wealth-tax Act, the Commissioner may furnish or cause to be furnished the information asked for in respect of the assessment only. But before doing so, he must be satisfied that it is in the public interest to do so. If this condition is fulfilled, his decision to furnish the information is final and cannot be called into question in any court of law.

3.10.8 Presumption as to assets, books of account, etc. [Section 42D]: This section provides that where any books of account or other documents, articles or things including money are found in the possession or control of any person in the course of a search under section 37A or where any books of account, other documents or assets have been delivered to the requisitioning officer in accordance with the provisions of section 37B, it may, in any proceeding under this Act, be presumed that -

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

Section 43 provides that no suit shall lie in any Civil Court to set aside or modify any order under the Act. It also provides for the immunity of the Government and its officers not merely in respect of acts authorised by the Act but also for acts done without jurisdiction but in bona fide belief and in good faith that they were authorised.

Section 44 relates to appearance before tax authorities by authorised representatives. Section 44A empowers the Central Government to enter into agreement with any foreign country or

specified territory outside India for the avoidance or relief of double taxation or for exchange of information for the prevention of avoidance of wealth-tax or for investigation of cases of such evasion or avoidance or for recovery of tax. Section 44B provides for unilateral relief in the case of countries with which no agreement exists.

All three provisions are exactly on the same lines as those of corresponding provision in the Income-tax Act. Students are advised to read these provisions from the bare Act.

3.10.9 Rounding off net wealth and tax, etc.: Section 44C provides for rounding off net wealth to the nearest multiple of one hundred rupees; similarly, section 44D provides for rounding off of wealth-tax, interest, penalty, fine or any other sum payable and the amount of refund due under the provisions of the Act to the nearest rupee.

3.10.10 Rule making powers: Section 46 deals with the power of the Central Board of Direct Taxes to make rules for carrying out the purposes of this Act.

Note: National Tax Tribunal (NTT) means the National Tax Tribunal established under section 3 of the National Tax Tribunal Act, 2005. The National Tax Tribunal Act, 2005 has been enacted by the Parliament in pursuance of Article 323B of the Constitution. It came into force with effect from December 28th, 2005. The notified date of establishment of the National Tax Tribunal by the Central Government is 6th January, 2006.

The objective behind the enactment of the National Tax Tribunal Act, 2005 is to modify the present system of appeals under the Income-tax Act by substituting the National Tax Tribunal for the High Court, for facilitating quick adjudication of disputes under direct and indirect tax laws and achieve uniformity in the interpretation of central legislation.

This Act provides that, on establishment of the National Tax Tribunal, High Courts will not have appellate jurisdiction in matters of direct and indirect taxes. This Act vests jurisdiction in NTT to decide direct and indirect tax disputes on appeal from the decision of the respective Appellate Tribunals. Appeal to NTT can be filed both by the assessee and the revenue, from an order passed by the ITAT or CESTAT, on a substantial question of law. Appeal to NTT will lie only if the NTT is satisfied that the case involves a substantial question of law. The NTT shall formulate the substantial question of law for the purpose of hearing of appeal by it.

A party to an appeal, other than the Government, may either appear in person or authorize one or more chartered accountants or legal practitioners or any person duly authorized by him or it to present the case before the NTT. The Government may authorize one or more legal practitioners or any of its officers to present its case before the NTT. It may be noted that the Act does not permit chartered accountants to present the case of the Government before the NTT.

The Act provides that any person, including any department of the Government, aggrieved by any decision or order of NTT may file an appeal to the Supreme Court within 60 days from the date of communication of the decision or order of the NTT to him. The Supreme Court can allow filing of the appeal beyond 60 days, if the appellant was prevented by sufficient cause from filing the appeal within the said period of 60 days.

However, the Bombay High Court, in *P.C.Joshi vs. Union of India* (2006) 152 Taxman 285, has passed an ad-interim order restraining the Government from constituting the NTT and transferring the matters pending in the High Court to the NTT. Therefore, the constitution of the NTT will take effect only after the stay is vacated.